

1947

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Recommended Citation

Roy Blough, "The Issue of Diversification in Federal Tax Policy," 3 Tax Law Review 1 (1947).

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The Issue of Diversification in Federal Tax Policy

ROY BLOUGH

THE idea of discovering an 'ideal' tax, or if not ideal at least the 'best' tax, and using it as a source of all revenue has been an attractive one to many people. Every few months a plan for a single tax of one variety or another appears, and its sponsor is often both irritated and puzzled by the lack of enthusiasm with which it is received in official circles.

The federal tax system is not likely ever to consist of a single tax. At the present time there are well over 100 different federal internal revenue taxes and hundreds of customs duties.¹ Every important form of tax is used except export taxes, the property tax and the general sales tax. The overwhelming majority of the internal revenue taxes are on commodities, transactions, and privileges.

Despite this variety of taxes, a politically important criticism of the federal tax system is that it is not sufficiently diversified. The criticism is directed to the dominance of the income tax as a source of federal revenue.² The criticism is variously that the income tax is relatively more important than it used to be, than it is in other national tax systems, and in any event than it ought to be.³ It is scarcely a clinching argument for greater diversity that the income tax is more important than it used to be, and still less that it is more important than in other national tax systems. However, the facts are of interest and will be reviewed briefly before turning to the important question of the desirability of greater diversity.

Diversity in the Federal Tax System. The relative importance of taxes on income in the federal revenue system has fluctuated widely over the

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¹ The exact number of taxes depends on what is counted as a tax. Taxes are difficult to count because the distinction between separate taxes and different rates for the same tax is not followed consistently throughout the Internal Revenue Code.

² An example is the following colloquy between Representative Gearhart (R., Calif.) and Roswell Magill, *Hearings before Committee on Ways and Means on Individual Income Tax Reduction*, 80th Cong., 1st Sess. 149 (March 14, 1947):

"Mr. Gearhart: Now the time has come when we should rewrite the tax bill comprehensively so as to eliminate as much injustice, as many of the inequities, as we possibly can. I think one of the greatest inequities, one of the greatest errors that crept into our tax system leading up to and through the World War has been the over-emphasis of the income tax as the principal source of the revenue of this country.

"Mr. Magill: I quite agree with you."

³ Cf. The Committee on Postwar Tax Policy, *A Tax Program for a Solvent America*, 30-38 (1945).

years. Rising from nothing, the income and profits taxes reached a high point of 73 per cent of total tax revenue in the fiscal year 1918, were down to 56 per cent in 1925, up to 66 per cent in 1929, down to a low point of 27 per cent in 1934, and up to a high point of 81 per cent in 1944, and down to 71 per cent in 1947, as shown on the accompanying table. The reasons for these changes can be summarized as changes in rates, changes in business conditions and the relative instability of revenues from the income tax. Space does not permit a detailed examination of the many factors involved.

The decline from the 1944 wartime peak reflects the fact that the bulk of tax reduction to date has been in taxes on incomes of individuals and corporations (including the excess profits tax).⁴ The proportion of income tax revenues to total tax receipts may be expected to fall further as incomes and profits settle down somewhat from present peak levels. Since the income tax is a relatively unstable source of revenue, the proportion of tax receipts from income taxes over a full business cycle would be lower than in the recent years of inflationary boom. Making allowances for these factors, however, the income tax is relatively more dominant in the federal tax system than it was before the war.

Diversity in Foreign Tax Systems. Data comparing the proportions of tax revenues derived from income taxes in the United Kingdom, Canada, Australia, New Zealand, and the United States were inserted in the 1947 House hearings on tax reduction by the Treasury at the request of a member of the Ways and Means Committee. The figures are for national governments, and the percentages are summarized in the following table:

PER CENT OF CENTRAL GOVERNMENT TAX REVENUES FROM TAXES ON INCOMES AND PROFITS⁵

	1932	1934	1936	1938	1940	1942	1944	1946
United States	56.0	30.2	39.3	52.5	46.6	67.7	86.0	80.2
United Kingdom	50.1	40.1	39.1	42.3	47.9	56.8	59.7	59.3
Canada	22.2	22.4	26.2	27.0	28.9	47.4	62.5	62.9
Australia	27.6	19.2	16.2	16.3	18.3	45.5	62.8	62.5
New Zealand	36.0	25.7	28.7	34.2	38.2	58.2	62.9	62.2

⁴ The reductions in various taxes brought about by the Revenue Act of 1945 were estimated as follows:

	(Millions of Dollars)
1. Corporation income and excess profits tax.....	2,900
2. Individual income taxes.....	2,644
3. Capital stock and declared value Excess profits.....	231
4. Automobile use tax.....	140

Items 1), and 2), accounted for 94 per cent of the estimated reduction. 1947 proposed reductions (H.R. 1 and H.R. 3950) applied exclusively to income taxes.

⁵ *Hearings before the Ways and Means Committee on Individual Income Tax Reduction (H.R. 1)*, 80th Cong., 1st Sess. 103-107 (March 13, 1947). The United States figures are calculated on a somewhat different basis from those appearing in Table 1, *infra*.

TABLE 1
FEDERAL TAX REVENUE, SELECTED YEARS, 1913-47
Relative Importance of Three Largest Sources

Year	Total Tax Revenue (billions)	Largest Source		Second Largest Source		Third Largest Source		Per Cent of Total From Three Largest Sources
		Tax	Per Cent of Tax Revenue	Tax	Per Cent of Tax Revenue	Tax	Per Cent of Tax Revenue	
1913	\$ 0.7	Customs	48	Liquor	35	Tobacco	12	95
1916	0.7	Liquor	34	Customs	29	Income	17	80
1918	3.9	Income	73	Liquor	11	Customs	5	89
1925	3.1	Income	56	Customs	17	Tobacco	11	84
1929	3.5	Income	66	Customs	17	Tobacco	12	95
1932	1.9	Income	56	Tobacco	21	Customs	17	94
1934	3.0	Income	27	Customs	11	Tobacco	14	52
1936	3.9	Income	36	Liquor	13	Tobacco	13	62

EXCLUDING EMPLOYMENT TAXES

1938	5.3	Income	50	Tobacco	11	Liquor	11	72
1939	4.7	Income	46	Liquor	12	Tobacco	12	70
1940	4.8	Income	44	Liquor	13	Tobacco	13	70
1941	6.8	Income	51	Liquor	12	Tobacco	10	73
1942	12.2	Income	65	Liquor	9	Tobacco	6	80
1943	21.2	Income	77	Liquor	7	Tobacco	4	88
1944	38.8	Income	85	Liquor	4	Tobacco	3	92
1945	42.4	Income	83	Liquor	5	Tobacco	2	90
1946*	36.3	Income	78	Liquor	7	Tobacco	3	88
1947*	34.8	Income	75	Liquor	7	Tobacco	4	86

INCLUDING EMPLOYMENT TAXES

1938	6.0	Income	44	Employment	12	Tobacco	9	65
1939	5.5	Income	40	Employment	14	Liquor	11	65
1940	5.7	Income	38	Employment	15	Liquor	11	64
1941	7.7	Income	45	Employment	12	Liquor	11	68
1942	13.4	Income	60	Employment	9	Liquor	8	77
1943	22.7	Income	72	Employment	7	Liquor	6	85
1944	40.6	Income	81	Employment	4	Liquor	4	89
1945	44.2	Income	79	Liquor	5	Employment	4	88
1946*	38.0	Income	74	Liquor	6	Employment	4	85
1947*	36.8	Income	71	Liquor	7	Employment	5	83

Sources:

1913-1936, TWENTIETH CENTURY FUND, FACING THE TAX PROBLEM.

1938-1946, Treasury Bulletin; except for 'customs' which is taken from the Secretary's Annual Report.

1947—Bureau of Internal Revenue release, dated July 31, 1947, and Statement by the President on the Review of the 1948 Budget, Aug. 20, 1947.

* After deducting tax refunds.

These figures indicate: (1) in all five countries the income tax greatly increased in relative importance during the war years, (2) the United States Federal Government derived a greater proportion of its tax revenues from income and profits taxes than did the other countries. A warning in using the figures is necessary. International comparisons are notoriously difficult to make and likely to be misleading because of differences in accounting and other methods. For example, the United States figure for 1946 takes no account of refunds of receipts of \$3.1 billions, almost all of which amount was income and profits taxes.⁶ Social insurance is financed in various ways; exclusion of the taxes may not correctly represent the actual situation. Most important of all, only central or national governments are included; the relative importance of state and local revenues and of income taxes in these revenues is not shown.⁷ Such information is necessary to a correct interpretation of the figures.

The Income Tax in Postwar Tax Programs. During and since the War a number of formal plans for federal postwar tax revision have been presented by different organizations. Most but not all of these plans were made during the last year or so of hostilities and before the reductions of the Revenue Act of 1945. The place of income taxation in these plans may help to point up the issue of diversity.

Beardsley Ruml and H. Chr. Sonne in July, 1944, proposed that the individual and corporation income taxes provide \$14 billion (which is 77.7 per cent) of an \$18 billion total (exclusive of old age security taxes and unemployment insurance taxes).⁸ This \$14 billion figure would be made up of individual income taxes, a tax on corporate franchises measured by incomes, and an undistributed profits tax. The point of view expressed in the memorandum leads to the conclusion that if the authors were financing a budget higher than \$18 billion they would favor raising a larger percentage from individual income taxes. They specifically stated that "the graduated, progressive individual income tax should be relied on as the key source of revenue."⁹

⁶ Cf. The Budget of the United States Government for the fiscal year ending June 30, 1948, M55.

⁷ For example, in the fiscal years ending in 1943, the local (including state and provincial) taxes in the United Kingdom amounted to only 7 per cent of total taxes, Canada to 19 per cent, and the United States to 28 per cent. Relatively little of state and local revenue in the United States is raised from the income tax. Accordingly, if federal, state, and local governments were considered as a unit, the degree of diversity in the United States would be much higher than for the national government alone, while in the United Kingdom, for example, the addition of local governments would make relatively little difference in the final result.

⁸ Beardsley Ruml and H. Chr. Sonne, *Fiscal and Monetary Policy*, 39 (1944).

⁹ *Id.* at 12.

The research committee of the Committee for Economic Development in August, 1944, proposed to collect approximately 75 per cent of total tax collections of \$18.7 billion (not including social security taxes) from personal and corporation income taxes.¹⁰ This was the highest budget presented by them. For a smaller budget, they proposed a lesser proportion from income taxes. The committee proposed that "the graduated, personal income tax should provide at least half of the total federal revenues needed."¹¹

Over against these proposals for a federal tax system which would be strongly dominated by the income and profit taxes, particularly the personal income tax, are a number of proposals which would lead to greater diversity in the sources of federal tax revenue. One of these is the so-called Twin City plan for postwar taxes published in June, 1944.¹² In this plan 56 per cent of tax revenues (excluding social security) were to come from individual and corporation income taxes. A general retail sales tax of 5 per cent was to be added to the tax structure.

The Committee on Postwar Tax Policy, of which Roswell Magill was chairman and Harley L. Lutz director of research (hereafter referred to as the Magill-Lutz Program) issued a program in July, 1945.¹³ Altogether the Committee presented 21 different tax schedules covering three levels of budgets and three national income levels. Combined individual and corporation income tax revenues estimated under these plans range from a low of 65.6 per cent to a high of 81.2 per cent, but most of them fall in the range between 74 and 78 per cent.

More extreme proposals have been made by individuals. Messrs. Hansen and Perloff in 1944 proposed to raise 65.2 per cent of a \$23 billion postwar budget from individual and corporation incomes.¹⁴ The \$23 billion total, however, included 5 billion dollars from payroll taxes, and if this were eliminated to make their figures more comparable with others they would raise about 83½ per cent of an \$18 billion budget from individual and corporate incomes.

Mr. Robert Nathan, writing in 1944, proposed that "as reductions are made in taxes after the war, all such reductions should be made in indirect taxes rather than direct taxes."¹⁵ He includes income, inheritance, and the estate taxes in the class of direct taxes. He proposed, moreover, that

¹⁰ Committee for Economic Development, *A Postwar Federal Tax Plan for High Employment*, 39 (1944).

¹¹ *Id.* at 18.

¹² The Twin Cities Plan, *Postwar Taxation*, 19 (1944).

¹³ Committee on Postwar Tax Policy, *A Tax Program for a Solvent America*.

¹⁴ ALVIN H. HANSEN AND HARVEY PERLOFF, *STATE AND LOCAL FINANCE IN THE NATIONAL ECONOMY*, 256.

¹⁵ ROBERT NATHAN, *MOBILIZING FOR ABUNDANCE*, 140.

"the Federal government should retain high income taxes and offer reimbursement to states and localities if they will reduce their indirect taxes."¹⁶ He suggests retention of "excise taxes on liquors, tobacco, and the like" to discourage their consumption.¹⁷

Since there would be little point in offering reimbursement for reduction in state and local indirect taxes as long as the federal revenue system contains such taxes, it appears that Mr. Nathan desired that the federal government be financed almost entirely from direct taxes, adding only receipts from restrictive excises, and would have the federal government collect even more revenues than it would require so as to reduce state and local indirect taxes. Since death taxes yield relatively little revenue at most, Mr. Nathan thus approaches the ultimate minimum in diversity of the federal tax system. The federal income taxes would be the sole large revenue source.

At what is perhaps the other extreme Professor Lutz early in 1944 proposed to raise only one-third of a total postwar budget of about \$15 billion (not including payroll taxes) from individual and corporation income taxes.¹⁸

There are, of course, other proposals for postwar tax systems, but these should suffice for our purposes. The conclusion may be reached that although there is wide divergence between the highest and lowest percentages of the tax proposed to be raised from individual and corporate incomes, in most proposals these taxes would continue to supply a proportion of the revenue comparable to that now produced by them.

The Corporate Income Tax and Diversity. The question may have risen in the reader's mind whether it is proper to treat the taxes on individual and corporation incomes as one income tax. Strictly speaking, several specific taxes are levied, some on individual and some on corporation incomes. However, with some exceptions the same definitions of gross income, deductions, credits and other provisions apply for both individuals and corporations.¹⁹ The difference in rates and the lack of integration between the corporation income tax and the individual income tax lead to some double taxation and add an element of diversity to the federal tax system. Much of this diversity in burden distribution, however, can be eliminated by appropriate methods of integrating the individual and corporation taxes.²⁰ Almost all of the proposals for postwar

¹⁶ *Ibid.*

¹⁷ *Ibid.*

¹⁸ Referred to, Chicago Association of Commerce, *Federal Postwar Taxation: a review of significant proposals*, 17. See also Lutz, *Taxation After the War*, COMMERCIAL AND FINANCIAL CHRONICLE, 2039 (May 18, 1944).

¹⁹ I.R.C. §§ 11-15, 22, 23, etc.

²⁰ Richard B. Goode, *The Postwar Corporation Tax Structure*, U. S. Treasury Depart-

federal taxation provide methods of integration, although some of these are much more effective than others in achieving the burden distribution and incentive effects which would come from a single income tax. Even without these changes to integrate the taxes, it is probably safe to say that the corporation income tax is more nearly like the personal income tax in burden distribution, administration and incentive effects as well as in degree of stability of revenue than is any other tax in the federal tax system.

Alternative Methods of Diversification. As a last step before moving on to a discussion of policy criteria, it is of interest to consider the possible revenue sources from which greater diversity could come. Tax policy is a problem in alternatives. If the income tax is to be de-emphasized and revenues diversified, provision must be made so that the revenue goal may be met. In a period when revenues can be reduced, that is, when the revenue goal is less than the anticipated receipts, diversity can be increased by applying all reductions to the income tax. That was largely the result of the 1945 reductions and was the basis of the proposed 1947 reductions.²¹ The amount of reduction that will be possible is uncertain. If it is insufficient to produce the desired degree of diversity, income tax reductions must be offset by increases in other taxes. What other taxes are available?

Proposals for adding diversity to the federal tax system have usually been to expand the use of excise taxes, impose a general sales tax, or both.²² This is not surprising, since the choice of alternatives is much narrower than might appear at first glance. Export taxes are specifically forbidden in the Constitution.²³ Property taxes also are not available for constitutional reasons; they are interpreted as being direct taxes subject to apportionment among the states according to population,²⁴ which would be inequitable and impractical. Other direct taxes on wealth have escaped Congressional consideration, at least in recent years, for the same reason. The estate and gift taxes could produce somewhat more revenue than they do. The impact of these taxes is very uneven among estates because of various ways of reducing or escaping tax.²⁵ A general tightening of

ment, Division of Tax Research, 1946; HAROLD M. GROVES, *Postwar Taxation and Economic Progress*, 20-39 (1946); RANDOLPH E. PAUL, *TAXATION FOR PROSPERITY*, 345-376 (1947).

²¹ See note 5, *supra*.

²² For example, see Committee on Postwar Taxation, *A Tax Program for a Solvent America*, 148-154. See also *Hearings before Committee on Ways and Means on Individual Income Tax Reduction*, 80th Cong., 1st Sess. 150.

²³ U.S. CONST., Art. I, § 9.

²⁴ *Pollock v. Farmers' Loan and Trust Company*, 157 U.S. 429 (1895).

²⁵ WILLIAM VICKREY, *AGENDA FOR PROGRESSIVE TAXATION*, 203-211. See also, *Federal Estate and Gift Taxes; a proposal for integration and correlation with the income tax*,

provisions would produce greater revenue and more uniformity. Moreover, exemptions could be decreased and rates, especially in smaller and medium-sized estates, could be raised. In any event, however, the increased revenue would not be large in relation to the amounts involved in the federal budget.²⁶ Even small amounts of increase are not likely; there may be losses instead. Although the federal estate and gift tax rates went up relatively much less than the income tax during the war,²⁷ there are demands that the rates be decreased.²⁸ Moreover, the states are pressing claims for a larger share of the federal estate taxes.²⁹ Proposals have been made that the federal government give up the estate and gift taxes entirely.³⁰

Prior to the first World War the principal sources of federal revenue were customs duties, the tax on alcoholic beverages, and the tax on tobacco.³¹ Substantial increases in revenue from imports could undoubtedly be secured by lowering the rates,³² although there might be some delay in revenue increase until world production expands. However, customs duties are at present dictated by social and economic objectives and not by the revenue objective, and there is little prospect of an early change toward a lower tariff policy. Imposing duties or increasing rates of existing duties on consumption articles which are not produced in this country, such as coffee and tea, could produce some revenue;³³ they would be the equivalent in burden distribution to sales or excise taxes on the common necessities of life.

a joint study prepared by an Advisory Committee to the Treasury Department and by the Office of the Tax Legislative Counsel, with the cooperation of the Division of Tax Research and the Bureau of Internal Revenue, 1947.

²⁶ Collections from the federal estate and gift taxes in fiscal year 1946, were \$677 million.

²⁷ Rates were increased 10 per cent by the Revenue Act of 1940, § 206, and were somewhat increased throughout most of the scale by the Revenue Act of 1941, § 401. The \$40,000 exemption and the \$40,000 insurance exclusion were merged into a \$60,000 exemption by the Revenue Act of 1942, §§ 404, 413, 454, 455.

²⁸ See for example, statement of Evans Woolen, Jr., before American Bankers' Assn., urging that "the trend in estate taxation should be reversed." N. Y. Times, Feb. 4, 1947.

²⁹ Cf. statement by Governor Alfred E. Driscoll of New Jersey at Round Table on Tax and Fiscal Policy, Governors' Conference, Salt Lake City, Utah, July 17, 1947.

³⁰ Committee on Postwar Tax Policy, *A Tax Program for a Solvent America*, 163-167.

³¹ See Table 1, *supra*.

³² But for another view, see statement of Rep. Bertrand W. Gearhart (R., Calif.) in *Hearings before Committee on Ways and Means, Individual Income Tax Reduction*, 149 (Mar. 14, 1947).

³³ In 1940, imports of coffee amounted to 2,061.5 million pounds, and of tea, 96.7 million pounds. *Statistical Abstract of the United States*, 687-688 (1946). Taxes on coffee and tea were considered by the Committee on Ways and Means as a wartime tax measure, but were not adopted.

The liquor excise is at the highest point in history;³⁴ it is a question whether it can be administered at present rates without an unacceptably large volume of evasion.³⁵ Certainly there is no prospect of its increase in the near future. The tobacco excises could be increased to raise some additional revenue, but the political forces which limited the wartime increase to one cent a package on cigarettes can undoubtedly prevent further postwar increases.

The payroll taxes were imposed for financing social security. The part imposed on workers is an income tax, although not included as such in this discussion because of the special character of the social security program and its financing. In the light of the repeated rate freezes beginning in 1939,³⁶ the prospect is slim for any increase in the payroll taxes, especially those imposed on employers, except for the specific financing of social security programs.

As sources of increased revenue to diversify the federal tax system, there remain excise taxes other than the traditional liquor and tobacco excises, and general sales taxes. For any large increase above present levels even this choice between specific excises and a general sales tax is largely verbal. To be suitable for specific excise taxation, a commodity should be used by a large number of people, should have a low elasticity of demand, should be capable of clear-cut definition, should not have directly competing non-taxable goods.³⁷ Very few commodities meet these tests, as appeared clearly when efforts were made during the war to find new revenue sources. Because of this fact, a general sales tax, with exemptions, is a much more likely choice than a multiplicity of items subject to special excise taxes. Of course, in practice the form might be that of a long list of items subject to low-rate special excise taxes, but the substance would be that of a general sales tax, whatever the name. A general sales tax might be at either the manufacturers' level or the retail level,³⁸ or conceivably the general turnover tax proposed in connection with the Townsend Plan for old-age pensions.³⁹ However, the defects of the turn-

³⁴ \$9 per proof gallon.

³⁵ Enforcement during the past few years has been aided by control over the supply of copper, rationing of sugar; and a high level of employment and income.

³⁶ The latest Act continues the tax rates on employers and on employees at one per cent each through the year 1949. Pub. L. No. 379, 80th Cong. The original statute provided for rate increases beyond this level beginning January 1, 1940.

³⁷ See, JENS P. JENSEN, *GOVERNMENT FINANCE* 365-69 (1937).

³⁸ See, *Considerations Respecting a Federal Retail Sales Tax*, Treasury Department, Division of Tax Research, Hearings before the House Ways and Means Committee on Revenue Act of 1943, 1124-61.

³⁹ For one example of the Townsend Plan, see H.R. 1 (1939).

over tax are so well known that its adoption is probably out of the list of possibilities.⁴⁰

Criteria for Considering the Diversity Issue. Proposals for tax legislation usually start with, and in any event quickly give rise to, conflicts of interest among taxpaying groups.⁴¹ In deciding tax issues Congress must resolve, compromise, or choose among conflicting private interests. To the extent that the decisions do not have a rational basis, there is not much that economic analysis can do except to point out the irrationality. For the most part, however, tax policy decisions appear to be based on rational criteria. The criteria which have the greatest bearing on the diversity issue appear to be those indicated in the following questions:

(1) What diversity, if any, is needed to achieve the desired revenue goal?

(2) What diversity, if any, is needed to achieve equitable tax distribution?

(3) What diversity, if any, is needed to achieve the desired degree of (a) revenue stability, or (b) revenue instability?

(4) What diversity, if any, is needed to protect and promote economic incentives?

(5) What diversity, if any, is needed to accomplish non-revenue or economic control objectives?

The large majority of tax students and tax policy-makers are in agreement that if a single tax is to be used in raising any given total amount of federal revenue, the income tax is superior to any other tax in all of the above respects except that of economic control and that of revenue stability. The question here is not whether the income tax is better *than* another tax on an all-or-nothing basis but whether it is better *with* one or more other taxes than standing alone in respect of each of the above considerations.

Diversity and the Revenue Goal. In times when tax increases are required to meet the revenue goal, it is not usual that the whole increase is derived from income taxes. Along with other reasons for not doing so, the statement is commonly made that the income tax cannot bear all the added load. Secretary Mellon took this position in 1932.⁴² Throughout the prewar period Secretary Morgenthau condemned the excise taxes, but

⁴⁰ See, *Hearings before Committee on Ways and Means, Social Security*, 789-790 (1939). See also, SEYMOUR HARRIS, *ECONOMICS OF SOCIAL SECURITY* 57-59 (1941).

⁴¹ Cf. Roy Blough, *Conflict and Harmony in Taxation*, *PROCEEDINGS OF THE AMERICAN PHILOSOPHICAL SOCIETY*, Vol. 88, No. 1, 22-28 (1944); JOHN R. COMMONS, *INSTITUTIONAL ECONOMICS*, 804-840 (1934); T. S. Adams, *Ideals and Idealism in Taxation*, 18 *AMERICAN ECONOMIC REVIEW* 1-8 (1928).

⁴² *Hearings before Committee on Ways and Means on Revenue Revision*, 72nd Cong., 1st Sess. 3-4 (1932).

he did not recommend replacing them with higher income tax rates. Each time they would have expired he acquiesced in their retention until the revenue situation should permit their repeal.⁴³ Was it any real lack of revenue-producing capacity on the part of the income tax that led to these recommendations by a conservative Republican and a New-Deal Democratic Secretary of the Treasury?

One point in the answer is reasonably clear. The revenue producing capacity of the income tax, averaging good years and bad, is greater than that of any other tax. The income tax is not restricted to a narrow base, nor, therefore, to limited revenue as were the tariff and the excises on liquor and tobacco in the years when they were the predominant revenue producers. The income tax has the entire income of the nation to draw on as a possible tax base. Since taxes are ordinarily paid from income, regardless of the kind of tax base by which their amount is measured, there is a presumption that whatever revenues are raised from other tax sources could instead be raised from taxes on incomes. If that presumption is badly grounded, it must be for reasons other than narrowness of possible base. Presumably the argument would be that heavier income taxes would eventually reach a point of maximum returns. When we observe the income tax rates and exemptions of today in contrast with those of 1932 or even 1939, we must conclude that the beliefs often expressed in those days that income taxes had passed their peak of productivity were exaggerated.⁴⁴ Still, this does not demonstrate that there is no limit.

Other things being equal,⁴⁵ yields of any tax, including the income tax,

⁴³ For example, see testimony of Secretary Morgenthau, *Hearings before Committee on Ways and Means on Revenue Revision*, 76th Cong., 1st Sess. 6 (1939).

⁴⁴ For example, Secretary Mellon and Under Secretary Mills in 1932 expressed the belief that in "normal times" a top surtax rate of 20 per cent would yield more revenue than one of 40 per cent. (*Hearings before Committee on Ways and Means, on Revenue Revision*, 72nd Cong., 1st Sess. 5, 14 (1932).) See also, testimony presented in June, 1940, before the Senate Finance Committee on behalf of the Committee on Federal Finance of the United States Chamber of Commerce, by Ellsworth C. Alvord, in the course of which he said: "I would suggest . . . that you . . . prepare a permanent long-range tax system . . . which will produce the maximum possible revenues for your Government consistent with your other political and economic policies. . . . My best guess is that over a period of ten years, the average revenue which you can get under that system will not be far from \$7 billion annually. . . . Our existing tax rates are far above the point of maximum productivity." *Hearings before Senate Committee on Finance, on Revenue Act of 1940*, 76th Cong., 3rd Sess. 90, 97.

⁴⁵ Other things are seldom equal, which is the reason the effects of tax measures are so difficult to determine. For example, the high income tax rates may be imposed to accompany an increase in government expenditures, which in turn may enlarge incomes so that instead of the revenue falling for each percentage point of tax rate, it may rise. The wartime experience is of course the outstanding example. Recognition of this fact does not involve any judgment as to the wisdom or lack of wisdom of government expenditures.

for each per cent of rate, should be expected to fall as the rate rises, or at any rate, after the rate has risen to a point justifying full enforcement efforts. High tax rates tend to reduce the base. This, however, is not the same as saying that the total yield of the tax declines as rates go up, which is the phenomenon of "diminishing returns." A one-tenth increase in rates would have to result in more than a one-tenth decrease in the tax base to reduce the total revenue. This might happen in taxes with narrow bases, such as specific excises or import duties, where the taxpayer could substitute something else for the taxed article. For it to happen in a general income tax would require either greatly increased tax evasion (in which the legal tax base is hidden from the taxing authorities), tax avoidance (in which income recognized for tax purposes is transformed into income not so recognized, such as tax exempt interest, or taxed at lower rates, such as capital gains), or tax repression (in which the income is prevented by the high tax from coming into existence).⁴⁶ Undoubtedly these factors would at some point bring about diminishing returns at least in some rate brackets. However, in testing the revenue capacity of the income tax the problem is not whether top bracket rates have reached the point of maximum or even of diminishing returns, but whether the tax as a whole has adequate revenue-producing capacity after making such adjustments as stopping up legal loopholes, improving enforcement, and lowering any rates which may be above the point of maximum return. There is little evidence indicating that the income tax has reached or passed its revenue-producing limits in this sense.

A somewhat separate matter is whether under given economic conditions a general reduction in taxes would increase revenues. The extensive analysis required for an adequate discussion of that point makes it necessary to omit it here.

Diversity and Equitable Tax Distribution. A conclusion that the income tax can raise all the needed revenue does not mean that this would necessarily be desirable. A second test of a tax policy is the equity of the distribution of the burden. So our second question is: What supplementation, if any, does the federal income tax require to achieve equitable tax distribution?

The accuracy with which tax burdens can be apportioned among people according to any desired pattern is one of the chief points of superiority of the income tax over all other taxes. Income is the chief source and measure of taxable capacity. By intelligent manipulation of deductions, exemptions, and rates it is possible if desired to recognize the different responsibilities of families of different size, the greater taxable capacity

⁴⁶ Tax evasion, avoidance, and repression will be discussed further in later sections.

represented by higher bracket incomes, and the greater tax-paying ability represented by investment income. The often-criticized complications of the income tax occur in part because of the tendency to add special, new provisions to the tax law rather than to thoroughly revise and integrate the whole. Mostly, however, income tax complications grow out of efforts to apply the tax in accordance with taxpaying ability in a complicated world.

In saying that the income tax is superior to other taxes in its adaptability to desired burden distribution is not necessarily to imply that the existing burden distribution is equitable. Tax justice is largely a matter of social values, and people differ in their views as to what is equitable. But the fact that distribution is at present according to a pattern that some may not like does not mean that the income tax is not adaptable to some other pattern. By increasing, decreasing, or wiping out exemptions, adjusting rates, changing the definition of gross income and modifying deductions and credits, the legal tax liability can be allocated in almost any desired fashion short of singling individuals out for special treatment.

Despite its superiority the income tax is subject to certain difficulties in practice which prevent the actual burden distribution from reaching the degree of perfection possible in the distribution of tax liability.

In the first place, incomes and exemptions do not always mean the same economic reality to people in urban areas and to people in rural areas, or to people in different regions. Not only different costs of living but different ways of life make nationally uniform exemptions and rate schedules inadequate to impose equal burdens on equal abilities. In general, rural America is relatively undertaxed by the income tax.⁴⁷ It is at least possible that the distribution could be improved at the expense of greater complication in defining gross income and deductions, but the whole problem could hardly be solved in this manner.

However, to call attention to this defect does not point to the form of tax diversity that would cure it. The present writer has not observed any proposed taxes which, if added to the federal system, would balance the income tax in this respect, without diminishing in other at least equally important ways the adaptability of the income tax to desired burden distribution.

A second defect of the income tax in its adaptability to any desired burden distribution is the fact that it cannot directly reach accumulated wealth. Wealth may be an important source or at least measure of individual taxpaying ability. The nearest the income tax can come to recog-

⁴⁷ Which is not to say that farmers are undertaxed considering federal, state and local taxes combined.

nizing the ability to pay inherent in wealth, is to place a higher rate on income from property than on income from personal services. Not only has this proved difficult in practice but it does not really solve the problem, since income from wealth is not necessarily proportionate to the value of the wealth. Because the Constitution, as interpreted, prevents any direct taxation on wealth, the estate and gift taxes have been our principal methods of directly reaching the wealth element in ability-to-pay. Present methods of applying these taxes leave much to be desired, but these defects of estate and gift taxation need not concern us here. Methods are available for improving these taxes as a means of distributing tax burdens in accordance with wealth if that end is desired.⁴⁸ The income tax could then be supplemented by appropriately devised estate and gift taxes in order to distribute the tax burden in whatever manner is desired. Proponents of greater diversity in the federal tax system have thus far shown little interest in this kind of revision.

A third respect in which the income tax may fail to be adaptable to the desired burden distribution is administrative in character. It concerns the difficulty of enforcing income taxes where the withholding tax procedure is not feasible. The bootleggers and black market operators can perhaps be overlooked, as they are only incidentally income tax violators. The fashionable surgeons and other professional men who are caught lead us to wonder how many get away.⁴⁹ A preference for cash over checks by certain doctors is a bad sign. So is the intense interest of many taxpayers in finding loopholes in the tax laws. And under present enforcement practices farmers, self-employed, farm laborers, and domestic servants certainly escape taxes in large numbers. It is not suggested that the income tax cannot be imposed on such incomes. However, a substantially different and more expensive administrative procedure than now employed will probably be necessary if the tax is to be equitably and effectively imposed on certain large groups of income recipients.

High rates of income tax encourage efforts to escape the tax. Evasion of a downright illegal character is made more worthwhile. Moreover, with the complicated tax laws necessary in a complex economy, there are many methods on the border-line of legality which taxpayers are encouraged by high rates to employ. These can usually be eliminated by prompt action of Congress. Such action is often difficult to achieve. Resentment against high rates which are deemed politically necessary may lead to the creation of loopholes rather than to closing them. Here again, to the extent that

⁴⁸ WILLIAM VICKREY, *AGENDA FOR PROGRESSIVE TAXATION*, (1947).

⁴⁹ Examples of tax evaders who were caught are reported from time to time in Treasury Department press releases. See for example, Treasury Department Press Service No. S-444, for release August 27, 1947.

lowering high rates may be necessary as a cure, it can be done within the framework of the income tax as long as the total required revenue is not too great.

The previous discussion leads the present writer to the conclusion that except for the estate and gift tax the addition of other taxes to the income tax can add little in making the federal tax system more adaptable to the desired burden distribution. This view is by no means universally shared.

Stability or Instability? Another consideration is that of revenue stability or instability. Can we get the desired degree of stability of revenue or instability of revenue through the income tax, or is greater diversity of tax sources needed to achieve this purpose? To answer this question, we need to know which, stability or instability of revenue, is to be the desired objective of tax policy. Each has its vigorous advocates.

Under traditional fiscal policy in which emphasis is placed on the achievement of an annually balanced budget, revenue stability is considered a desirable characteristic of the federal tax system. The 1932 recommendations of Secretary Mellon previously referred to, were entirely in that tradition.

Of the recent tax studies the one which most strongly supported revenue stability is the Magill-Lutz Committee Report:

Revenue stability is an important factor in the tax program which we are proposing for the postwar period. . . . In our opinion the economic craft which carries us all is capable of righting itself after the wave-like variations that beset it, and a revenue system devised to supply all reasonable needs under a considerable diversity of economic circumstances will assure far greater buoyancy than can be provided by addition to a public debt already so large as to be a subject of grave concern.

The report goes on to point out that

the principal characteristics of a tax system whereby revenue stability is likely to be attained is diversity in the methods of taxation.⁵⁰

The income tax itself may be designed to produce much more stable revenue at fixed tax rates than the present rate structure produces. The yield from a proportional income tax with no exemptions, for example, would be much more stable than the yield from the present system. However, since incomes are less stable over the business cycle than are expenditures for consumption, even a proportional income tax would yield less stable revenue than taxes which fall on consumption, especially on general consumption of necessities. If revenue stability be an important purpose, diversity can help to achieve it.

⁵⁰ Committee on Postwar Tax Policy, *A Tax Program for a Solvent America*, 30-31 (1945).

The deliberate enlargement of revenue instability, on the other hand, is a highly regarded technique of compensatory fiscal policy.⁵¹ The larger the tax payments in boom times, the greater the anti-inflationary effect of taxes. The smaller the tax payments in depression, the less the deflationary effects of taxes. These results are most powerful when the variations in tax payments occur in taxes on income groups which spend the largest fractions of their incomes, *i.e.*, the low income groups. While all advocates of compensatory fiscal policy appear to favor instability of revenue, there are differences of opinion among them as to how important such variations are and what methods should be employed to produce them. One major point of difference is whether tax rates should be raised in boom periods and lowered in periods of underemployment.

One position is that revenue instability should be built into the tax structure so that without any changes in the tax rates the revenues automatically would be much higher in boom years than in depression years. Revenue instability of this character underlies the fiscal policy proposals of Messrs. Ruml and Sonne, and probably of the tax report of the C. E. D. To achieve a high degree of automatic instability in revenue requires the use of highly unstable taxes. Probably a progressive individual income tax and a corporation income tax (at proportional rates or at rates progressive to much higher income levels than at present) would give the maximum automatic instability.

The other position is that tax rates should be flexible. Variations in revenue yields over the business cycle would be achieved largely through rate changes, rates being reduced in depressions and raised in boom times.⁵² This is the very opposite of the rate flexibility practiced under traditional fiscal policy. The addition of flexible rates to automatic instability greatly increases the degree of instability attainable since tax revenues can be reduced to zero if desired. Moreover, it permits less emphasis on a tax structure designed to produce unstable revenues and allows more emphasis on other considerations than if no flexibility is employed.

The policy of employing flexible rates does not add any necessity for diversity in the federal tax system. The individual income tax, and especially that portion withheld at source, is perhaps best adapted of all taxes to the application of flexible rates. Corporation income taxes, manufacturers' sales taxes, and specific excise taxes are not very well suited for the application of flexible rates. The expectation of stable rates of tax on business reduces uncertainty, which would be increased by frequent changes in corporate income tax rates. The corporate income tax, more-

⁵¹ See A. H. HANSEN, *ECONOMIC POLICY AND FULL EMPLOYMENT*, 140-43 (1947) for a recent statement.

⁵² *Ibid.*

over, does not have a direct and immediate impact on consumer purchases. Manufacturers' sales and excise taxes do affect consumer prices and purchases directly and immediately. However, when the rates of tax are raised or lowered, compensating taxes or refunds should be provided for goods in the hands of wholesalers and retailers.⁵³ This is expensive and confusing and if done frequently would add the administrative and compliance problems of retail sales taxes to those at the manufacturers' level.

About the only tax other than the individual income tax that is adaptable to rate flexibility for counter-cycle purposes is the general retail sales tax. In order to make much of a variation in tax on consumer purchasing power between boom and depression, this tax during boom periods would have to be levied at relatively high rates and be subject to wide rate variations, because of its relatively high innate stability of yield.

Diversity and Incentive to Work, Manage, Invest, and Take Risks. Perhaps the brave new postwar world will be one of unlimited buoyancy and expansion. Perhaps the problems that troubled us during the prewar depression will be little more than the memories of bad dreams. In that case, we can turn to our other troubles. But, in the meantime we should not disregard problems that on the basis of experience seem likely to confront us. Recurring unemployment—perhaps even chronic unemployment—is in that category. Minimizing the repressive effects of taxation on employment becomes thus a major tax consideration. Our task here is to inquire whether diversity of the federal tax system is required to avoid or minimize the repressing effects of taxation on employment.

In considering its effects we must distinguish the income tax at moderate rates from the income tax at very high rates. At moderate rates the income tax has long been considered by economists to have less undesirable effects than excise taxes, sales taxes, or business taxes measured by gross receipts rather than net income. The income tax exercises the minimum of distorting effects on the use of resources both at the demand level and at the production level. It results in the least loss of consumer surplus. It causes the least discrimination among competitors. It has the least tendency to drive business into bankruptcy. In short, the general net income tax has been considered the most neutral in its incentives on business operations and individual economic decisions—and the individual income tax is superior to the corporation income tax in that respect.

Taxes may impede production and employment in a variety of ways. Most important are their effects in reducing consumer demand and re-

⁵³ Cf. H.R. REP. No. 1106, 79th Cong., 1st Sess. 12, which discusses the provision providing refunds on floor stocks when excise tax rates are lowered. Revenue Act of 1945, Sec. 302.

ducing inducements to work and take risks. Unfortunately it is very difficult to avoid reducing demand and also inducements at the same time.

The income tax is almost ideally adapted for avoiding tax repression on consumer demand, since through exemption and rate adjustments the tax can be made relatively light on persons in the lower income groups, who in general spend on consumption the largest proportions of their incomes. Sales and excise taxes, on the other hand, would for the most part impose relatively the heaviest burdens on such persons. Accordingly, if the objective is to minimize the repression of consumer demand by taxes, a tax system without diversity does it better than a diversified system.

High rates of income taxes, particularly on larger incomes, reduce the source from which savings are made. This might conceivably seriously threaten the growth of new capital. On the other hand savings out of current income which do not find their way promptly into new capital, reduce the demand for goods and accordingly production and employment. It is doubtful whether the total volume of savings is likely to be too low under 20th century conditions. Undistributed corporate profits, a banking system with room for expansion, and the tendency of individuals to save, would seem to assure at least adequate savings except in time of war and in other inflationary periods. However, business expansion may still be hampered by lack of capital, since the savings may be in the hands of the wrong people for the needed investment, and since investment of savings may be impeded. It is indeed the willingness to invest rather than the available volume of savings which is the more important limiting factor.⁵⁴

High rates of income taxes adversely affect the incentives for working and taking risks, by reducing the net return for effort and risk. In the case of investment the effect on the return for risk is the most important one. The discouragement which high rates of income tax place on the taking of risks is decreased as the provision for the offset of losses against other income becomes more complete.⁵⁵ The income tax could be greatly improved in this respect.⁵⁶ The discouragement which high rates of income tax place on working arises from the competition in the worker's mind between increased leisure and increased income. Discouragement of

⁵⁴ Indeed actual savings, as distinguished from attempted or intended savings, are themselves limited by the volume of investment. Cf. J. M. KEYNES, *THE GENERAL THEORY OF EMPLOYMENT, INTEREST, AND MONEY*, 61-65 (1936).

⁵⁵ See, Evsey D. Domar and Richard A. Musgrave, *Proportional Income Taxation and Risk-Taking*, 58 *QUARTERLY JOURNAL OF ECONOMICS* (May, 1944).

⁵⁶ See, TAX INSTITUTE, INC., *HOW SHOULD CORPORATIONS BE TAXED?* (1947). This book is useful in connection with much of the subject-matter of this paper.

management, which has been stressed in recent months, involves both the risk factor and the leisure factor.

How important the income tax is in reducing incentives has not been studied in a definitive way. The important point here is that the income tax taken as a whole is probably not high enough seriously to affect incentives. If some parts of the tax do so the adjustment can be made within the income tax without the necessity of further diversity.

Diversity and Non-Revenue Objectives. Economists and students of taxation are divided on the question of whether taxation should be used to promote economic control objectives. However, Congress has been under no restraint in the matter, and has used taxation for economic control from 1789 on.⁵⁷

The most important economic control objective has been the protection of specific industries from competition, either foreign or domestic. Our system of import duties has long since ceased to have much revenue significance. Tariffs are imposed for protection and for the most part, revenue is a minor consideration. A few internal revenue taxes, notably that on oleomargarine, are imposed also largely for the purpose of protecting an industry from its competitors.

It will be observed that protection of industry has been accomplished not through income taxes but through import and excise taxes. The income tax being a general tax applied to net income has, as we have previously seen, a minimum of distorting influence. The objective of granting protection to an industry requires a tax which will have a distorting influence. Accordingly, to the extent to which protection of industries is an accepted objective, it will be necessary to retain other forms of tax than the income tax. From their restrictive nature, however, they are not likely to be large revenue producers and accordingly will not do much to show diversity in the revenue picture.

A second objective of economic control which has been adopted from time to time, is the use of taxation to discourage consumption of specific commodities deemed to be harmful. Thus, we have a very heavy tax on opium, and the taxes which are imposed on narcotic drugs are used as the basis for supporting a detailed system of regulations. The tax on alcoholic beverages is often justified because of the optional character of the consumption of such beverages. It is not improbable, however, that many people look upon a heavy alcohol tax as desirable because of its restrictive effect on alcohol consumption. In Great Britain it appears that alcohol taxes were imposed with the specific purpose of cutting down drunkenness in the population.⁵⁸

⁵⁷ See TWENTIETH CENTURY FUND, *FACING THE TAX PROBLEM* 129-214 (1937) for a discussion of the use of taxation as an instrument of social control.

⁵⁸ URSULA K. HICKS, *PUBLIC FINANCE* 144 (1947).

Here again, the achievement of an economic objective requires use of taxes other than the income tax. There are, however, only a very few goods and services the use of which society seeks to discourage; accordingly, it is not likely that any extension of such taxes beyond their present level will be called for to support this objective.

Another non-revenue objective which has undoubtedly entered into the consideration of progressive rates of tax on incomes and estates is the desire to reduce the inequalities of wealth and income.⁵⁹ The income tax is the most suitable tax instrument for reducing inequalities of income, while a combination of the income tax and the estate tax can be employed to reduce inequalities of wealth. The amount of revenue from the estate tax necessary to achieve the desired decrease in inequality of wealth will, of course, depend upon the amount of equalizing desired. For the most part the desire is to reduce very large fortunes; since there are not very many of these, the amount of revenue involved is not likely to be sufficiently large to increase greatly the diversity of the federal tax system.

Diversity and Federal-state Fiscal Relations. The greater the number of taxes used by the federal government, the greater the conflict or duplication of taxes between the federal government and the state government. The federal and state governments have shown no hesitancy about entering the fields which the other had already tapped. Thus, the federal government has gone into the taxation of gasoline, while state governments have gone into the taxation of tobacco. If the federal government were to impose a general retail sales tax, the extent of the duplication would be greatly increased as 29 states impose such a tax.⁶⁰ Adoption of a federal manufacturers' sales tax would constitute direct duplication in 6 or more states which apply sales taxes or their equivalent at the manufacturing level, and indirect duplication for other states which impose retail sales taxes, since the manufacturers' sales taxes would constitute a duplicate sales tax paid by the final consumer. If the amount of the sales tax imposed by the federal government were separately quoted in retail sales as is the case with certain of the articles subject to manufacturers' excise taxes, for example, electric light bulbs, the duplication would be direct so far as the consumer is concerned.

Over the next few years, the state and local governments are likely to need every source of revenue which they can successfully impose. State governments are at a considerable handicap in imposing income taxes on both individuals and businesses. In part, the handicap arises from the administrative difficulty a state has of finding people and of allocating

⁵⁹ Cf. HENRY C. SIMONS, *PERSONAL INCOME TAXATION* vi-vii (1937).

⁶⁰ Treasury Department, Division of Tax Research, *Federal-State Tax Coordination*, Table 19 (July, 1947).

personal and business incomes among the states. In part, the handicap arises from the danger of driving people and businesses from the state because of higher income taxes than are imposed in other states. The federal government is able to exploit the income tax as a source of revenue to a much greater extent than can the states. A high tax rate in one or a few states may interfere with the use of the tax by the federal government, since Congress is sensitive to combined federal and state tax burdens.

States by and large are able to impose sales and excise taxes successfully. Some difficulty arises out of interstate commerce, but for the most part this has been solved, for example, in the case of the gasoline tax. A very productive state sales tax need not be sufficiently high in rate to promote a great deal of interstate purchasing, although some of this goes on. Certain of the taxes, for example, the tax on local admissions, can be administered equally as well by the state or local governments as by the federal government.

Under these circumstances, it is not surprising that proposals have been made that the federal government withdraw to the greatest extent possible from the excise tax field, leaving this source of revenue for the exploitation of the states.⁶¹ Whatever may be the outcome of this effort to reduce the federal use of excise tax sources, mutually helpful federal-state fiscal relations would not be promoted by expanding the federal use of excise and sales taxes.

Political Aspects of the Diversity Issue. It has been pointed out above that a general sales tax and its practical equivalent, a long list of excises, are about the only available methods of diversifying the federal tax system. Observation of the political situation today suggests the conclusion that at least in some quarters the proposal to diversify the federal tax system is part of a larger campaign to introduce a federal general sales tax. This campaign does not necessarily grow out of any great admiration for the sales tax. The underlying objective appears to be that of reducing greatly the rates of income tax in the higher brackets. The decision to promote the sales tax rather than to rely solely on revision of the income

⁶¹ For example, see statement by Horace Hildreth, Governor of Maine, following the Round Table on Tax and Fiscal Policy, at the Governors' Conference, Salt Lake City, Utah, July 14, 1947: "Tax studies by experts, with which I agree, indicate that it would be desirable for the federal government to withdraw from the so-called nuisance tax field, in favor of the several states and leave to the states such taxes as gasoline taxes, alcoholic beverage taxes, amusement and admissions taxes and luxury taxes."

A joint conference of thirty United States Congress members and Governors, meeting under the sponsorship of the Governors' Conference of the Council of State Governments, on September 27, 1947 reported that "This conference is of the opinion: (1) that the Federal government should reduce Federal excise taxes as soon as practicable. . . ." N.Y. Times, Sept. 28, 1947.

tax itself appears to rest on the following beliefs as to public tax reaction: first, that the majority of people will insist on a continuation of a relatively high degree of income tax rate progression so that substantial reduction of rates in the upper brackets would necessarily be accompanied by proportionately still greater reduction in the lower brackets; second, that people think about the burdens of the income tax and the sales tax as separate matters and do not accurately combine the burdens in making their political decisions; and third, as a corollary, that the majority of people would accept a sales tax combined with an income tax having a low maximum rate and an apparently high degree of progression, while they would reject an income tax with the same low maximum rate and relatively higher rates in the lower brackets. Of course, so far as burden distribution is concerned, the combination sales and income tax would be heavier on the bulk of the people than would the income tax alone, and would not recognize differing family responsibilities, but apparently it is believed these facts would not be decisive in determining public opinion.⁶²

The strategy that would seem to be indicated by this political judgment would be first, to induce acceptance of a substantial rate reduction in the higher income brackets while raising exemptions and cutting rates sharply in the lower brackets. Such action would reduce revenues more than the revenue goal would permit; while this might not be clear at first, it would shortly become obvious. The strategy then would presumably be to introduce a general sales tax or its equivalent as the proper method to raise the needed revenue and balance the budget.

It will be interesting to observe over the next year or so to what extent this political strategy is followed and whether the political judgment on which it rests proves to be a sound one.

⁶² Sales and excise taxes have long been objected to because they are hidden and the taxpayer is not conscious of them. For example, Henry C. Simons in 1943 recommended "elimination or radical reduction of excise taxes (especially on beer, tobacco, admissions, liquor, etc.) as an element in the federal revenue system." He went on: "My main objection to these levies, incidentally, is that they are paid without an awareness of their heavy burdens. . . . the revenue devices of political cowardice." NATIONAL TAX ASSOCIATION, PROCEEDINGS OF 36TH NATIONAL CONFERENCE, p. 440 (1944).