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ORIGINS OF A FLAT TAX

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The push toward radical reform of our federal system of graduated income tax rates hit the political scene like a sonic boom during 1995. No less than eight proposals were circulated or formally submitted by members of Congress, including plans by Senators Richard Lugar (R-Ind.) and Arlen Specter (R-Pa.), which were made the centerpieces of their respective campaigns for the Republican nomination in the 1996 presidential elections.[1] Furthermore, presidential candidates such as former Tennessee Governor Lamar Alexander,[2] political commentator Pat Buchanan,[3] Senator Bob Dole (R-Kan.),[4]

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1. Tax reform plans already introduced in Congress include the following: The Freedom and Fairness Restoration Act of 1995, H.R. 2060, 104th Cong., 1st Sess. (1995) (submitted by Rep. Richard Armey (R-Tex.) on July 19, 1995) and its companion S. 1050, 104th Cong., 1st Sess. (1995) (submitted by Richard Shelby (R-Ala.) on July 19, 1995); H.R. 1780, 104th Cong., 1st Sess. (1995) (submitted by Mark Souder (R-Ind.) on June 7, 1995) and its companion S. 488, 104th Cong., 1st Sess. (1995) (submitted by Sen. Arlen Specter (R-Pa.) on Mar. 2, 1995); Crane Tithe Tax Act of 1995, H.R. 214, 104th Cong., 1st Sess. (1995) (submitted by Rep. Philip Crane (R-Ill.) on Jan. 4, 1995) and its companion the Flat Tax Act of 1993, S. 188, 103d Cong., 1st Sess. (1993) (submitted by Sen. Jesse Helms (R-N.C.) on Jan. 26, 1993); USA Tax Act of 1995, S. 722, 104th Cong., 1st Sess. (1995) (submitted by Sen. Sam Nunn (D-Ga.) on Apr. 25, 1995). *See* JOINT COMMITTEE ON TAXATION, 104TH CONG., 1ST SESS., DESCRIPTION AND ANALYSIS OF PROPOSALS TO REPLACE THE FEDERAL INCOME TAX (Joint Comm. Print 1995); JOINT COMMITTEE ON TAXATION, *Description and Analysis of Proposals to Replace the Federal Income Tax*, 82 Stand. Fed. Tax Rep. (CCH) No. 29, at 30-38 (June 15, 1995).

Plans that have been announced but not yet introduced include a "flat" tax proposal by House Democratic Leader Richard Gephardt (D-Mo.), in which the majority of the country would pay a flat tax while the richest would pay graduated rates. *See* Lucinda Harper, *Gephardt Outlines Tax-Reform Plan Cutting Deductibles*, WALL ST. J., July 7, 1995, at A2. Other announced plans include various sales tax proposals by Senator Richard Lugar (R-Ind.), House Ways and Means Chairman Bill Archer (R-Tex.), Representative Dan Schaefer (R-Colo.), and Representative Billy Tauzin (D-La.). Jonathan Peterson, *Chorus Builds for Radical Remake of U.S. Tax Policy*, L.A. TIMES, Apr. 6, 1995, at A1; *see also* Amy Kaslow, *Radical Tax Reforms Gain New Attention*, CHRISTIAN SCI. MONITOR, Apr. 12, 1995, at 1; Stephen Moore, *Ax the Tax*, NAT'L REV., Apr. 17, 1995, at 38, 38.

States are also getting involved. Flat tax plans have been proposed in South Carolina, Arkansas, and California. *Clarifying California*, WALL ST. J., Dec. 6, 1995, at A18; John Heilprin, *S.C. Senate Endorses Legislation for Flat Tax*, POST & COURIER (Charleston, S.C.), May 18, 1995, at A8; James Jefferson, *Rep. Reopens Plan for Ark. Flat Tax*, COM. APPEAL (Memphis, Tenn.), July 28, 1995, at B10.

2. *U.S. GOP Candidate Alexander Backs Flat Tax*, REUTERS, May 12, 1995. *But see* Rena Pederson, *Clarifying the Flat Tax*, DALLAS MORNING NEWS, Jan. 21, 1996, at 23 (reporting that Alexander recently called one flat tax plan a "nutty idea").

3. Marcia Stepanek, *Republicans Flat Excited About New Tax Proposals*, S.F. EXAMINER,

and publisher Malcolm S. "Steve" Forbes, Jr., as well as leaders in both the House and Senate,[5] expressed support for these proposals and their underlying theories during the 1996 campaign. These reform plans, advertised as revenue-neutral, suggest either replacing the current graduated income tax rate structure with a "flat" or proportionate rate, or abolishing the income tax altogether in favor of a national consumption or sales tax. The devil, however, is in the details.[6] Consequently, House Majority Leader Newt Gingrich (R-Ga.) and Senate Majority Leader Bob Dole tabbed Jack Kemp to lead a GOP commission to investigate the possibility of overhauling the tax system.[7] Regardless of which, if any, proposal survives the political process, tax reform is sure to be on the public agenda in 1996.

While the public has echoed the radical sentiments expressed by tax reformers, a basic loyalty to graduated rates remains. In a *Wall Street Journal* poll, two-thirds of respondents said that the current system was "unfair."[8] Likewise, a *Newsweek* poll found that only 27% of respondents favored the current system in which rates range from 15% to 39%.[9] Much of this dissatisfaction, however, represents a plea for simplification rather than support for the proposed alternatives.[10] Opinion surveys and focus groups reveal that "the

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Apr. 17, 1995, at A11.

4. *Id.*

5. *Enthusiasm Growing for Income Tax Reform*, ORLANDO SENTINEL, June 9, 1995, at A3 (discussing House Minority Leader Richard Gephardt's plan to announce his proposal); John Harwood, *Presidential Hopeful Forbes Talks Up Flat Tax*, WALL ST. J., Jan. 2, 1996, at 38; Lisa Holton, *The Flat Tax; What Is It? Who Gains? Will It Fly?*, CHI. SUN-TIMES, Apr. 23, 1995, at 41; Peterson, *supra* note 1, at A1; B.J. Phillips, *Flat-Tax Fever*, TAMPA TRIB., Apr. 29, 1995, at 15. Representative Robert K. Dornan (R-Cal.), a long shot Republican presidential candidate, and Massachusetts Governor William Weld, a rumored candidate, also publicly proclaimed their support for the flat tax. Amy Bayer, *Dornan Joins GOP Presidential Race, Vows to Fight Moral Decay*, SAN DIEGO UNION-TRIB., Apr. 14, 1995, at A6; *Publisher Forbes May Seek GOP Presidential Nomination*, PALM BEACH POST, July 9, 1995, at A14; Doris S. Wong, *Weld Backs Flat-Rate U.S. Income Tax*, BOSTON GLOBE, July 20, 1995, at 46.

6. *See* Edwin Chen, *Details Divide GOP's Flat-Tax Boosters*, L.A. TIMES, May 18, 1995, at A14.

7. Gerald F. Seib, *Flat to Flatter Goes Tax Debate for Republicans*, WALL ST. J., Apr. 12, 1995, at A16. A report from the commission was released on January 17, 1996. *See* Cal Thomas, *Flat Tax: It's a Good Alternative to Our Confusing System*, DALLAS MORNING NEWS, Jan. 18, 1996, at 19A. There are also reports that President Clinton has directed the National Economic Council to evaluate the options for tax reform. Douglas Stanglin et al., *Taxing Debate*, U.S. NEWS & WORLD REP., July 10, 1995, at 14, 14.

Unfortunately, the Kemp Commission Report offered few details. Its basic prescription for reform is some type of flat rate tax which allows full deductibility of the payroll tax and requires a two-thirds super-majority vote in Congress to increase the rate. *See* REPORT OF THE NATIONAL COMMISSION ON ECONOMIC GROWTH AND TAX REFORM, UNLEASHING AMERICA'S POTENTIAL (1996).

8. Ronald G. Shafer, *Tax Overhaul? Yes. Flat Tax? Not So Fast*, WALL ST. J., Apr. 28, 1995, at A1.

9. *Poll: Majority Favors Flat-Tax Proposal*, WASH. TIMES, Apr. 9, 1995, at A2.

10. *See Keep it Simple . . .* , INDIANAPOLIS NEWS, June 8, 1995, at A6; *Make Taxes Simpler, Not Flat*, WIS. ST. J., Aug. 6, 1995, at B3; Henry G. Mogensen, *All Would Gain from Tax Reform*, WIS. ST. J., Apr. 29, 1995, at A7; *Time for Reform; Tortuous Tax System Needs Simplification*, COLUMBUS DISPATCH, May 6, 1995, at A12; *see also* Sheldon D. Pollack, *Tax Complexity, Reform, and the Illusion of Tax Simplification*, 2 GEO. MASON INDEP. L. REV. 319 (1994) (arguing that most tax reform proposals claim to simplify the tax code because this makes good press, but few come close to this goal).

long-held notion that the tax code should be 'progressive,' requiring the rich to pay a higher percentage of their income in taxes than the poor . . . remains firmly rooted in the minds of many middle-income taxpayers."[11] Thus, many resist reform when they realize that it involves a significant departure from our current system of graduated rates.[12]

Indeed, graduated rates have become entrenched in our notion of what constitutes a "fair" system of taxation. It is common to hear people suggest the somewhat oxymoronic solution of a "flat" tax which contains more than one tax rate.[13] As popular columnist William Safire wrote, "[m]ost of us accept as 'fair' this principle: The poor should pay nothing, the middlers something, the rich the highest percentage."[14] Given this "political logic of progressive taxation,"[15] Representative Sam M. Gibbons (D-Fla.), the ranking

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11. Clay Chandler, *Will the Republicans Trip over Tax Reform? Strategists Say a Crusade Could Backfire, Painting GOP as Pawns of Corporations, Rich*, WASH. POST, Aug. 13, 1995, at H1.

12. In several *Wall Street Journal* and NBC News polls, a majority of people favored retaining graduated rates despite their eagerness for radical reform. *The Flat Tax Is Losing Its Appeal Among U.S. Voters, Poll Finds*, WALL ST. J., Mar. 8, 1996, at R2 (stating that 54% supported a graduated tax while only 39% preferred a flat tax); *see also* Christina Duff & Gerald F. Seib, *Panel Shaping GOP's Tax Plan Recommends Single Low Rate*, WALL ST. J., Jan. 18, 1996, at A6 (stating that 54% supported a graduated income tax system, while 41% supported a flat tax); Gerald Seib, *Forbes Boomlet: A Rogue Force Stalks the Field*, WALL ST. J., Dec. 6, 1995, at A20. The results in a *Newsweek* poll and a poll by *Time* and CNN, however, showed that more respondents favored some form of flat rate taxation. *Flatter Is Better, Both Parties Agree Tax System Too Complicated*, SAN DIEGO UNION-TRIB., July 7, 1995, at B6; *Poll: Majority Favors Flat-Tax Proposal*, *supra* note 9, at A2. With the majority of plans billing themselves as "flat," while still providing deductions and graduated rates, the *Newsweek* poll and the poll by *Time* and CNN may be misleading. *See Reformers Really Want a Flat Tax with Wrinkles*, PALM BEACH POST, July 15, 1995, at A14. Many respondents may be simply unfamiliar with the choices. *See* Chandler, *supra* note 11, at H1 ("Nearly seven in 10 respondents to a February CBS News/New York Times survey said they had never 'heard or read anything' about the flat tax."). At a minimum, the numbers indicate substantial support for change without substantial support for moving away from graduated rates.

13. *See A Flat Tax That America Might Buy*, BUS. WK., June 12, 1995, at 110, 110 ("We favor a modified flat tax that would flatten the rate structure into two or three rates and preserve deductions for home mortgage interest contributions."); Phillips, *supra* note 5, at 15; William Safire, *Flat Tax Plan*, TIMES-PICAYUNE, Apr. 24, 1995, at B5 (arguing for a plan in which after a $15,000 exemption, earnings up to $150,000 would be taxed at a rate of 25% and anything over that would be taxed at 30%); *Talking Straight About Taxes, Another Debate on Tax Reform Is Welcome, but Let's Not Pretend This Will Be Easy*, PLAIN DEALER, Apr. 26, 1995, at B10 [hereinafter *Talking Straight About Taxes*].

14. Safire, *supra* note 13, at B5. This is a reasonable reflection of the American attitude toward graduated rates. *See* Michael Kinsley, *The Flat Tax Society*, NEW YORKER, May 1, 1995, at 7, 8 (arguing that the wealthy should pay a disproportionate share of the taxes since they receive a disproportionate share of society's benefits); Letters to the Editor, *The Rich Should Pay Plenty*, WASH. POST, July 22, 1995, at A20.

Reaction to the Christian Coalition's endorsement of the flat tax illustrates the moral principles which many believe should underlie the tax system. One commentator wrote that "[w]hen you recall that Christ's ministry was designed to uplift the poor and bring social justice to the world, it makes you wonder why the flat tax is being called 'Christian.'" Yardley Rosemar, *Christian Coalition's Contract: But Does Jesus Favor a Flat Tax?*, NEWS & REC. (Greensboro, N.C.), May 26, 1995, at A15. A similar story is revealed by three Tennessee bishops' criticisms of sales taxes. "Tennessee takes in most of its revenue through sales taxes, and the bishops are worried that's too much of a burden on their poor. 'Jesus is on our side,' the clerics argue." *Higher Authorities*, WALL ST. J., June 8, 1995, at A12.

15. *Should America Keep Its 'Progressive' Tax System?*, INVESTOR'S BUS. DAILY, July 24, 1995, at B1 ("The political logic of progressive taxation has kept multiple rates in the U.S. tax

Democrat on the House Ways and Means Committee, declared that "'[a]ny new tax system, should result in the same tax burden on each income group as the current tax system imposes.'"[16] Thus, both the Domenici-Nunn "USA tax," which taxes income of all kinds but creates a deduction for anything a person saves,[17] and the Gephardt "flat tax," which retains five different rates,[18] have been hailed because they allow for "steeply graduated marginal tax rates."[19] According to a *Washington Post* editorial, the ability to tax high incomes at a higher rate than low ones "is consistent with a well-established American tradition of fairness."[20]

This conception that graduated, and hence progressive, rates are inherently fair is not confined to the popular press and political commentators. Academics often uncritically accept the historical supposition that the ratification of the Sixteenth Amendment[21] in 1913 sanctified the marriage between the principles of fairness and graduated rates and approved an explicitly redistributive rationale for the income tax.[22] Akhil Amar wrote that "[t]he popular legislative history of ratification [of the Sixteenth Amendment] reveals not merely an endorsement of an income tax simpliciter, but popular approval of a predictably progressive—that is, a redistributive—income tax."[23] Because the first post-Sixteenth Amendment income tax included graduated rates, the assumption is that the progression principle was also ratified in 1913.[24]

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system for decades.").

16. David E. Rosenbaum, *Chairman Proposes Redefining Tax Code*, N.Y. TIMES, June 7, 1995, at A22. Representative Gephardt's "flat" tax proposal, which provides for rates of 10%, 20%, 26%, 32%, and 34%, is an example of the attempt to preserve the graduated structure. *See* Harper, *supra* note 1, at A2.

17. David Wessel, *Nunn-Domenici 'USA Tax' Puts Levy on Consumption to Encourage Saving*, WALL ST. J., Apr. 26, 1995, at A2.

18. Thomas Oliphant, *Gephardt's Version of Flat Tax Is Fairer to Middle Class*, BOSTON GLOBE, July 11, 1995, at 13.

19. Wessel, *supra* note 17, at A2; *see* Robert Kuttner, *Dueling Tax Plans: One Adds Up, The Other Doesn't*, BUS. WK., May 15, 1995, at 28; *Tax Fairness*, WASH. POST, Apr. 27, 1995, at A20; Murray Weidenbaum, *Postcard-Size or Not, America Needs a New Tax Plan*, CHRISTIAN SCI. MONITOR, May 18, 1995, at 19.

20. *Tax Fairness*, *supra* note 19, at A20. Tommy Denton, in his blunt fashion, noted that "all taxpayers should bear an equitable—and thus progressive—proportion of the burden necessary to support the common good, including and especially the awesomely wealthy. Fair's fair." Tommy Denton, *Let's Be Fair*, BALTIMORE SUN, July 19, 1995, at A15.

21. The Sixteenth Amendment states, "The Congress shall have the power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration." U.S. CONST. amend. XVI.

22. *See* Marc Linder, *I Like Ike: Bringing Back Eisenhower-Era Progressive Taxation*, 67 TAX NOTES 833, 834 (1995) ("Bringing back Eisenhower-era progressive taxation . . . would also fulfill the other traditional purpose of the income tax by reducing the market's increasingly unequal distribution of income through redistribution."); Martin J. McMahon, Jr., *Individual Tax Reform for Fairness and Simplicity: Let Economic Growth Fend for Itself*, 50 WASH. & LEE L. REV. 459, 461 (1993) ("Advocates of changing the tax system to encourage economic growth do not seem to view the tax system as a vehicle to collect adequate revenues fairly or to soften the harsh distributional results that capitalism sometimes produces."). Some recognize that this was not the theory enacted in 1913, but imply that it should have been. *See, e.g.*, ROBERT STANLEY, DIMENSIONS OF LAW IN THE SERVICE OF ORDER: ORIGINS OF THE FEDERAL INCOME TAX, 1861-1913 (1993).

23. Akhil R. Amar, Comment, *Our Forgotten Constitution: A Bicentennial Comment*, 97 YALE L.J. 281, 291-92 & n.45 (1987) (critiquing Richard Epstein's argument that redistributive legislation offends deeply rooted Constitutional principles).

24. *See* Marjorie E. Kornhauser, *The Rhetoric of the Anti-Progressive Income Tax Move-*

The history of income taxation in this country before and immediately after the ratification of the Sixteenth Amendment, however, reveals a struggle of more than fifty years to replace a regressive tax system with a proportional, not progressive, one. Each income tax proposal was just one component of a larger tariff or revenue bill. During the three significant periods of discussion for the income tax—1861-1872, 1893-1895, and 1909-1913—the justification for income taxes, and their progressive structures, was to balance out the regressive effects of other aspects of the federal revenue system and to require the wealthy to contribute their proportionate share.[25] The only experiment with a graduated income tax prior to the Sixteenth Amendment, which was enacted to counterbalance the heavy effects of consumption taxes during the Civil War, was promptly discarded when those effects appeared to dissipate.[26] When attention later became focused on the inequity of the wealthy's equal rather than proportionately larger tax contribution, an income tax enacted in 1894 contained a flat rate similar in form to many of the recent proposals.[27] Thus, the Sixteenth Amendment's failure to address progressive rates in its approval of an income tax "without apportionment among the several States, and without regard to any census or enumeration,"[28] was not because progression was implicit within an income tax. Indeed, a motion on the floor of Congress to amend the proposed Sixteenth Amendment to allow for graduated rates was withdrawn by its sponsor, Senator Joseph W. Bailey (D-Tex.), because it would not have passed and he did not want the measure of opposition recorded.[29]

Thus, when Congress employed graduated rates in the first post-Amendment income tax measure in 1913, it was not to enact a progressive overall revenue system. These rates were politically and popularly intertwined with the tariff reduction bill within which they were contained. Under what contemporary economist Edwin R.A. Seligman called the "special compensatory theory,"[30] the Democrats who controlled the bill in both Houses supported the slightly graduated rates as a measure to equalize the overall regressive effects of the tariffs and internal excise taxes which provided the federal government with the bulk of its revenues. Operating within the patchwork quilt of federal taxation, graduated income tax rates were seen as a temporary measure necessitated by inequality elsewhere in the fabric. A transition was beginning from a system which taxed people based upon their "necessity to consume" to a system which taxed them based upon their "ability to pay." Strongly in favor of free trade, the Democrats hoped for a period when the income tax would

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ment: A Typical Male Reaction, 86 MICH. L. REV. 465, 465 (1987) ("In 1913, the general public, economists, and politicians argued about the exact schedule of rates and exemptions, but the idea of graduated or progressive rates was accepted with surprising ease and generally has remained unquestioned ever since.") (footnote omitted).

25. *See* discussion *infra* part II.
26. *See* discussion *infra* part II.B.
27. *See* discussion *infra* part II.C.
28. U.S. CONST. amend. XVI.
29. 44 CONG. REC. 4120 (1909).
30. EDWIN R.A. SELIGMAN, THE INCOME TAX: A STUDY OF THE HISTORY, THEORY AND PRACTICE OF INCOME TAXATION AT HOME AND ABROAD 30-31 (2d ed. 1914).

become the primary source of federal revenues. At that time, Democrats declared they would cast their support for the enactment of a flat rate income tax as the only just and equal form of taxation. Only the Insurgent Republicans, a small faction of the party composed mainly of politicians from the West and Midwest, and the few members of the Progressive Party in Congress supported the principle that the wealthy should pay at a higher rate simply because of their swollen fortunes.

Despite this history, the latter view has endured. "Ability to pay" has become associated with the philosopher's notion of "equality of sacrifice" rather than the politician's description of a shift from taxation measured by the "need to consume" to taxation measured by the "ability to pay"—a shift from near absolute equality of payment to proportional equality of payment.[31] This article examines the historical underpinnings and assumptions leading up to the adoption of the graduated income tax in 1913 to disclose the fallacy that Congress intended to enact even a mildly progressive federal revenue system. Considering the system as a whole, the Revenue Act of 1913, much like its predecessors, was a political compromise which resulted in the adoption of a flat rate principle in federal taxation.

Section I explains the conceptual background and terminology of the federal revenue system. The historical argument, which begins in section II, examines the short-lived income taxes enacted during the Civil War and in 1894. Section III explores the political background and congressional debates surrounding the inclusion of a graduated rate structure in the Sixteenth Amendment and the Act of 1913. Finally, the article concludes that history supports the adoption of a flat tax principle, but not in the form suggested by many of the current proposals.

I. BACKGROUND AND TERMINOLOGY

Distributions of tax burdens can exist in a variety of manners as a percentage of an individual's overall income. Generally, the terms proportionate, progressive, and regressive refer to these burdens.[32] The proportionate tax is perhaps the easiest to understand conceptually. Each dollar of taxable income under a proportionate or "flat" tax is taxed at the same rate. Thus, a person who earns $1 must pay $.10 under a 10% flat rate system of taxation while a person who earns $100 must pay $10, one hundred times the contribution of the lower-income individual. Wealthier individuals pay higher absolute

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31. *See* McMahon, *supra* note 22, at 464 ("If equity in the tax rates requires an attempt to approximate equal sacrifice or to measure 'ability to pay' across broad ranges of incomes, rates should be far more progressive than the current rate schedule.").

32. Seligman described a fourth manner of apportioning the burdens of taxation called the degressive tax, where a tax is progressive to a certain level and then proportionate thereafter. SELIGMAN, *supra* note 30, at 30. Of course, this describes all progressive taxation which does not define its upper rate by an infinite number. According to Seligman, the term "degressive taxation" is reserved for systems where a low proportional rate is seen as the normal one and lesser incomes receive an even lower rate. *Id.* Perhaps because of this philosophical uncertainty or the reality of high rates, this term is not often cited in popular literature on the subject. *But see* Kornhauser, *supra* note 24, at 471 (using the term "degressive tax").

amounts to the government, but not because their dollars are treated differently than those of other taxpayers.

In a progressive tax system, the percentage of tax paid to the government increases with income. Under our current regime, this is accomplished through graduated marginal rates. Using the above example, the individual who earns $1 pays nothing, while those earning $50 and $100 might pay $5, or 10% of income, and $20, or 20%, respectively. Progressive taxation, however, can be accomplished without graduated marginal rates. For example, a proportionate rate of taxation coupled with an exemption results in progressive taxation.[33] An exemption of $1 would relieve the earner of $1 from paying any tax at all. Individuals earning $50 and $100 would pay tax on only $49 and $99 of their respective incomes. Since the dollar removed from the $50 earner's income is a greater percentage of his income than the dollar removed from the $100 earner's income, the progressive effect is intensified. Combining a proportionate rate with a flat rebate or grant to all taxpayers achieves the same result.[34]

The regressive form of taxation has been said to be so unpopular "that the term itself has become colored."[35] Under this system, individuals pay a lower percentage of their incomes in taxes as they become wealthier. For this reason, the consumption taxes of the nineteenth and early twentieth centuries were thought to be regressive. This does not mean, however, that the absolute amount paid cannot rise with income. One percent of $100 is still a higher absolute number than 50% of $1. Thus, even under regressive rates, wealthier individuals may contribute more to the government than lower-income taxpayers.

Some of the continuing loyalty to graduated rates can be attributed to confusion over the terminology and the practical application of current proposals. Critics disparage the flat rate tax plans for their apparent lack of progression and dismiss consumption or sales tax alternatives due to their supposedly regressive effects.[36] Putting aside the normative question of what constitutes the proper distribution of tax burdens, neither criticism is fair or accurate in light of the proposals currently circulating.

For instance, all of the current flat tax proposals are progressive in the sense that each contains a generous exemption.[37] Some proposals even con-

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33. *See* WALTER J. BLUM & HARRY KALVEN, JR., THE UNEASY CASE FOR PROGRESSIVE TAXATION 4 (1953); ROBERT E. HALL & ALVIN RABUSHKA, LOW TAX, SIMPLE TAX, FLAT TAX 25 (1983).

34. *See* Joseph Bankman & Thomas Griffith, *Social Welfare and the Rate Structure: A New Look at Progressive Taxation*, 75 CAL. L. REV. 1905, 1908 (1987).

35. BLUM & KALVEN, *supra* note 33, at 3.

36. *See, e.g.*, Edwin Chen, *Administration Opposes Consumption Based Tax Plan*, L.A. TIMES, June 8, 1995, at A18; Dan Schaefer, *Beyond Repair, Sales Tax Best 'Reform' for Unfixable Income Tax Code*, ROCKY MTN. NEWS, May 21, 1995, at A98; *Talking Straight About Taxes*, *supra* note 13, at B10; *Tax Reform Pitfalls*, SACRAMENTO BEE, Apr. 27, 1995, at B6; Weidenbaum, *supra* note 19, at 19. As will be discussed in the conclusion, most of the flat tax plans, through their exemption of all investment income and capital gains, amount to consumption tax plans, effectively blurring the distinction between the two.

37. *See* Louis S. Richman, *The Flat Tax*, FORTUNE, June 12, 1995, at 36. Under Senator Specter's plan, "Four-person households with incomes below $25,500 would pay no tax at all." Stepanek, *supra* note 3, at A11. Under Representative Armey's plan, individuals would get a

tain multiple rates to the extent that charitable, religious, and educational organizations retain their tax exemptions.[38] Studies estimate that because of tax avoidance schemes, the present effective tax rate paid by the top 5% income group is only 17.4%, rather than the nearly 40% top marginal rate imposed by statute.[39] Thus, Representative Armey's proposal, a phased-in 17% tax rate on earned income over and above a standard deduction of $24,700 for a married couple filing jointly plus an additional standard deduction of $5,000 for each dependent, coupled with a proposed elimination of deductions, should be considered no less progressive than the current system. Critics respond that certain deductions actually promote progressivity by targeting lower-income individuals or by encouraging income redistribution.[40] Senator Specter's plan to institute a 20% tax rate on earned income above $16,500 plus an additional $4,500 for each dependent, however, partially addresses this concern because it preserves the deduction for up to $100,000 of home mortgages and the deduction for charitable contributions.[41] Flat rate proposals, therefore, are not only progressive, but potentially as progressive as the current system. In effect, the existence of a flat rate is meaningless as a measure of a proposal's progressivity.[42]

Consumption or sales tax plans are equally undeserving of the criticism directed toward them. Critics contend that sales taxes are regressive because the money paid constitutes a larger percentage of a poor person's income than of a wealthier person's income. This logic assumes, however, that the poor and wealthy spend their money in the same way. Since we know that this is not true, legislators could construct a sales tax as progressive as any other form of taxation. For example, Senator Lugar's plan exempts from the tax food and medicine and a minimum number of purchases by the poor.[43] Senators Nunn and Domenici go one step further in their tax plan by explicitly

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personal allowance of $10,700, married joint-filers would get $21,400, and there would be an extra $5,000 deduction for each dependent child. Jackie Calmes, *Flat-Tax Plan Is Revised by Rep. Armey to Reduce Projected Loss of Revenue*, WALL ST. J., July 20, 1995, at A14. Thus, a family of four earning $50,000 would pay about 6% in taxes while a family earning $200,000 would pay about 14%. *Id.* Professors Blum & Kalven describe this "inescapable" increment of progression as "keyed to at least a minimum subsistence standard of living," and thus discuss "whether any added degree of progression" can be justified. BLUM & KALVEN, *supra* note 33, at 4. However, given the expansive exemptions proposed, with a family of four not paying taxes at all until its income reaches $36,800, it is hard to ignore this exemption as an independent basis for progression. *See* Robert S. Stein, *Is a Major Tax Overhaul Ahead?*, INVESTOR'S BUS. DAILY, Apr. 13, 1995, at A1.

38. *Hearings on Flat Tax Proposals Before the Senate Committee on Finance*, 104th Cong., 2d Sess. (May 18, 1995) (statement of Michael J. Graetz, Professor, Yale Law School), *available in* LEXIS, Nexis Library, Federal Document Clearing House Congressional Testimony, CURNWS File [hereinafter *Hearings*].

39. Bradley D. Belt, *Flat, Flatter, Flattest: Singing from the Same Tax 'Hymnal'*, CHRISTIAN SCI. MONITOR, May 12, 1995, at 19 (citing a recent study by Jonathan Gruber of MIT, published in a Progressive Policy Institute report).

40. *See* Holton, *supra* note 5, at 41.

41. Gerald F. Seib, *GOP Sen. Specter, Advocating Flat Tax, Religious Tolerance, Seeks Presidency*, WALL ST. J., Mar. 31, 1995, at A14.

42. *Cf.* Scott Shepard, *Flat Tax Fever; 'Dream Bill' Catches Fire, Draws Flack*, PALM BEACH POST, Apr. 15, 1995, at A10 ("I've never thought a steeply graduated tax code was progressive—or even fair, for that matter. The progressivity of the (flat) tax code is in exempting the poor from income tax rates.") (quoting Jack Kemp).

43. Stein, *supra* note 37, at A1.

allowing for graduated rates ranging from 19% to 40%.[44] A rebate or credit which would simulate the flat tax's exemption for a base level of consumption may even accompany a consumption tax.

Thus, even if one measures "fairness" by the progressivity of the tax, it is not a function of the graduation of the rates. A flat tax can be highly progressive if enough people are completely exempt from paying a tax, while a graduated rate tax can become regressive if the bulk of the deductions favor the wealthy. A common mistake is to debate the merits of a plan based upon its ability to achieve a particular distribution of tax burdens, without considering the grounds for preferring that distribution. Legislators should determine how to allocate the tax burdens and then decide the simplest and most efficient method of accomplishing this result.

We must, therefore, evaluate the theories for deciding whether the tax system should be progressive, proportionate, or regressive. Philosophers and political commentators have expounded on the proper distribution of tax burdens since taxation began. Although universally rejected by theorists, the "pseudo-democratic contention of strict dollar for dollar equality died hard," in the minds of the public during the nineteenth century.[45] Absolute equality of payment was inherent within poll taxes, stamp taxes, and many forms of consumption taxes. Philosophers, however, scoffed at the morality of this type of distribution. Instead, philosophers primarily discussed four theories between 1861 and 1913 as bases for the distribution of the tax burdens: (1) the sacrifice theory; (2) the benefit theory; (3) the redistributive theory; and (4) the compensatory theory.

From the beginning, philosophers were drawn to the sacrifice theory. "The most pronounced early support for progressive taxation, as well as '[t]he largest part of the intellectual history of progression theory has been the development of the sacrifice doctrine.'"[46] John Stuart Mill, in *Political Economy*, stated,"'The true principle of taxation'" is that each person "'shall feel neither more nor less inconvenience from his share of the payment than every other person experiences from his.'"[47] Mill premised his argument upon the notion that certain goods were necessities while others were luxuries.[48] Everyone first devoted their income to necessities until achieving a certain point of satiation, whereupon they could spend their remaining income on luxuries.[49] Since taxes are presumably drawn off the top of a person's income, a head tax takes away from a poor person's necessities while merely cutting back a rich person's luxuries. Thus, the rich person must pay more to feel the same sacrifice as the poor person. The difficulty with this argument is its practical im-

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44. Wessel, *supra* note 17, at A2.

45. JOHN D. BUENKER, THE INCOME TAX AND THE PROGRESSIVE ERA 8 (1985).

46. Jay M. Howard, *When Two Tax Theories Collide: A Look at the History and Future of Progressive and Proportionate Personal Income Taxation*, 32 WASHBURN L.J. 43, 63 (1992) (alteration in original) (quoting Walter J. Blum & Harry Kalven Jr., *The Uneasy Case for Progressive Taxation*, 19 U. CHI. L. REV. 417, 456 (1952)).

47. STEPHEN F. WESTON, PRINCIPLES OF JUSTICE IN TAXATION 187-88 (1903) (quoting 5 JOHN S. MILL, POLITICAL ECONOMY, ch. 2, § 2 (N.Y., D. Appleton & Co. 1888)).

48. *Id.* at 188-89.

49. *Id.*

plementation. As Edwin R.A. Seligman conceded, "Equality of sacrifice, indeed, we can never attain absolutely or exactly, because of the diversity of individual wants and desires."[50] In order to combat this difficulty, philosophers often translated the negative conception of "equality of sacrifice" into the positive indicia of taxation based upon "ability to pay." Sometimes called the "faculty theory," one receives an exemption for income presumed necessary to satisfy basic individual needs.[51] Thus, under this theory, only the "clear" income is taxed. Beyond that, the principle that "ability increases in a greater ratio than income" warrants a progressive rate.[52] While politicians often cited the phrase "ability to pay" to justify the transition from a consumption-based tax system, it did not always coincide with the philosophers' use of this term.[53] For example, politicians often justified property taxes because they taxed based upon the "ability to pay,"[54] yet they were more proportional than progressive.

The benefit theory, although sometimes scoffed at by intellectuals, had political appeal in the Gilded Age. Under the benefit theory, "[f]or every 'benefit' there must be a corresponding tax."[55] No exemption is defensible under this theory, since even an individual without property needs protection of his or her person.[56] Theoretically, this suggests a proportionate tax since under a fair and impartial government, the benefit of protection does not necessarily increase geometrically with respect to income.[57] Under the political circumstances of the day, when the public perceived that special laws and government favors resulted in huge fortunes being amassed in large monopolies and heavily protected industries, the benefit theory supported at least a temporary progression in the system. Today, libertarians and free market advocates sometimes invoke the benefit theory because of its analogy to bargained-for consideration in a contractual exchange.[58]

The redistributive rationale is premised on the assumption that progression redistributes income to benefit society's welfare. This can operate in a theoretical or practical sense. On a theoretical level, a small increase of money in a poor person's pocket increases his or her welfare more than that same amount in a wealthy person's pocket.[59] On a practical level, politicians have long

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50. SELIGMAN, *supra* note 30, at 32. Seligman thought this problem could be overcome by recognizing that marginal utility theory supports some level progression in the system. *Id.* at 32-33. This argument is not necessarily true even in the abstract. *See Should America Keep Its 'Progressive' Tax System?*, *supra* note 15, at B1.

51. SELIGMAN, *supra* note 30, at 31.

52. WESTON, *supra* note 47, at 241.

53. Stephen Weston, a student of Seligman, who later became president of Antioch College in Ohio, noted that many confuse the benefit and ability theories and thus advocate proportional taxation under the guise of the "ability to pay" concept. *Id.* at 226 & n.2.

54. STANLEY, *supra* note 22, at 25.

55. WESTON, *supra* note 47, at 247.

56. *Id.*

57. *See id.* at 226.

58. For a discussion of this modern development, see Kornhauser, *supra* note 24, at 491. Liberal scholars still invoke the traditional notion of the benefit theory to justify progressive rates. *See* Kinsley, *supra* note 14, at 8.

59. *See* Blum & Kalven, *supra* note 46, at 477 (agreeing with this intuitive notion, while ultimately rejecting a redistributive rationale for progression).

recognized that an extreme disparity in income can lead both to excess power and the arbitrary exercise thereof on the part of the wealthy. In turn, the poor become resentful and threaten radical action against a nation's basic institutions.[60] Thus, some measure of redistribution of wealth operates in a real sense to reduce that excess power, and in a symbolic sense to defuse the poor's anger with respect to both wealth and the wealthy.[61]

Modern observers have paid little attention to the fourth rationale for distributing the benefits of taxation, the compensatory theory. Despite the wide acceptance of the compensatory theory's notion that some degree of progression is necessary to compensate "for the regressivity of other taxes in our overall tax system," Professors Walter Blum and Harry Kalven decided to forego discussion of it, concluding that "it does not involve the adoption of the principle [of progression] itself."[62] But as Jerold Waltman explained, the theory was of central importance to early supporters of the graduated income tax:

> One of the key supporting arguments for progression in income taxes, especially in the early years, was that it helped to offset the regressive character of other taxes, especially the customs duties. Customs duties had the double effect of taxing consumers through higher prices and enriching American manufacturers. A graduated income tax, therefore, would redress this inequity.[63]

Seligman called this the "special compensatory theory" to distinguish it from the general compensatory theory.[64] General compensatory theory combined the redistributive and benefit rationales to reason that "'taxation ought to counterbalance the inequalities consecrated by custom and by law'"[65] whereby "the legal conditions of society naturally favor the rich."[66] Under the special compensatory theory, one form of taxation is made progressive to counterbalance the regressive effects of another specific form of taxation. Thus, Seligman explained:

> When indirect taxes exist, they often, it is said, act regressively and hit the poor harder than the rich. The direct tax, with its progressive scale, is designed to act as an engine of reparation. In order to attain equal treatment the regressive indirect taxes must be counterbalanced by the progressive direct tax.[67]

Under the special compensatory theory, therefore, the graduated income tax may be only an example of "ostensible progression," advocated by those

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60. *See* STANLEY, *supra* note 22, at 234. The populist movement is an example of the view that the government and the rich conspire against the poor in times of great disparity causing the poor to become desparate and threaten violence. *See* Barbara B. Woodhouse, *Who Owns the Child?*, 33 WM. & MARY L. REV. 995, 1023-24 (1992).

61. Robert Stanley argued that the income tax between 1861 and 1913 was primarily to address the anger of the poor. STANLEY, *supra* note 22, at 234.

62. BLUM & KALVEN, *supra* note 33, at 5 & n.10.

63. JEROLD L. WALTMAN, POLITICAL ORIGINS OF THE U.S. INCOME TAX 10 (1985).

64. EDWIN R.A. SELIGMAN, PROGRESSIVE TAXATION IN THEORY AND PRACTICE 146 (2d ed. 1908).

65. *Id.* at 144 (quoting French writer Villiaumé) (citation omitted).

66. *Id.*

67. *Id.* at 146.

willing to accept progression in one area in order to achieve the overall goal of proportionate taxation.[68] Although not a mathematically precise counterweight, a graduated income tax "is a crude way of accomplishing some kind of proportionality overall."[69] This article argues that under the compensatory theory the United States was striving toward the overall goal of a flat or proportionate tax system during the period before and immediately after the ratification of the Sixteenth Amendment.

II. THE HISTORY OF INCOME TAX

A. *Early Efforts at an Income Tax*

Over the last fifty years, income and payroll taxes have accounted for the majority of federal revenues.[70] This, however, was not always the case. In the nineteenth and early twentieth centuries, the United States relied on high tariffs and excise taxes as its principle source of revenues.[71] This reliance was so great that by the 1850s, the federal tax system was dependent on import duties for 92% of its overall revenues.[72] The tariff schedules, publicly justified as protection for domestic industries and privately as rewards for special interests,[73] included manufactured goods, raw materials, consumer products, and luxury items, and covered industries in every part of the country.[74] The import duties on food, clothing, and shelter items, however, brought in the bulk of the tariff revenues.[75] Implicit in the notion that such indirect taxes need not be apportioned among the states was the expectation that the duties would be passed along to consumers in the form of higher prices.[76] Given the finite limit on an individual's ability to consume, a general understanding existed that the poor spent a greater percentage of their incomes on such goods than the wealthy.[77] Since domestic manufacturers were the beneficiaries of the duties, the regressive effect was exacerbated. Although this effect may have been minimized in some respects by the reliance on property taxes

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68. *Id.* at 146-47.

69. CHARLES O. GALVIN & BORIS I. BITTKER, THE INCOME TAX: HOW PROGRESSIVE SHOULD IT BE? 22 (1969).

70. Professor Sheldon Pollack recently testified before the Senate Finance Committee that the income tax accounted for 45% of federal receipts from all taxes in 1950, jumping to nearly 73% in 1985, with a projected $739 billion in 1995. *Hearings, supra* note 38 (testimony of Sheldon Pollack); *see* SIDNEY RATNER ET AL., THE EVOLUTION OF THE AMERICAN ECONOMY 518 (1979) (concluding that income and payroll taxes added up to about 70% of total tax revenues in the late 1970s).

71. Pete V. Domenici, *The UnAmerican Spirit of the Federal Income Tax*, 31 HARV. J. ON LEGIS. 273, 275 (1994); Jay Starkman, *Is a Consumption Tax the Answer?* ATLANTA J. & CONST., Apr. 26, 1995, at A15. In 1914, the federal income tax accounted for a mere 9.7% of the total receipts of the federal government. *Hearings, supra* note 38 (testimony of Sheldon Pollack).

72. STANLEY, *supra* note 22, at 25.

73. Daniel K. Tarullo, *Law and Politics in Twentieth Century Tariff History*, 34 UCLA L. REV. 285, 289-90 (1986).

74. STANLEY, *supra* note 22, at 25-26.

75. *Id.* at 26.

76. *Id.* at 25. John D. Buenker concluded that "virtually the entire cost of [customs duties] was added on to the eventual price paid by the consumer." BUENKER, *supra* note 45, at 31.

77. BUENKER, *supra* note 45, at 31-32; STANLEY, *supra* note 22, at 26.

at the state and local level,[78] it still energized the national debate over how to allocate the hardships of federal taxation.

Initially, the income tax was a method for reaching the pockets of people who escaped taxation altogether. Legislators made the first proposal for a federal income tax toward the end of the War of 1812, after war expenditures had produced a national debt of $100 million.[79] When the war began, the national government doubled the customs duties it had been using to raise the majority of its revenue.[80] As the drop in trade caused these sums to dwindle, Thomas Jefferson's Secretary of the Treasury, Alexander Dallas, turned to internal revenues from excise and property taxes, and eventually, to proposals for income and inheritance taxes.[81] In light of the relative tax burdens, Dallas may have been motivated by a desire to impose some of the costs of financing the war on the nation's manufacturers and financiers.[82] Although the latter push came too late to secure passage,[83] some believe the country only escaped income taxation "by a close margin."[84] Instead, Congress adopted a high protective tariff in 1816.[85]

A crude version of a state income tax already existed prior to the Civil War. Several states imposed "faculty" taxes on income from professions, trades, and employments during the colonial period "as an adjunct to the property tax."[86] The advent of professions and income derived from sources other than real property made the property tax incomplete. "Since most colonial revenue was derived from imposts on real and personal property, the faculty tax was designed to reach 'those persons who derived their income from other sources.'"[87] Most states abandoned or ignored these attempts soon after the turn of the century.[88] After the Panic of 1837, however, many states found themselves mired in financial difficulties.[89] Presidents Andrew Jackson and Martin Van Buren had withdrawn funds from federal improvement projects,[90]

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78. RATNER ET AL., *supra* note 70, at 517.

79. JOHN F. WITTE, THE POLITICS AND DEVELOPMENT OF THE FEDERAL INCOME TAX 67 (1985).

80. *Id.*

81. BUENKER, *supra* note 45, at 2-3; WITTE, *supra* note 79, at 67. Henry Carter Adams reported that the normal income from customs duties was about fourteen million dollars, but the actual income for the years 1812 to 1816 fell far short of this despite the doubling of rates. HENRY C. ADAMS, TAXATION IN THE UNITED STATES, 1789-1816, at 69 (N.Y., Burt Franklin 1884).

82. BUENKER, *supra* note 45, at 3.

83. *Id.*

84. RANDOLPH E. PAUL, TAXATION IN THE UNITED STATES 8 (1954).

85. In the Tariff Act of April 27, 1816, the average duty was raised to 20%. BENDER'S FEDERAL REVENUE LAW 352 (1917); WITTE, *supra* note 79, at 67. While these first duties were moderate by late nineteenth century standards, a twenty-year stretch of increasingly protectionist enactments followed. PERCY ASHLEY, MODERN TARIFF HISTORY 142 (3d ed. 1920).

86. SELIGMAN, *supra* note 30, at 397-99 (discussing the faculty taxes in Vermont, Connecticut, Rhode Island, New Hampshire, Massachusetts, South Carolina, Delaware, Maryland, and Pennsylvania). John D. Buenker reported that "[a]n estimated one-third of the states partially financed the costs of the Revolutionary War through some variation of the faculty tax." BUENKER, *supra* note 45, at 2.

87. BUENKER, *supra* note 45, at 1.

88. *See* SELIGMAN, *supra* note 30, at 388-400.

89. *Id.* at 400.

90. WITTE, *supra* note 79, at 400 n.2.

and efforts to have Congress assume some of the states' increasing indebtedness were unsuccessful.[91] As a result, six states turned to some form of income taxation.[92] Not all of the push, however, should be attributed to a desire to make up for the lost revenues. Underlying many of the laws was a desire to equalize the tax burdens in the wake of the development of "paper" wealth and salaried workers.[93]

Two states, Pennsylvania and Maryland, attempted to raise revenue by imposing a tax on salaries and a lesser tax upon incomes and profits derived from professions, faculties, and employments.[94] As revenue raisers, however, the income tax was an abject failure for both states. In 1843, Pennsylvania's income tax raised $1,386 out of a total taxation revenue in the state of $910,000.[95] Maryland's tax fared no better, and in 1850, after collecting no income tax in the previous year, the law was gutted of all its force.[96]

The four southern states which instituted a form of income tax during that period (Virginia, North Carolina, Alabama, and Florida) may have had different motivations. According to Seligman, the income tax in these states was partly "a concession to the demand for more equal taxation."[97] In some of the states, such as Alabama, cotton factors, merchants, and the professional classes had escaped the brunt of taxation which was borne primarily by large plantation owners.[98] Thus, in 1843, Alabama imposed a tax of $.25 on every $100 of income from auctioneers, factors, cotton brokers, and commission brokers.[99] The following year, Alabama added a tax of .5% on the incomes of professionals such as lawyers, doctors, government officials, bankers, professors, and employees of mercantile houses.[100] By contrast, North Carolina's income tax was primarily directed at the failure to tax so-called "unearned income." Passed in 1849 with a statement in the preamble that "there are many wealthy citizens of this state who derive very considerable revenues from moneys which produce interest, dividends and profits, and who do not contribute a due proportion to the public exigencies of the same," the act imposed a 3% tax on all interest and investment income.[101] Virginia straddled the fence between these two approaches. In 1843, it imposed a tax on three separate classes of receipts: income from employment, fees from professions, and interest or profit from investment.[102] By 1853, Virginia graduated the tax on income and fees up to 1% on amounts over $1,000, while that

91. SELIGMAN, *supra* note 30, at 400.
92. WITTE, *supra* note 79, at 400 n.2.
93. STANLEY, *supra* note 22, at 25.
94. SELIGMAN, *supra* note 30, at 400-01. Maryland exempted income derived from taxed property. *Id.* at 401. This indicates that Maryland wanted to balance the tax burdens.
95. *Id.* at 400.
96. *Id.* at 401.
97. *Id.* at 402.
98. *Id.*
99. *Id.* at 404.
100. *Id.* at 404-05. Florida's tax was quite similar to Alabama's. *See id.* at 405.
101. *Id.* at 403-04. The law contained an exemption for investment income below $60 and also imposed a $3 annual tax on all professionals after their fifth year of practice provided their income exceeded $500. *Id.* at 404.
102. *Id.* at 402-03.

portion of the tax on investment applied to income from public securities climbed from 2.5% to 3.5%.[103] Apparently, the experiment with graduation was not successful or was no longer needed. Thus, in 1861 before the war began, Virginia replaced the graduated rate structure with a proportional tax of 1% on the amount in excess of $500.[104] Virginia's tax earned an appreciable amount of income during this period.[105] In general, however, most pre-Civil War state income taxes proved to be utter failures. Inadequate administration and lack of enforcement resulted in repeal or pitifully small revenues. The failure to properly administer and enforce the taxes, however, should not obscure the attempt to employ the income tax as a means of compensating for the inequality in state tax burdens.

B. *Civil War and Reconstruction*

Despite its inauspicious beginnings in this country, Congress not only adopted the first federal income tax at the onset of the Civil War,[106] but adopted one with explicitly graduated rates. Initially, Congress attempted to generate revenue without resorting to an income tax. Abraham Lincoln assumed the presidency in March of 1861 carrying a debt of almost $75 million, which was likely to increase under the weight of the war.[107] Salmon Chase, Lincoln's Secretary of the Treasury, proposed deficit reduction measures including a combination of Treasury notes, stepped-up sales of public lands, and increased tariffs and excise taxes.[108] The House Ways and Means Committee also prepared two bills designed to raise revenues from foreign and domestic sources.[109] The first imposed duties on tea, coffee, and sugar.[110] The second levied taxes on whisky, beer, porter, carriages, promissory notes, bank bills, and imposed a license tax.[111] Controversy soon developed, however, because the impact of the bills, especially on the price of such basic commodities as tea, coffee, and sugar, fell disproportionately on the poorer classes.[112] This effect only exacerbated the burden on consumers who, prior to the Civil War, had borne almost the entire weight of taxation derived from customs duties and excise taxes.[113] Since Congress would likely cut the rates in the two

103. *Id.* at 403.

104. *Id.* at 407.

105. *Id.* at 406.

106. WITTE, *supra* note 79, at 67.

107. *Id.*

108. *Id.* On July 17 and August 5, 1861, Congress passed loan acts which empowered the "Secretary to borrow $250 million in three-year, 7.3 per cent Treasury notes, or in twenty-year bonds not exceeding 7 per cent." SIDNEY RATNER, TAXATION AND DEMOCRACY IN AMERICA 64 (1980). Lawrence Friedman suggested that part of the initial preference for methods other than direct taxation was the concern for encroaching on state sovereignty more than it already had. LAWRENCE M. FRIEDMAN, A HISTORY OF AMERICAN LAW 564 (2d ed. 1985).

109. RATNER, *supra* note 108, at 64.

110. *Id.*

111. *Id.*

112. *Id.*

113. Daniel L. Simmons, *The Tax Reform Act of 1986: An Overview*, 1987 B.Y.U. L. REV. 151, 152.

bills, the Ways and Means Committee decided to also submit a plan for direct taxation.[114]

On July 23, 1861, Thaddeus Stevens, the Republican chair of the Committee, described as "powerful," "domineering," and "dictatorial," proposed a $30 million direct tax on land, with each state's share to be apportioned by population.[115] This evoked another round of controversy. Farmers would bear the brunt of this tax,[116] as consumers bore the brunt of the excise taxes and customs duties. Those with large holdings of stock, however, would be virtually exempt from taxation.[117] Thus, the House initially recommitted the bill with instructions to amend it to include a tax on "real and personal estate."[118] When the Committee was unable to accomplish this in a constitutional manner, the bill was again recommitted with instructions to reduce the direct tax portion and to add an income tax.[119] Justin S. Morrill, a Vermont Republican and chair of the Ways and Means Subcommittee on Taxation, returned to the floor of the House on July 29 with a new bill combining an income tax with a direct tax reduced by one-third from Stevens' original proposal.[120] Morrill argued for a tax which imposed an equality different from that imposed by the consumption taxes or apportioned by direct taxes (which both focused on equality of payment): a tax "not upon each man an equal amount, but a tax proportionate to his ability to pay."[121]

In the meantime, Republican Senator James F. Simmons, a Rhode Island manufacturer, proposed adding an income tax provision to the tariff bill which was passed in the House on July 18 and introduced in the Senate on July 25.[122] As in the House, the impetus for the income tax was not to shift the tax burden entirely, just to distribute it more equally. Simmons attempted to minimize the impact of the increase in customs duties by discussing them in the context of the previous forty years' rates, but the effect was still a doubling of the rates in just four years.[123] Thus, the income tax was designed to balance the burden on consumption. Republican Senator William Pitt Fessenden of Maine concurred in this decision, announcing that "I am inclined very much to favor the idea of a tax upon incomes for the reason that, *taking both measures together*, I believe the burdens will be more equalized on all

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114. RATNER, *supra* note 108, at 64.

115. PAUL, *supra* note 84, at 8-9; RATNER, *supra* note 108, at 64; WITTE, *supra* note 79, at 67.

116. *See* RATNER, *supra* note 108, at 64.

117. *See id.*

118. *Id.*

119. *Id.* at 64-65.

120. *Id.* at 65; *see* CONG. GLOBE, 37th Cong., 1st Sess. 323 (1861) (statement of Rep. Thomas R. Horton) (R-N.Y.).

121. CONG. GLOBE, 37th Cong., 2d Sess. 1194 (1862).

122. RATNER, *supra* note 108, at 66; *see* CONG. GLOBE, 37th Cong., 1st Sess. 254 (1861).

123. *See* CONG. GLOBE, 37th Cong., 1st Sess. 254 (1861). According to Senator Simmons, the rates during the last forty years ranged from 14.5% to 38%. *Id.* Thus, the proposed rate in the tariff bill of 31 7/8% did not appear so high. *Id.* In 1857, however, the rate was 16% on the entire schedule (taking into account both dutiable and free goods) and in the Act of 1860 the rate was increased to 21 7/8%. *Id.* The actual increase in rates was both swift and substantial.

classes of the community, more especially on those who are able to bear them."[124]

On July 29, 1861, both the House and Senate passed bills combining an income tax with other revenue-raising measures.[125] The House measure proposed a tax of 3% on incomes above $600 while the Senate proposed a tax of 5% on incomes above $1000.[126] A compromise returned by the Conference Committee preserved all of the changes proposed by the Senate in the tariff and direct tax rates.[127] Accompanying these measures was a 3% tax on incomes exceeding $800, which the Committee raised to 5% on income derived from property owned by United States citizens residing abroad.[128] Additionally, Congress taxed income from Treasury notes or other U.S. securities at 1.5% in order to spur the purchase of war bonds.[129] Finally, Congress allowed a deduction for national, state, or local taxes imposed on property from which income is derived.[130] Thus, the first income tax was essentially a flat rate tax designed to equalize the burdens imposed by the other revenue raising measures with which it was passed.

Passage of a bill permitting the use of an income tax, however, did not translate into the actual assessment of an income tax. Chase succeeded in frustrating the bill through delay. He made no effort to assess or collect any taxes and he made every effort to persuade Congress of the wisdom of this strategy.[131] This tactic would not work for long. The financial burdens of the war were mounting by 1862.[132] In January of 1862, banks throughout the country suspended specie payment and the government followed suit, virtually curtailing private and public credit.[133] Ignoring Chase's modest request that $50 million be raised through new internal taxes, Congress passed a resolution on January 21, 1862, calling for the imposition of a tax which, when combined with the tariff, would raise at least $150 million.[134]

In response to this congressional resolution, the House Ways and Means Committee submitted a bill on March 3, 1862 which provided for revenue through a combination of internal taxes, income taxes, and an inheritance tax.[135] The bill taxed incomes exceeding $600 at 3%, which was similar to the 1861 tax except for the lowered exemption.[136] In introducing the bill, Justin Morrill stated that the provision for an income tax, though perhaps "the least defensible," was necessary to prevent salaried workers from escaping

124. *Id.* at 255 (emphasis added); RATNER, *supra* note 108, at 66.
125. WITTE, *supra* note 79, at 68.
126. *Id.*
127. RATNER, *supra* note 108, at 66-67.
128. *Id.* at 67.
129. *Id.*
130. J.S. SEIDMAN, SEIDMAN'S LEGISLATIVE HISTORY OF FEDERAL INCOME TAX LAWS, 1938-1861, at 1042 (1938).
131. RATNER, *supra* note 108, at 70; Paul C. Roberts & Lawrence M. Stratton Jr., *The Roots of the Income Tax*, NAT'L REV., Apr. 17, 1995, at 42.
132. WITTE, *supra* note 79, at 68.
133. RATNER, *supra* note 108, at 68-69.
134. *Id.* at 69.
135. *Id.*
136. *Id.* at 72.

taxation altogether.[137] While the Committee was concerned about the possibility that the income tax would subject some forms of income to double taxation, Thaddeus Stevens closed his comments by noting that

> the committee thought it would be manifestly unjust to allow the large money operators and wealthy merchants, whose incomes might reach hundreds of thousands of dollars, to escape from their due proportion of the burden. They hope they have succeeded in excluding from the tax the articles and subjects of gain and profit which are taxed in another form.[138]

After the bill passed the House and was sent to the Senate,[139] the Senate Finance Committee left the flat rate income tax unchanged, but struck the direct tax provision of the bill.[140] Senator Fessenden was the lone member of the Finance Committee to vote to retain that provision and, confessed, "I am afraid the majority against me will be about as large in the Senate as it was in the committee."[141] After the Senate voted to strike the direct tax, Simmons proposed that the income tax rates be raised and made graduated to make up for the lost income.[142] With no objection to this amendment, Fessenden introduced it before the full Senate.[143] The amendment as passed by the Senate proposed a 3% tax on incomes between $600 and $10,000, a 5% tax on incomes between $10,000 and $50,000, and a 7.5% tax on the excess over $50,000.[144] A conference committee resolved the differences between the Senate and House versions by eliminating the highest rate, but preserving the principle of graduated rates introduced by the Senate.[145] Rather than eliminating the direct tax as the Senate had proposed, the Committee chose to suspend it for two years.[146]

Sidney Ratner suggested that the graduated income tax rate structure introduced in the 1862 act "was not adopted for its own sake but as a byproduct of the increase in the rates."[147] John Witte expanded upon this sentiment, stating that "progressivity was introduced not out of concern for equity, but rather to increase revenues."[148] Although there was discussion of the need for revenue, the concept of equity was underlying. When told that the final bill removed the direct tax and retained the graduated income tax rates passed in the Senate, Representative Alexander Hamilton Rice (R-Mass.), "protest[ed] against that kind of injustice" flowing from such a "discrimination."[149] Ac-

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137. CONG. GLOBE, 37th Cong., 2d Sess. 1196 (1862).
138. *Id.* at 1577.
139. *Id.* The margin of victory was an overwhelming 125 to 14. *Id.*
140. RATNER, *supra* note 108, at 72.
141. CONG. GLOBE, 37th Cong., 2d Sess. 2350 (1862).
142. *Id.* at 2486.
143. *Id.*
144. *Id.*
145. *Id.* at 2891 (statement of Rep. Thaddeus Stevens) (R-Pa.); *see* Act of July 1, 1862, ch. 119, 12 Stat. 432, 473, *repealed by* Act of June 30, 1864, ch. 172, 13 Stat. 223, 303.
146. RATNER, *supra* note 108, at 73. Congress repealed the direct tax in 1864. *Id.*
147. *Id.* at 72.
148. WITTE, *supra* note 79, at 69.
149. CONG. GLOBE, 37th Cong., 2d Sess. 2891 (1862).

cording to Rice, replacing the direct tax with the graduated rates exempted the property-owning farmers from taxation altogether, while increasing the burden on the owners of income-producing industry.[150] Rice stated, "I am at a loss to know upon what principle of justice one class of industry should be taxed five per cent. upon its industry and another class of industry exempted from such taxation."[151] Stevens responded that "we resisted the suspension of the direct tax after the present year as long as we could without losing the bill, and I did not think it proper to lose the bill rather than suspend that direct tax."[152]

Concluding that equity was an afterthought concedes too much and ignores aspects of the debates. Removal of the direct tax affected provisions other than the income tax. Consumption taxes assumed their share of the burden.[153] Senator Zachariah Chandler (R-Mich.) criticized the bill because he believed that if it imposed a 3% tax on consumption, it should equally impose a 3% tax on income. Chandler stated:

> You tax the day laborer moderately on his consumption, three per cent., a very small item indeed; and you tax the man of wealth the same way, and if you tax him in the same ratio for his income, he feels the satisfaction of knowing that this is a reasonable burden, a burden which he ought to bear, and thus you induce men rather to enlarge than to diminish their incomes under the feeling of justice, equity, and propriety.[154]

Senator Simmons stood up to justify the graduated rates, explaining that "the consumption of this country has twenty-five per cent. put on it by this bill."[155] He continued, "[t]he poor people pay as much, and rather more, generally, than rich men on their consumption."[156] Thus, he saw the graduation in the income tax as a counterbalance to equivalent rises in the tax on consumption. Citing the example of sugar, he stated, "We put three quarters of a cent on sugar last March a year ago, and now it is two and a half cents. The taxes have been increased in consequence of the rebellion. I find no trouble in my own mind in levying this income tax."[157] Similarly, Timothy Otis Howe, the radical Republican Senator from Wisconsin,[158] responded to the argument that the agricultural sector was now exempt from taxation by pointing out that "the great amount of this revenue is to fall upon consumption, and consump-

150. *Id.*
151. *Id.*
152. *Id.*
153. PAUL, *supra* note 84, at 10.
154. CONG. GLOBE, 37th Cong., 2d Sess. 2486 (1862).
155. *Id.*
156. *Id.*
157. *Id.* The price of sugar during the war was particularly volatile. The wholesale price of sugar rose from 9 cents a pound in 1861 to 23.5 cents a pound in 1864. BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, HISTORICAL STATISTICS OF THE UNITED STATES: COLONIAL TIMES TO 1970, pt. 1, at 209 (1975) [hereinafter HISTORICAL STATISTICS].
158. RATNER, *supra* note 108, at 72.

tion is not limited to the eastern cities; it is regulated by the number of individuals."[159]

Adoption of the progressive principle occurred against the backdrop of the other taxes in the bill—taxes which imposed a much heavier burden on the poorer classes. Although war expenses had increased considerably by 1864, the lower rate for income from treasury securities in the 1862 Act allowed Congress to finance much of its efforts through private creditors.[160] By 1863, due to the efforts of the Confederate navy and to the benefits of rate manipulation,[161] Congress received ten times more income from the sale of federal securities than from tariffs.[162] Thus, when Justin Morrill reported a bill to the House on April 14, 1864, which eliminated the 1862 Act's progressive rates and proposed a 5% tax on all incomes above $600,[163] some suggest he was acting out of deference to the nation's wealthy private creditors.[164]

At the same time, however, prices were rising, primarily because of the internal revenue measures in the 1862 Act.[165] In fact, prices rose an average of 117% during the war, while money wages rose only 43%.[166] Moreover, the proposed bill sought to double many of the internal revenue rates while increasing the general ad valorem tax from 3% to 5%.[167] Thus, with the compensatory rationale for graduated rates still viable, Augustus Frank, a Republican railroad director from upstate New York,[168] proposed an amendment to the bill providing for a 5% tax on incomes above $600, a 7.5% tax on incomes between $10,000 and $25,000, and a 10% tax on incomes over $25,000.[169] Frank argued that these graduated rates, rather than upsetting the private creditors, would actually please them: "the larger the tax we pay at this time the safer we are and the better will be the securities of the Government."[170] Frank's proposal, however, sparked a debate over the propriety of graduated rates.

Thaddeus Stevens, while supporting the 1862 Act's rates as a political compromise, lashed out at Frank's amendment.[171] Stevens argued:

> It seems to me that it is a strange way to punish men because they are rich. I do not know but there ought to be an indictment against every man who ventures to go above $600 in income . . . . If any

159. CONG. GLOBE, 37th Cong., 2d Sess. 2350 (1862).
160. STANLEY, *supra* note 22, at 31.
161. PAUL, *supra* note 84, at 11; RATNER, *supra* note 108, at 82.
162. STANLEY, *supra* note 22, at 31.
163. RATNER, *supra* note 108, at 82.
164. *See* STANLEY, *supra* note 22, at 33.
165. *Id.* The consumer price index, with a value of 100 assigned to the year 1860, rose on all items from 101 in 1861 to 113 in 1862, and to 139 in 1863. HISTORICAL STATISTICS, *supra* note 157, at 212.
166. ASHLEY, *supra* note 85, at 181.
167. RATNER, *supra* note 108, at 82 n.9.
168. *Id.* at 83.
169. CONG. GLOBE, 38th Cong., 1st Sess. 1876 (1864).
170. *Id.*
171. *See id.*

> man dare go above a certain amount, more than I am worth or any other member, then we should take it all."[172]

Others argued for levying a flat tax at a higher rate rather than preserving the inequality which spurred the wealthy to evade the 1862 tax and resent the war effort.[173]

Several members of Congress advanced theories in favor of the graduated rates. Representative Rufus P. Spalding (R-Ohio) invoked a form of the sacrifice theory in favor of Frank's amendment, arguing that the $600 exemption would allow everyone to pay for necessities, leaving the tax to operate only on the purchase of luxuries.[174] The sacrifice theory's weakness, however, was exposed by Representative John A. Griswold (R-N.Y.), who asked Spalding "[are there not] a vast number of men who are richer on an income of $1,000 than others who have eight or ten thousand?"[175]

Perhaps more compelling was the use of the compensatory theory. Representative Henry L. Dawes of Massachusetts[176] responded to Stevens by denying that it was a punishment to ask the wealthy to pay their fair share, asking Stevens whether he thought "that the poor should pay the taxes for the rich?"[177] Iowa Republican J.B. Grinnell concurred and further proposed that the 10% tax be broadened to apply to incomes of $10,000.[178] Although Grinnell's wartime justification for the rates is sometimes used by observers to dismiss the whole episode,[179] the principle he actually relied upon was a "patriotic" version of the compensatory theory. Grinnell stated:

> I say, that a man who has an income of over ten thousand dollars should be required to live out of that income in time of war, and not be able to lay aside more than ninety per cent. of his income and to pay only ten per cent. of it to the Government, is only reasonable. They do not contribute to the Government a proportion anything like that paid by those who are worth a less sum of money who have gone into our Army.

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172. *Id.* For similar expressions in the House, see *id.* at 1877, 1940 (statements of Rep. Hubbard (R-Conn.) and Rep. Justin Morrill (R-Vt.), respectively).

173. *See id.* at 1876, 1877 (statements of Rep. Justin Morrill (R-Vt.) and Rep. John Griswold (D-N.Y.) with Rep. Hubbard (R-Conn.), respectively). Representative Hubbard argued that a flat rate of 8% on all incomes exceeding $600 would be preferable to a graduated system. *Id.* at 1877. The returns of the 1862 Act fell far short of the $85,456,000 projected by Chase, amounting instead to only $37,640,000. RATNER, *supra* note 108, at 82.

174. CONG. GLOBE, 38th Cong., 1st Sess. 1877 (1864); RATNER, *supra* note 108, at 84.

175. CONG. GLOBE, 38th Cong., 1st Sess. 1877 (1864).

176. RATNER, *supra* note 108, at 83.

177. CONG. GLOBE, 38th Cong., 1st Sess. 1876 (1864).

178. *Id.*

179. *See* PAUL, *supra* note 84, at 714; Frank W. Hackett, *The Constitutionality of the Graduated Income Tax Law*, 25 YALE L.J. 428, 442 (1916); Patrick E. Hobbs, *Entity Classification: The One Hundred-Year Debate*, 44 CATH. U. L. REV. 437, 442 (1995); Roberts & Stratton, *supra* note 131, at 38. In the debates over later income tax proposals, opponents often argued that the exigency of war justified the Civil War experience. *See, e.g.*, 50 CONG. REC. 3839 (1913) (statement of Sen. Lodge) (R-Mass.); 26 CONG. REC. 1599-1600 (statement of Rep. Ray) (R-N.Y.), 1730 (statement of Rep. Grosvenor) (R-Ohio), 6694 (statement of Sen. Sherman) (R-Ohio) (1894).

> . . . To equalize burdens and mete equal justice is the purpose of my amendment.[180]

Although Grinnell was referring in part to consumption taxes, implicit in his argument was that the poor's personal contribution to the defense of the Union had gone unmatched by many of the wealthy.[181] Thus, "in view of the certain tariff increases and impending direct tax debate," Frank's amendment passed the House and was sent to the Senate.[182]

The Senate revived the debate over graduated rates. As in the House, however, "supporters tended to portray the tax as a balance wheel in the context of a predominantly regressive system, while opponents located inequities in the income tax law itself."[183] Initially, Senator Fessenden announced on May 27, 1864 that the Senate Finance Committee had modified the House bill, striking out the 10% rate and leaving it at 7.5% on all incomes exceeding $10,000.[184] Republican Senator Lyman Trumbull of Illinois, while arguing that even the highest rate should be preserved, offered this defense of progression:

> [B]y the terms of this bill the poor man often pays as much tax as the rich man. He pays upon all the articles which he consumes. A man in this country worth $5,000, who is living comfortably and who has an income perhaps of six hundred or one thousand dollars a year, has as many mouths to feed, as many members in his family to clothe and to shoe and to furnish with all the necessaries of life, as the man who has an income of $500,000 a year; and he pays just as much tax on his sugar and his tea and his meats and everything which he buys. That is not equal; that is, it is not according to the property of the individual. To make this up to some extent we propose by this bill to put a tax upon income.[185]

When Republican Senator John Sherman of Ohio protested that graduated rates imposed a "different rule of taxation" on the wealthy, Trumbull asked "if he does not regard it as applying a different rule of taxation when the poor man pays just as high taxes on all articles he consumes under this bill as a rich man."[186]

Some attacked the principle of progression altogether, arguing that a flat or proportionate rate even as high as 10% would be preferable to the proposed "discrimination" in the rates.[187] Senator Solomon Foot (R-Vt.) pointed out

180. CONG. GLOBE, 38th Cong., 1st Sess. 1876-77 (1864).

181. For example, Garrett Davis of Kentucky, a soldier during the war, asked, "Will any gentleman point to me a single millionaire or a man in the United States whose income is above $25,000 that has gone to the field?" *Id.* at 2515.

182. STANLEY, *supra* note 22, at 33.

183. *Id.* at 34.

184. CONG. GLOBE, 38th Cong., 1st Sess. 2513 (1864).

185. *Id.*

186. *Id.* at 2514.

187. *Id.* (statements of Sen. Sherman (R-Ohio), Sen. Foot (R-Vt.), and Sen. Johnson (D-Md.)).

that such a uniform rate would tax people according to their "ability to pay."[188] Foot further stated:

> Under such a rule the man of large estate, having a large income, pays a larger tax or impost than the man of less estate and less taxable income, just in the exact proportion that his assessed income is larger than that of the man of less estate. In this case the burden falls upon the two in the exact proportion to the relative amount of their respective incomes. We ought to ask no more or no less.[189]

Senator Reverdy Johnson, a moderate Democrat from Maryland explained that "the question now is not whether [a wealthy man] is to pay more income tax because he is rich, but whether he is to pay a great deal more by increasing the rate by which you tax the income of the poor man."[190] Thus, while Trumbull's argument supported a proportional income tax of some kind, it did not necessarily require a graduated one.

Radical Republican Massachusetts Senator Charles Sumner, although nominally aligned with Trumbull against Fessenden's proposed amendment, attempted to rebuild the case on different grounds. Sumner cited the sacrifice rationale espoused by French economist J.B. Say to justify the House bill's steeply graduated rates.[191] According to Sumner, Say, in reliance in part upon the works of Adam Smith, wrote, "If a person had to pay 200f. more in taxes upon every addition of 1,000f. to his revenue, still he would multiply his enjoyments in a larger ratio than his sacrifices."[192]

The end result in favor of graduation, though, appeared to be reached under something closer to the compensatory rationale. Initially, Fessenden's amendment for lower graduated rates passed, despite Kentucky Unionist Garrett Davis' fervent support of Sumner's argument.[193] The next day, however, a proposal to levy the highest tariff rates of the war passed in the House.[194] Furthermore, during the interval in the Senate, Radical Republican James W. Grimes of Iowa "succeeded in getting the Senate to suspend indefinitely the operation of the direct tax" slated to be collected in 1865 under the House bill.[195] These two developments served both to increase the burden on poor consumers and ease the burden on wealthy landowners. It also created a definite shortfall in the revenue bill. Thus, on June 6, 1864, the Senate reversed gears and approved, first, an amendment by Senator James F. Wilson of Iowa for a 7.5% tax on all incomes over $5,000 and second, an amendment

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188. *Id.*

189. *Id.* (statement of Sen. Foot).

190. *Id.*

191. *See id.* at 2514-15.

192. *Id.* at 2515.

193. *See id.* The amendment to the House bill was passed 22 to 15 with 12 senators absent. *Id.* Sumner joined the majority, recognizing that "such a tax would probably produce comparatively little, and I am sure in certain quarters would be odious." *Id.* at 2513, 2515.

194. STANLEY, *supra* note 22, at 34; *see* CONG. GLOBE, 38th Cong., 1st Sess. 2751 (1864). The bill raised the average rate on dutiable commodities from the 37.2% level imposed in 1862 to 47.02%. RATNER, *supra* note 108, at 88.

195. RATNER, *supra* note 108, at 85.

by Senator Grimes for a 10% tax on all incomes over $15,000.[196] Although Grimes attributed this development to the impact made on the Senators by Sumner's May 27 speech,[197] this conclusion seems doubtful given the Senate's rejection of the higher graduated rates at that time. Rather, it was more likely Wilson's two rationales—to make up for lost revenues and to broaden the tax burdens—that swayed the Senate.[198] Even Grimes relied in part upon a general compensatory rationale in responding to Missouri Unionist Senator John B. Henderson's criticism of his proposal. In this repect, Grimes stated, "If there is any class of men that the distinction ought to be made in favor of and not against it is the very class of men we have discriminated against [in other ways]."[199] The bill was sent to the Committee of the Conference where it emerged with an even more steeply graduated rate of 10% on incomes above $10,000.[200]

Although the 1864 Act produced the highest revenue collections from income taxes during the War,[201] the Treasury continued to struggle.[202] Secretary Chase failed to properly market the government bonds and, somewhat unexpectedly, Lincoln accepted his resignation.[203] After appointing former Senate Finance Committee chair William Pitt Fessenden as the new Treasury Secretary, things picked up a bit.[204] Fessenden, however, recommended in a report issued in December 1864 that more revenue was necessary to continue prosecuting the war effort.[205] Thus, on February 9, 1865, Justin Morrill introduced a bill to amend the 1864 Act by increasing the tax from 7.5% to 10% on incomes over $3,000.[206] The House rejected Illinois Democrat Lewis W. Ross' proposal for a radically progressive income tax, which set the highest rate at 20% on incomes over $20,000. It settled instead on a moderate solution offered by Kentucky Unionist Robert Mallory which raised the tax to 10% on incomes over $5,000.[207] With minor modifications, Congress adopted this proposal in the final version of this amendment to the 1864 Act.[208] The Act was later challenged before the Supreme Court in *Springer v. United*

196. CONG. GLOBE, 38th Cong., 1st Sess. 2759 (1864).
197. *Id.* at 2760.
198. *Id.* at 2759.
199. *Id.* at 2760.
200. Act of June 30, 1864, ch. 173, 13 Stat. 223, 281 (repealed 1933); RATNER, *supra* note 108, at 85. A few days later, after Secretary Chase realized that an unanticipated shortfall would develop over bounties promised to aid in the recruitment and retention of soldiers, Congress passed the Emergency Income Tax Act of July 4, 1864. RATNER, *supra* note 108, at 89. This Act imposed a special flat income tax of 5% on all incomes over $600, assessed on income which accrued in 1863 and as an addition to the 1862 rates. *Id.*; STANLEY, *supra* note 22, at 35.
201. STANLEY, *supra* note 22, at 36.
202. PAUL, *supra* note 84, at 14.
203. *Id.*
204. *Id.*
205. RATNER, *supra* note 108, at 96.
206. *Id.* at 97.
207. *Id.* at 97-98.
208. *See* Act of Mar. 3, 1865, ch. 78, 13 Stat. 469, 479; CONG. GLOBE, 38th Cong., 2d Sess. 1293 (1865).

States,[209] but its provisions were upheld without discussing the Act's graduated feature.[210]

By 1866, with the war over, the political compromise that previously had supported a graduated income tax began to unravel.[211] Although the country was left with an enormous debt and significant reconstruction expenses, the war tax system as a whole became a "fearful weight."[212] Frederick A. Pike of Maine remarked in a House floor debate that they had received "petitions from struggling manufacturers . . . from all quarters of the land, asking for relief."[213] Political economist David Wells, the recently appointed Special Commissioner of the Revenue, issued a report in 1866 which found that high prices were the chief cause of postwar stagnation.[214] Hence, Wells' report recommended to Treasury Secretary Hugh R. McCulloch that they lower these prices by effecting a wholesale reduction in national taxation, beginning with internal revenues and tariffs.[215] The graduated income tax, although now derided by many, was still not ready for modification.

When Justin Morrill attempted, as he had in 1864, to introduce an income tax bill which eliminated the graduated income tax and imposed a flat 5% rate on incomes over $1,000, his measure was soundly defeated.[216] Representative Pike noted that until achievement of a reduction in prices, such a measure must wait:

> Every laboring man in the country pays a tax upon what he eats, drinks, and wears. And until we come to the point of relieving the great body of people in the country from onerous taxes upon everyday's consumption it is a question whether or not the men who are able to pay should not pay this increased proportion of their income to the General Government.[217]

Pike instead proposed a tax of 5% on incomes exceeding $1,000 and 10% on incomes exceeding $5,000.[218] Morrill, a fierce abolitionist and a founder of the Republican Party,[219] responded to this logic by invoking the mantra of

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209. 102 U.S. 586 (1880).

210. The Court held that the tax was more akin to a duty or an excise than a direct tax such as property or capitation tax. *Springer*, 102 U.S. at 602. Thus, the tax was properly not apportioned. *See id.*

211. PAUL, *supra* note 84, at 23.

212. *Id.*

213. CONG. GLOBE, 39th Cong., 1st Sess. 2783 (1866). Pike was specifically referring to the "many small and weak manufacturers of the country," who were hurt by tariffs on raw materials. *Id.*

214. STANLEY, *supra* note 22, at 44.

215. *Id.* The wholesale price index, with a value of 100 assigned to the years 1910-14, indicated a value of 193 in 1864 and 185 in 1865, after a pre-war low of 89 in 1861. HISTORICAL STATISTICS, *supra* note 157, at 201. Perhaps even more revealing, the Federal Reserve Bank of New York's cost-of-living index, with a value of 100 assigned to the year 1913, had climbed from 63 in 1861, to 102 in 1865, to 103 in 1866, and to 102 in 1867. *Id.* at 212. Burgess's cost-of-living index revealed a similar pattern on the same scale, with a 61.2 in 1861, up to a 108.1 in 1865. *Id.*

216. RATNER, *supra* note 108, at 113.

217. CONG. GLOBE, 39th Cong., 1st Sess. 2783 (1866).

218. RATNER, *supra* note 108, at 113.

219. *Id.* at 65.

racial equality, the subject of much attention in recent months: "In this country we neither create nor tolerate any distinction of rank, race, or color, and should not tolerate anything else than entire equality in our taxation."[220] He went too far, however, when he compared the defense of a steeply graduated tax proposed by Representative Ross to "the same ground that the highwayman defends his acts."[221] Morrill's comparison attracted the ire of a number of representatives,[222] and although Morrill admitted that he may have expressed himself "a little too strongly," he argued that because "[o]ur urgent necessities during the war hav[e] ceased, I think we ought to relieve ourselves at the earliest moment from such a tax."[223] Despite having allies in this view,[224] they generally misunderstood that the majority view, as opposed to Ross' radicalism, was not that the wealthy should endure an inequality, but rather that they should not receive an exemption. To the extent that an inequality existed, it compensated for the inequality of other forms of taxation which resulted from the "necessities" of war and caused higher prices. Representative Ithamar C. Sloan, a Wisconsin Republican who later served as the dean of the law department at the University of Wisconsin, pointed out Morrill's inability, or lack of political desire, to see the bigger picture:

> Now, throughout consideration of this bill the chairman of the Committee of Ways and Means [Morrill] has resisted strenuously all propositions to relieve from taxation many articles the tax upon which is oppressive and burdensome to the industry of the country. The tax upon those articles tends to depress and check the business and enterprise of the country.[225]

Sidney Ratner likewise concluded, "The House majority felt that the poorer classes bore many small but burdensome taxes which ought to be reduced or removed before the more wealthy classes received relief."[226] After the House passed Pike's proposal,[227] it sent the Bill to the Senate, which adopted it without much debate or modification. In fact, the Senate's sole modification was to lower the exemption to $600.[228]

Because the final act declared the income tax payable every year until and including 1870,[229] Morrill needed only to bide his time. Indeed, his argument did not fall upon deaf ears, for less than a year later Congress swung around to Morrill's position. Sensing this change, Morrill again presented, on Febru-

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220. CONG. GLOBE, 39th Cong., 1st Sess. 2783 (1866).

221. *Id.* Ross's views on the progressive income tax, largely based on a sacrifice or redistributive rationale, were not widely shared. As in 1865, Ross proposed a graduated tax with a high rate of 25% on incomes in excess of $60,000. *Id.*

222. *See id.* at 2784 (statements of Rep. Spalding (R-Ohio), Rep. Sloan (R-Wis.), and Rep. Paine (R-Wis.)).

223. *Id.*

224. *See id.* (statement of Rep. Price) (R-Iowa), and at 2785 (statements of Rep. Davis (R-N.Y.) and Rep. Hale (R-N.Y.)).

225. *Id.* at 2784.

226. RATNER, *supra* note 108, at 113.

227. CONG. GLOBE, 39th Cong., 1st Sess. 2786 (1866).

228. *See* RATNER, *supra* note 108, at 114.

229. *Id.*

ary 13, 1867, a revenue bill to the House which proposed the imposition of a flat, rather than graduated, tax of 5% on incomes over $1,000.[230] In presenting this proposal, Morrill argued:

> Few nations tolerate an income tax at all, and there is no nation which has any other than a uniform rate. The Treasury needs money; but on a question of taxation justice must be dealt out with an even hand, and the rule of perfect equality should be immovable as the poles.[231]

By this time, the reductions in internal taxes in 1866 and in the proposed bill, coupled with the first of many years of federal budget surpluses,[232] made the graduated income tax ripe for Morrill's attack. Thus, the House defeated, by a vote of 73 to 26, Illinois Republican Representative Jehu Baker's[233] proposal to amend the bill to add 10% tax on incomes over $6,000.[234] As Pennsylvania Representative George F. Miller explained, "The tax upon incomes for the last two years has yielded more revenue to the Government than the tax upon anything else. . . . [M]en [in the great cities] have made very fair and honest returns of their incomes, and from that source has come an enormous sum for our Treasury."[235] The inaccuracy of Miller's statement does not detract from its reflection of his desire to justify the end of graduation by suggesting the end of the need to compensate for regressive taxes.[236] In any event, repealing the graduation feature while retaining the income tax itself was a recognition of the high consumer prices.[237] As a political matter, however, and much like the state income taxes which followed the same pattern,[238] Congress could

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230. CONG. GLOBE, 39th Cong., 2d Sess. 1218 (1867).

231. *Id.*

232. *See* RATNER ET AL., *supra* note 70, at 346. The bill proposed to reduce the excise taxes on 51 goods, including such necessaries as "clothing," "salt," and "sugar," for a total savings of $36,730,500 after some additional across-the-board cuts. CONG. GLOBE, 39th Cong., 2d Sess. 1218 (1867) (statement of Rep. Morrill) (R-Vt.).

233. RATNER, *supra* note 108, at 115.

234. CONG. GLOBE, 39th Cong., 2d Sess. 1482-83 (1867). The House also rejected two somewhat more moderate graduated income tax proposals from Rep. Ralph Hill (R-Ind.) and Rep. Pike (R-Me.). *Id.* at 1483.

235. *Id.*

236. Paul reports that 1866 was indeed the income tax's greatest year in terms of revenue production, totalling $73 million. PAUL, *supra* note 84, at 29. The income tax, which paid only 10% of total expenditures in 1862, amounted to 25% in 1864 and 1865. *Id.* However, it still paled in comparison with the "$180 million in customs receipts and $236 million from other internal revenue sources." *Id.* Perhaps searching for another rationale, future President James A. Garfield of Ohio argued for a flat tax on constitutional grounds instead. CONG. GLOBE, 39th Cong., 2d Sess. 1482 (1867). This rationale, unlike the compensatory theory, was openly contested. *See id.* at 1483 (statement of Rep. Hill) (R-Ind.).

237. The Federal Reserve Bank of New York's cost-of-living index was still at 102 in 1867, but dropped to 91 in 1870. HISTORICAL STATISTICS, *supra* note 157, at 212.

238. Income taxes in several states, including Virginia, North Carolina, Georgia, and Texas, were graduated for a brief period during or after the Civil War. *See* SELIGMAN, *supra* note 30, at 406-14. In all such cases, the rates were eventually made proportional again or the tax was abandoned completely. *See id.* For example, Virginia and North Carolina both imposed a graduated tax in 1866, but the states returned to a flat tax in 1870 and 1869 respectively. *See id.* Seligman suggested that this trend occurred in the South because

> [p]ractically none of [the southern states] had developed the system of the general property tax as it was found in the North, and it was felt to be entirely out of the question to expect that the burdens of the impending conflict should be borne entirely by owners of

no longer justify the graduation in the income tax by suggesting that the wealthy were almost completely exempt from taxation.[239]

As 1870, the date set for the expiration of the income tax, approached, anti-income tax sentiment grew. The *New York Tribune* succinctly stated on February 5, 1869, that "'[t]he [i]ncome [t]ax is the most odious, vexatious, inquisitorial, and unequal of all our taxes.'"[240] Congress started receiving petitions in opposition to the renewal of the tax in early 1870 from such diverse sources as the Boards of Trade of Buffalo and Cleveland, the California legislature, and the Union League Club of New York City.[241] In addition, citizens of New York City and Philadelphia organized anti-income tax associations, and papers from San Francisco, California to Erie, Pennsylvania voiced their opposition.[242] The advent of the first period of economic prosperity since the war[243] added to the movement against the income tax. Wholesale prices, which had been falling in small increments each year since 1864, experienced a drop between 1869 and 1870 which was more than double the decline from the previous year.[244] Sugar, for example, which had been 16 cents/lb. in 1868 and 1869, fell to 13.5 cents/lb. in 1870.[245] Wheat, which had been $2.541 a bushel in 1868, decreased to only $1.373 a bushel in 1870.[246] At the same time, the gross national debt had been reduced by more than $300 million since 1866 and the per capita debt dropped more than 18%.[247] The continued high taxes, coupled with the general prosperity, thus allowed the government to amass budget surpluses which were used to draw down the national debt.[248] While public sentiment supported this for awhile, the tide had turned so that, according to Senator John Sherman, the new slogan was "[s]top paying the national debt and throw off taxes."[249]

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real estate and slaves.

Id. at 406.

239. This was certainly more than just a mere battle of conscience, though, as Randolph Paul noted: the banking and manufacturing interests fought vigorously against the merchants and importers for the reduction of the income tax. PAUL, *supra* note 84, at 27. Indeed, the Radical Republicans won significant majorities in both houses of Congress in the 1866 elections, and the price for some of their social causes was an alliance with the industrial sector on economic issues. RATNER, *supra* note 108, at 114-15. As is sometimes true, however, the political strength of a lobby rises with the popular force of its position. *See* WITTE, *supra* note 79, at 285-88. In this case, Congress could respond to the "plight of the wealthy" only when the war ended and the burden on the masses was lifted.

240. RATNER, *supra* note 108, at 122 (quoting the *New York Tribune*, Feb. 5, 1869).

241. STANLEY, *supra* note 22, at 45.

242. *Id.*

243. *Id.* at 54.

244. *See* HISTORICAL STATISTICS, *supra* note 157, at 201.

245. *Id.* at 209.

246. *Id.* Of course, much of this immediate price decline was due more to the post-war policy of monetary contraction, an attempt to make paper dollars convertible one-for-one into specie instead of the fifty cent premium on gold over the paper dollar, rather than the reduction in consumption taxes. RATNER ET AL., *supra* note 70, at 355. This economic reality does not negate the compensatory theory rhetoric or its vision of the understanding of equality in taxation.

247. *See* RATNER, *supra* note 108, at 123 ("The total gross debt was reduced from $2,755 million in 1866 to $2,430 million in 1870, and the per capita debt was lowered from $77 in 1866 to $63 in 1870.").

248. *See id.*

249. CONG. GLOBE, 41st Cong., 2d Sess. 4714 (1870). Senator Henry W. Corbett (R-Or.),

Despite this political and economic groundswell, an interesting alliance developed to temporarily forestall the complete repeal of the income tax. Domestic manufacturers and agricultural producers, flush with the recent economic prosperity, sought a return to explicitly protective tariffs.[250] Thus, early in 1870, the Ways and Means Committee submitted a tariff bill which made reductions almost exclusively in "purely revenue articles," while effecting a significant increase in duties on "protected articles."[251] Debate over the bill, however, was deadlocked.[252] Although "the proposed tariff bill pretended" to "satisfy the pressure for reduction in taxes," it was not enough.[253] A bill was introduced to lower internal taxes while maintaining the income tax essentially at its prior level.[254] Apparently, the pro-tariff forces aligned with the pro-income tax forces to effectuate this move. According to Robert Stanley's study of the roll call votes in Congress on the two issues, 94 of the 154 voting delegates, or two-thirds of those voting, supported both the income tax bill and the tariff bill.[255] Stanley argues this refutes the progressive model that pits the urban, Northeastern Republicans against the rural agrarians on these issues.[256] According to Stanley, this is proof of the "centrist" designs of the establishment.[257] The results, however, are not surprising in a Congress operating under notions of equality informed by the compensatory theory.

A call to reduce taxes, just as in a demand to raise them, could be accomplished through an infinite number of variations involving excise taxes, tariffs, and income taxes. Congress was wary of tipping the scale too far in one direction. Thus, Representative Austin Blair (R-Mich.) reminded Congress that "every dollar which we take off this income tax, which applies to the rich men of the country, must be laid upon the poorer men of the country."[258] Representative Eugene M. Wilson (D-Minn.), echoing this sentiment, argued that for every dollar lost because the income tax was reduced, "we are prevented from

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arguing a proposition with which many contemporary politicians might agree, asked:

> Why should we attempt to pay off the entire debt within our generation? The system of Alexander Hamilton, to pay off a debt within the generation by which it was created, may have been wise in those days, when our income was very limited and population small; but with a country increasing so rapidly in population as ours, with people coming from all portions of the globe, settling in the United States and taking up our public lands, given them as a gratuity, and who will eventually, by reason of taking these lands, become comparatively wealthy, why not provide for those people paying a portion of the tax necessary to discharge the debt?

Id. at 4718.

250. *See* STANLEY, *supra* note 22, at 45-46.

251. RATNER, *supra* note 108, at 123-24. Duties often distinguished between "purely revenue articles," for which there was no significant domestic competition and the principal reason for imposing a duty was to raise revenue, and "protected articles," which were designed to raise the costs of a foreign good, so as to protect the domestic manufacturers of the same good from outside competition. *Id.*; *see also* BENDER'S FEDERAL REVENUE LAW 356 (Matthew Bender & Co., 1917).

252. STANLEY, *supra* note 22, at 46.

253. RATNER, *supra* note 108, at 124.

254. *Id.*

255. STANLEY, *supra* note 22, at 51.

256. *See id.*

257. *See id.* at 51-53. Stanley uses this term in a pejorative sense to describe all efforts to preserve the status quo.

258. CONG. GLOBE, 41st Cong., 2d Sess. 3994 (1870).

seeking lower tariff duties."[259] Perhaps recognizing this zero-sum game, pro-tariff domestic manufacturers viewed the maintenance of some form of income tax as preferable to the continued existence of heavy internal duties on their products.[260] This frustrated Democrat Stevenson Archer of Maryland, who decided to oppose the income tax "[b]ecause it is to be kept up for the benefit of manufacturers and high tariff men, who control large bodies of voters, maintaining this burden in order to remove more special taxes from their shoulders."[261]

After the House passed an income tax of 3% on incomes in excess of $2,000 as a companion to the tariff bill, a similar discussion was held in the Senate.[262] Senator John Sherman of Ohio, chair of the Senate Finance Committee, led the tariff/income tax alliance against the other internal tax forces. Recognizing the popular demand for a reduction of taxes, he noted, "The real question is, what taxes ought to be repealed [and] which among them bear most upon the industry of our people?"[263] Sherman advocated retaining the tariff and the income tax, while Congress focused its attention on reducing internal taxes.[264] Although the internal taxes and the customs duties both impacted consumption, Sherman distinguished them, arguing that the customs duties "are indirect."[265] In this respect, Sherman stated, "They are mainly upon articles of luxury or consumption, so well distributed that the taxes fall fairly and in just proportion to ability to pay . . . they are as well distributed as any taxation on consumption can be."[266] He argued that because any tax on consumption "is in its nature an unequal tax," an income tax was necessary to compensate for the unequal burden.[267] Some countered Sherman's assertion by noting that the income tax instituted its own inequality even with a flat rate as it contained an exemption for those earning less than $1,000.[268] Sherman responded with a clear invocation of the compensatory theory's logic:

> You may, therefore, properly exempt the great mass of the people, but solely on the ground that their tax on the articles consumed by them is more than any income tax that could possibly be laid on the rich.
>
> Take the ordinary consumption of tea, sugar, and coffee . . . . If the ordinary quantity of these three articles is consumed, the duty on them alone for a man whose income is derived from his daily labor is more than the highest income tax that has ever been levied in the United States; and therefore this exemption in favor of the great mass

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259. *Id.* at 4023.
260. *See id.* (statement of Rep. Wilson) (D-Minn.).
261. *Id.* at 4033.
262. *See id.* at 4063-64.
263. *Id.* app. at 377.
264. *Id.* app. at 377-78.
265. *Id.* app. at 377.
266. *Id.*
267. *Id.* app. at 379.
268. *See id.* at 4714 (statement of Sen. Henry Winslow Corbett) (R-Or.).

> of the people of $1,000 . . . is exempted on the ground that they already, in other ways, pay a larger tax.[269]

Sherman's threat to either restore the so-called "special taxes" and "gross receipts taxes," or strike out those sections of the tariff bill which repealed revenue tariffs if the income tax was not renewed,[270] perhaps ultimately persuaded some members of Congress. Thus, pro-tariff and anti-special tax forces compromised with income tax supporters to retain the income tax, albeit at the low rate of 2% and with a short lifespan of only two years.[271]

Despite this minor setback, income tax opponents continued their attempt to repeal the tax during the years 1871 and 1872. They voiced the criticisms which had been circulating for a decade: It was inquisitorial because it invaded a man's private finances; it encouraged perjury; it was a war tax which had outlived its usefulness; it was too expensive to collect; it was unnecessary because of surpluses; it was unconstitutional because it was unapportioned; and it was discriminatory and unequal.[272] Income tax supporters attempted to demonstrate that these criticisms could be levied on any form of tax, but to no avail. As John Rice of Kentucky admitted, "[T]he question of revenue reform and reduction of taxation is engrossing more of the attention of the people than any other with which this Congress has to deal."[273] This time, however, the argument that the popular clamor was for a reduction in consumption taxes, not a reduction in income taxes, went unheeded.[274]

The economy further improved during the early 1870s. The business failure rate dropped to between one-quarter and one-third of its rate during the panic year of 1857 and stood at its lowest point until after World War I.[275] As a consequence, budget surpluses remained high. In fact, from 1870 to 1872, the surpluses were around $100 million, five times higher than the highest antebellum figure in 1836.[276] With prices on noncompeting goods continuing their free-fall,[277] the pressure to equalize the burdens of the regressive consumption taxes no longer carried much weight. Sherman felt that these days of giddy prosperity would soon pass, at which time the public would again demand a compensatory income tax:

> It will not do to say that each person consumes in proportion to his means. This is not true. Every one must see that the consumption of the rich does not bear the same relation to the consumption of the poor as the income of the one does to the wages of the other.

269. *Id.*
270. *Id.* at 4716.
271. RATNER, *supra* note 108, at 126-27.
272. *See, e.g.*, CONG. GLOBE, 42d Cong., 2d Sess. 1735 (1872) (statement of Rep. Rice) (D-Ky.) (cataloging the criticisms of income tax opponents); CONG. GLOBE, 41st Cong., 3d Sess. 720 (1871) (statement of Sen. John Scott) (R-Pa.).
273. CONG. GLOBE, 42d Cong., 2d Sess. 1734 (1872).
274. *See id.* at 1737.
275. STANLEY, *supra* note 22, at 54.
276. STANLEY, *supra* note 22, at 284 n.105 (citing HISTORICAL STATISTICS, *supra* note 157, at Series Y 254-57).
277. *See id.* at 201. The consumer price index dropped from 141 in 1870 to 135 in 1872. *Id.* at 212.

> As wealth accumulates, this injustice in the fundamental basis of our system will be felt and forced upon the attention of Congress. Then an income tax, carefully adjusted, with proper discriminations between income from property and income from personal services, and freed from the espionage of our present law, will become a part of our system.[278]

Certainly, generous "contributions" to political campaigns during the 1872 campaign, later exposed in the Credit Mobilier scandal, helped grease the skids on the income tax's exit.[279] But these elements, just as the arguments against the income tax, were present before. The conditions under which the income tax was allowed to expire are what is significant. During the political campaign, pro-tariff supporters secured a "consumer-oriented" tariff bill which further reduced revenue tariffs and even dropped protective tariffs 10%, leading to the campaign promise of a "free breakfast table."[280] Coupled with the falling prices and rising wages, Congress perceived (or at least hoped that the public perceived) that it no longer needed to balance out the regressive effects of the tariff and other consumption taxes. While this may not have been precisely true, it illustrates that the income tax, and its graduation, was a function of the need to portray a flat or proportionate distribution of overall tax burdens, not a progressive one. Some radical supporters of the income tax wanted to equalize incomes rather than just rates. Some opponents failed to comprehend how the income tax compensated for the regressive consumption taxes. On balance, however, the graduated income tax during the Civil War and Reconstruction was viewed as part of a flat-tax based revenue scheme.[281] When the obscene inequity of the exclusive reliance on tariff taxes became less noticeable, the system appeared to be flat once again and the need for the income tax as a counterweight had passed.

C. *The Income Tax of 1894*

The income tax issue continued to simmer during the 1870s and 1880s,[282] but a number of influences converged to make it a reality in 1894.

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278. CONG. GLOBE, 42d Cong., 2d Sess. 1708 (1872).

279. RATNER, *supra* note 108, at 135.

280. *Id.*; STANLEY, *supra* note 22, at 55; *see also* BENDER'S FEDERAL REVENUE LAW, *supra* note 85, at 356 ("Duties were removed from revenue producers, and political influences growing out of the war were able to maintain the high protective policy."). One author noted:

> Whilst apparently a concession to Free Trade, the new Act really strengthened the position of Protection; its authors had gratified the general desire for a reduction of taxation, but they had done this particularly in regard to internal duties and what may be called 'breakfast-table taxes'; and consequently, as in 1870, they had made the country still more dependent for Federal revenue upon the purely protective duties.

ASHLEY, *supra* note 85, at 188.

281. Indeed, the income tax was not unique as a compensatory tool. Sherman pointed out, "During the war, these [customs] duties were increased to counterbalance the internal taxes levied upon domestic industry." CONG. GLOBE, 42d Cong., 2d Sess. 1709 (1872).

282. WITTE, *supra* note 79, at 70. Fourteen different income tax bills were introduced into Congress between 1873 and 1879. FRIEDMAN, *supra* note 108, at 565. Tennessee Representative Benton McMillin introduced bills to reinstitute an income tax from 1879 through the early 1890s.

Great fortunes were amassed during the high prosperity and high protectionism of the 1880s.[283] This focused attention back to the inequities of the tariff system during the election of Democrat and former President Grover Cleveland in 1892.[284] Coupled with popular unrest and economic dislocation engendered by the panic and depression of 1893,[285] conditions justified another attempt at an income tax. Although the income tax adopted rested upon compensatory theory, the tax itself was flat, rather than graduated.[286]

The high protective tariffs enacted at the end of Reconstruction essentially remained intact through the beginning of the 1890s.[287] The sustained period of economic growth during the 1880s strengthened this practice, which was justified on the ground that it benefitted industry and raised wages.[288] Not only did this prosperity create annual surpluses of over $100 million,[289] but it also permitted the cost-of-living to remain relatively low during the period.[290] The tariff began to show signs of weakness, however, during the 1888 election campaign. Grover Cleveland, searching for an issue to galvanize supporters after an uninspiring first term, broke with precedent and concentrated solely on the tariff issue in his State of the Union address of December 6, 1887.[291] In an attempt to appeal both to farmers desiring to sell in free markets abroad and manufacturers looking to buy cheaper supplies, Cleveland called for general reductions in the protective tariff and free raw materials.[292] According to Cleveland's biographer Allan Nevins, the speech, which newspapers throughout the country reprinted, "'was read as no Presidential messages since Lincoln's had been.'"[293] Frank Taussig, a noted historian of the tariff, commented that Cleveland's message made the tariff question "more distinctly a party matter than it had been at any time since the Civil War."[294] Although Cleveland eventually lost his re-election bid to Republican Benjamin Harrison in 1888,[295] the tariff question did not fade from the political scene. In 1890, the Republicans secured passage of the McKinley Tariff Act, "an out and out protective measure" designed as a monument to the "American System" of industrial development based upon strong protectionism.[296]

RATNER, *supra* note 108, at 172.

283. WITTE, *supra* note 79, at 70.

284. *Id.*

285. *Id.*

286. FRIEDMAN, *supra* note 108, at 565.

287. *See* BENDER'S FEDERAL REVENUE LAW, *supra* note 85, at 356; RATNER ET AL., *supra* note 70, at 389.

288. SELIGMAN, *supra* note 30, at 493.

289. WITTE, *supra* note 79, at 70.

290. HISTORICAL STATISTICS, *supra* note 157, at 212.

291. SPEECHES OF THE AMERICAN PRESIDENTS 263 (Janet Podell & Steven Anzovin eds., 1988); STANLEY, *supra* note 22, at 110.

292. STANLEY, *supra* note 22, at 110. For a discussion of the farmer's shifting interest in the tariff, see SELIGMAN, *supra* note 30, at 494.

293. SPEECHES OF THE AMERICAN PRESIDENTS, *supra* note 291, at 263.

294. F.W. TAUSSIG, THE TARIFF HISTORY OF THE UNITED STATES 253 (8th ed. 1967). According to Percy Ashley, Cleveland "declared uncompromisingly in favour of a very considerable reduction of duties." ASHLEY, *supra* note 85, at 196.

295. STANLEY, *supra* note 22, at 110.

296. BENDER'S FEDERAL REVENUE LAW, *supra* note 85, at 356. The phrase, "American System," was popularized by Henry Clay in the first half of the nineteenth century. JOHN K.

With passage of the McKinley Act, the Republicans erected a lightning rod for a storm of protest against the advantages of accumulated wealth. During the late 1880s and early 1890s, Populism spread as a principally agrarian political entity geared toward "restor[ing] the economic individualism, the political democracy, and the morality of personal responsibility that existed in earlier America."[297] The movement was not an assault against the accumulation of wealth per se, but against the improper advantages assumed by the wealthy. Similar concerns had prompted the passage of the Interstate Commerce Act in 1887, which prohibited railway price-fixing, and the Sherman Anti-Trust Act in 1890, which declared contracts and combinations in restraint of trade illegal.[298] For the farmer, however, the very real consequences of the steady decline in agricultural prices after the Civil War overshadowed these broad concerns.[299] The wholesale price index for farm products fell from 133 in 1867 to 71 in 1890.[300] The farmers themselves attributed this decline to issues of monetary policy,[301] although they felt that the protectionist tariff exacerbated their plight. In fact, the farmers had initially supported protectionism as a boon to their success in domestic markets, but increasingly saw it as inconsistent with American agriculture's movement into the export market: farmers bought supplies and goods in a protected market while selling in a predominantly free market. When coupled with their belief that the tariff benefitted the manufacturers who were propping up the gold standard on Wall Street, the McKinley Tariff Act was an unwelcome sight.[302]

Given this hostility, President Harrison was on the defensive during his first State of the Union address after the passage of the McKinley Act, claiming objections to the Act were based upon "misinformation."[303] The Demo-

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GALBRAITH, ECONOMICS IN PERSPECTIVE: A CRITICAL HISTORY 157 (1987).

297. Marjorie E. Kornhauser, *The Morality of Money: American Attitudes Toward Wealth and the Income Tax*, 70 IND. L.J. 119, 136 (1994). For a general discussion of the Populist movement, see LAWRENCE GOODWYN, DEMOCRATIC PROMISE: THE POPULIST MOMENT IN AMERICA (1976).

298. GALBRAITH, *supra* note 296, at 161-62. Railroads were particularly subject to criticism for their facilitation of the growth of wealth. *See* Hobbs, *supra* note 179, at 442-43. Families such as the Goulds and Vanderbilts amassed part of their fortunes as a result of this industry. *Id.* This entire movement was also intimately connected to the push for tariff reform, since many viewed the tariff as protecting trusts from competition. *See* Marjorie E. Kornhauser, *Corporate Regulation and the Origins of the Corporate Income Tax*, 66 IND. L.J. 53, 75 n.82 (1990).

299. *See* RATNER ET AL., *supra* note 70, at 267.

300. *Id.*

301. *Id.*; SELIGMAN, *supra* note 30, at 494. The principal difficulty, according to the Populists, was the long-held notion that paper dollars must be supported by some underlying specie such as gold or silver. *See* RATNER ET AL., *supra* note 70, at 353. Price fluctuations in those commodities, rather than the decision of a central government body such as the Federal Reserve Board today, regulated the money supply and the value of money itself. *See id.* As a response to this perceived problem, farmers helped create the "Greenback" party, referring to the color of paper notes issued during the Civil War which were not backed by specie. *See* GOODWYN, *supra* note 297, at 11. Democrats, including William Jennings Bryan, sought a change from the de facto gold standard to allow silver coinage or at least a truly bimetallic standard because of the greater quantity of the latter mineral. *Id.* at 439-42; *see also* RATNER ET AL., *supra* note 70, at 358-61. Advocacy of the silver standard helped propel the Democrats to victory in 1892. SELIGMAN, *supra* note 30, at 495.

302. *See* SELIGMAN, *supra* note 30, at 494.

303. Benjamin Harrison (Dec. 3, 1889), *in* 2 THE STATE OF THE UNION MESSAGES OF THE PRESIDENTS, 1790-1966, at 1668 (Fred L. Israel ed., 1967) [hereinafter UNION MESSAGES].

cratic victory in 1892, returning Cleveland to the White House, was seen by many as a mandate for tariff reform.[304]

Soon after Cleveland's election, the country was thrown into another panic, sparked by the failure of a major railroad company and a drop in the Treasury's gold reserves in April 1893.[305] The ensuing depression was "one of the longest and most severe in history."[306] Gross national product dropped 10% and unemployment rates were as high as 20% with four million jobless.[307] Deflation in the agricultural sector intensified, and farms foreclosed at rates as high as 75% in some western counties.[308] The 1890 treasury surplus of $105 million became a deficit of $70 million in 1894, due in part to the increase in government spending on aid and public works programs.[309] These efforts, however, were insufficient. Labor strife, which had become more prominent during the late 1880s and early 1890s, intensified in tone and force.[310] During the spring and summer of 1894, violence erupted in Pennsylvania, Buffalo, and Cleveland, and culminated in the Pullman strike of June and July 1894. This strike in turn led to a series of bloody confrontations between workers and law enforcement officials.[311] "Coxey's Army," a band of destitute and discontented citizens led by Populist Jacob Coxey of Ohio, symbolized the tension of the times. The "Army," seeking work relief and demanding inflationary monetary policy, took over the grass outside the Capitol building in Washington D.C.[312]

With this inauspicious beginning to his presidency, Cleveland set out to make good on his promise for tariff reform.[313] During the fall of 1893, the House Ways and Means Committee began to explore the issue. Representative

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304. ASHLEY, *supra* note 85, at 213 ("The causes of the change in public opinion are not very clear; the new tariff had not been sufficiently long in force for any definite opinion to be formed as to its effects; but no one could allege that the issue had not been clearly set before the country."); PAUL, *supra* note 84, at 34; PAUL C. ROBERTS, NAT'L REV., Apr. 17, 1995, at 9; SELIGMAN, *supra* note 30, at 495. In Harrison's State of the Union message after his defeat, he conceded, "The result of the recent election must be accepted as having introduced a new policy. We must assume that the present tariff, constructed upon the lines of protection, is to be repealed and that there is to be substituted for it a tariff law constructed solely with reference to revenue . . . ." Benjamin Harrison (Dec. 6, 1892), in 2 UNION MESSAGES, *supra* note 303, at 1711-12.

305. RATNER ET AL., *supra* note 70, at 360-61; STANLEY, *supra* note 22, at 111 n.22.

306. STANLEY, *supra* note 22, at 111.

307. *Id.*; Barbara B. Woodhouse, *"Who Owns the Child?":* Meyer *and* Pierce *and the Child As Property*, 33 WM. & MARY L. REV. 995, 1024 n.123 (1992).

308. STANLEY, *supra* note 22, at 111; Woodhouse, *supra* note 307, at 1024 n.123.

309. BUENKER, *supra* note 45, at 24. Private relief efforts were, of course, significant. During the winter of 1893-94, relief referrals increased by 50% over the previous year. "In Chicago three times as much cash relief was distributed." STANLEY, *supra* note 22, at 111.

310. Some of the more infamous incidents of labor unrest occurring after the Civil War included the July 1877 national railroad strikes, the May 1886 strike and Haymarket riot in Chicago, and the 1892 Homestead, Pennsylvania iron and steel strike at the Carnegie Steel Works. RATNER ET AL., *supra* note 70, at 317; Gilbert C. Fite, *Election of 1896*, *in* THE COMING TO POWER 225, 227 (Arthur Schlesinger ed., 1971).

311. RATNER ET AL., *supra* note 70, at 317; Fite, *supra* note 310, at 227; Woodhouse, *supra* note 307, at 1024 n.120.

312. Fite, *supra* note 310, at 227; Woodhouse, *supra* note 307, at 1024.

313. Democratic Senator Patrick Walsh of Georgia later declared that the Wilson Tariff Bill was "the partial fulfilment [sic] of the contest inaugurated by President Cleveland in his tariff-reform message to Congress in 1887." 26 CONG. REC. 5381 (1894).

William Jennings Bryan, a Populist leader from Nebraska, approached Chairman William L. Wilson (D-W.V.) with the possibility of attaching an income tax provision to the tariff bill. The income tax had become popular with farmers in Nebraska and elsewhere who were heavily burdened by a real property tax which effectively exempted wealthy professionals and investors.[314] A study which found that the federal system of indirect taxes claimed 70% to 90% of the poor's income, while taking only 3% to 10% of the wealthy's income, also influenced Bryan.[315] To correct these inequities Bryan sought to include an income tax with the proposed tariff reductions.[316]

Wilson, who was initially receptive to Bryan's idea, appointed Tennessee Democrat Benton McMillin to chair the Internal Revenue Subcommittee responsible for overseeing the income tax.[317] However, after receiving Bryan's proposal, which imposed a graduated tax on all incomes in excess of $2,500, Wilson and the Cleveland administration argued for separating the income tax measures from tariff reform so as not to jeopardize the latter.[318] The December 1893 report of Treasury Secretary John G. Carlisle, outlining the Administration's position, called for free raw materials, reduced rates on necessities, and only a small tax on "legacies and successions."[319] On December 4, 1893, Cleveland reiterated this position in his first State of the Union

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314. SELIGMAN, *supra* note 30, at 495. Lawrence Friedman came to a similar conclusion:

> It was hard enough to assess land and houses fairly; at least real estate was visible, and there were records of title. Chattels were easy to hide, and intangibles most furtive of all. The general property tax essentially reduced itself to a tax on land and buildings. A rich taxpayer could easily evade taxes on invisible assets.

FRIEDMAN, *supra* note 108, at 567. Seligman argued that this failure of the general property tax to balance out the regressive effects of national consumption taxes, spurred the income tax movement:

> In theory the system of state and local taxation is calculated to reach the respective abilities of the property-owners; but in practice, as has repeatedly been pointed out, the general property tax has broken down completely; and, especially so far as personal property is concerned, the wealthier classes stand from under. Everywhere we meet the growing complaint that great wealth does not bear its share of the public burden. If, then, the tariff, as it actually exists, imposes too large a share of the burden on the expenditure of the poorer classes, and if the state and local revenue systems do not succeed in reaching the abilities of the more well-to-do classes, the argument becomes exceedingly strong in favor of some form of tax which will redress the inequality.
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> It is this argument which, as we have seen, was really at the bottom of the movement for the income tax in 1894 . . . .

SELIGMAN, *supra* note 30, at 640.

315. LOUIS W. KOENIG, BRYAN: A POLITICAL BIOGRAPHY OF WILLIAM JENNINGS BRYAN 130 (1971). This study is most likely the one performed by Thomas G. Shearman entitled, "The Owners of Wealth," in FORUM, Nov. 1889, at 262-73. *See* BUENKER, *supra* note 45, at 32.

316. STANLEY, *supra* note 22, at 113.

317. KOENIG, *supra* note 315, at 130; STANLEY, *supra* note 22, at 113; *see also* RATNER, *supra* note 108, at 172. Ratner suggests that Bryan may have been inspired to move for an income tax by a May 8, 1893 letter from a friend, C.H. Jones, editor of the *St. Louis Republic*, advocating a graduated income tax as "the most effective weapon for use against the Plutocratic policy." *Id.* The letter goes on, however, to suggest the need to increase revenues to pay Civil War pensions through some other method than tariffs or internal revenue measures. *Id.* at 173; STANLEY, *supra* note 22, at 113 n.29. This implies a rationale closer to compensatory than redistributive.

318. RATNER, *supra* note 108, at 173; STANLEY, *supra* note 22, at 113.

319. STANLEY, *supra* note 22, at 112.

message, adding only "a small tax upon incomes derived from certain corporate investments."[320]

Without mentioning an income tax, Wilson introduced the tariff bill to the House on January 8, 1894. Nonetheless, Bryan and McMillin, who convened a Democratic caucus to appeal the decision of the Ways and Means Committee, managed to secure approval to introduce an income tax amendment.[321] Wilson, in turn, set out to make the tax more palatable, and negotiated with Bryan and McMillin for removal of the tax's graduated feature.[322] On January 29, 1894, McMillin introduced an income tax amendment to Wilson's tariff bill which proposed a 2% tax on all incomes in excess of $4,000.[323]

The resulting debate over income tax had a different tenor than during the Civil War. Although the tax was still based on the compensatory theory, the debate was directed more toward the lack of contribution from the wealthy and less toward the undue burden on the poor. For example, Representative McMillin noted that, while Congress had abandoned the income tax after the Civil War, tariff taxation "has gone steadily on, increasing from day to day and from year to year."[324] The nearly $8 per day raised from every man, woman, and child in the United States to support the government comes "almost exclusively from consumption."[325] Thus, according to McMillin, "[w]ant, not wealth, pays the taxes."[326]

Democrats blamed the pro-tariff forces' "bait and switch" tactics during Reconstruction for this inequity. Representative John J. McDannold (D-Ill.), in proclaiming his support for an income tax, cried,

> [w]e removed the tax upon the strictly revenue articles of coffee and tea under the shallow cry of a 'free breakfast table,' while we increased the tax upon the table itself, the cloth which covered it, the plates, the cups, the spoons, the knives and forks, the napkins, and everything that went to make up that 'untaxed breakfast table.'[327]

As McMillin explained, "There is $500,000 in the hands of one man that is not taxed any more than the $20,000 in the hands of the other. Is this right? Is this justice?"[328] The general sentiment of the pro-income tax forces was that the system of tariff taxation had allowed the wealthy to escape their fair share of taxation.[329] To the prolonged applause of the House, McMillin announced:

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320. Grover Cleveland, *in* 2 UNION MESSAGES, *supra* note 303, at 1761.

321. KOENIG, *supra* note 315, at 130-31; PAUL, *supra* note 84, at 34; RATNER, *supra* note 108, at 172-73; STANLEY, *supra* note 22, at 114-15; *see* SELIGMAN, *supra* note 30, at 496-97.

322. KOENIG, *supra* note 315, at 132.

323. 26 CONG. REC. 1594 (1894); *id.* app. at 411-13 (Jan. 29, 1894) (statement of Rep. Benton McMillin) (D-Tenn.).

324. *Id.* app. at 413.

325. *Id.*

326. *Id.*

327. *Id.* at 1617.

328. *Id.* app. at 415.

329. *See id.* app. at 413 (Rep. McMillin); *id.* at 1609 (Rep. Osee Hall) (D-Minn.); *id.* at 1616 (Rep. John J. McDannold) (D-Ill.); *id.* at 1617-18, 1620 (Rep. John Sharp Williams) (D-Miss.); *id.* at 1656 (Rep. William Jennings Bryan) (Populist-Neb.); *id.* at 1664 (Rep. John Davis) (Populist-Kan.); *id.* at 1731 (Rep. Hernando de Soto Money) (D-Miss.); *id.* at 1733 (Rep. Constantine B. Kilgore) (D-Tex.); *id.* at 1755 (Rep. Edward Lane) (D-Ill.).

"I would be the most reluctant to use the power of government to tax wealth unjustly. But I am also unwilling to let wealth escape all governmental taxation."[330]

The inequity of the tariff system seemed self-evident to a society inundated with evidence as to the accumulation of wealth. "'[T]he publication of lists of millionaires was becoming a new journalistic sport.' Significantly, both the liberal Democratic *New York World*, published by Joseph Pulitzer, and the conservative Republican New York *Tribune* published lists of millionaires in the 1890s, complete with the sources of their incomes."[331] Many members of Congress were keenly aware of this concentration of wealth. Populist Senator William Allen of Nebraska read into the Congressional Record a list of New York millionaires and their annual untaxed income.[332] William Jennings Bryan quoted an essay by a member of the Census Department which concluded that 9% of the families owned 71% of the wealth.[333] South Carolina Representative William Talbert quoted Senator Daniel Voorhees' 1890 estimate that capitalists owned over 80% of the wealth.[334] The recounting of one tale told by Voorhees made clear the implications of this concentration of wealth: "When darkness settled over Egypt and she lost her place among the great nations of the earth, 3 per cent of her population owned 97 per cent of her wealth. When Babylon went down, 2 per cent of her population owned all the wealth."[335]

Income tax supporters portrayed the exclusive reliance on a consumption tax as a cause of this concentration of wealth. In this respect, McMillin stated: "The taxes having continually increased upon consumption, and no corresponding increase having been placed upon accumulation, we see such colossal fortunes amassed as were never concentrated in any other age or in any other country of the world."[336] Representative Uriel S. Hall of Missouri, believed by some to be the father of the income tax,[337] demonstrated the tariff tax's twofold benefit to the rich in a real-world context:

> [T]here was in 1889 $63,000,000, or about $1 per capita, taken from the consumers of wool and woolen goods, cotton and cotton goods, and iron and steel goods for the purpose of revenue for the United

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330. *Id.* app. at 413.

331. BUENKER, *supra* note 45, at 28.

332. 26 CONG. REC. 6712 (1894). The incomes ranged from $1.75 million for Louis C. Tiffany to $7.6 million for John D. Rockefeller. *Id.*

333. *Id.* at 1657. George Holmes, a member of the Census Department, published an article entitled, "The Concentration of Wealth," in the December 1893 edition of the *Political Science Quarterly* which demonstrated the vast accumulations of wealth in the few and suggested that progressive income taxation be used to keep the concentration to a minimum. RATNER, *supra* note 108, at 189-90. The methods and results of such studies are open to criticism. *See* Michael Novak, *The Inequality Myth: What Wealth Gap?*, WALL ST. J., July 11, 1995, at A16. Holmes's conclusion that 9% of the population owned 71% of the wealth can be favorably compared with the strongest recent estimate that 1% of the population owns 40% of the wealth in America today. *Id.* (citing Keith Bradsher, *Gap in Wealth in U.S. Called Widest in West*, N.Y. TIMES, Apr. 13, 1995).

334. 26 CONG. REC. 1674 (1894).

335. *Id.*

336. *Id.* app. at 415.

337. PAUL, *supra* note 84, at 37; Kornhauser, *supra* note 297, at 139 n.85 (citing ROY G. BLAKEY & GLADYS C. BLAKEY, THE FEDERAL INCOME TAX 15 n.22 (1940)).

> States Government by the tariff tax. I believe that it will be safe to say that in order to secure this revenue of $63,000,000 that it cost the people of the United States $450,000,000, the balance, $387,000,000, being paid as a bounty by the people to the monopoly manufacturing establishments under this protective tariff system. In other words, for every dollar placed in the Treasury of the United States there was $7 put in the pockets of the protected manufacturers on account of the tariff tax . . . .[338]

What riled supporters of the income tax the most, however, was that the wealthy were unwilling to temper their greed and pay a proportionate share of the tax burden. Democrat John Sharp Williams of Mississippi, a consistent supporter of the income tax from 1894 through 1913, exclaimed that,

> [t]hese tax-fattened paupers, the owners of the industries which can not stand alone, the industries which the charity of the nation (by their own claim at any rate, true or false) maintains and sustains, these men grown rich by taxing all consumers for their private benefit, have the unparalleled audacity to object to being themselves taxed for the public benefit.[339]

Opponents responded that the income tax was a tax upon thrift, not upon unfair accumulation.[340] Moreover, they claimed that the wealthy as a group were not opposed to the measure. W. Bourne Cockran, a Tammany Democrat and unofficial spokesman for the wealthy,[341] reported that,

> no word of opposition to this measure . . . has ever been expressed by any rich man in the United States. On the contrary, I know that some of the wealthiest men in this country support it. I know that Mr. Gould in an interview favored it, and I am told by the gentleman from Missouri that Mr. Carnegie favors it.[342]

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338. 26 CONG. REC. 1612 (1894).

339. *Id.* at 1620.

340. *See id.* app. at 467 (Rep. W. Bourne Cockran) (D-N.Y.); *id.* at 1599-1600 (Rep. George Washington Ray) (R-N.Y.); *id.* at 1650 (Rep. Joseph H. Walker) (R-Mass.); *id.* app. at 207 (Rep. Robert Adams, Jr.) (R-Pa.). Cockran responded to the adherents of the benefit theory that "[t]his is not a tax upon the men who have enjoyed any special benefit from the Government; it is a tax upon the men who have made the best use of the benefits which are common to all." *Id.* app. at 465.

341. The Tammany political machine in New York responded to the wishes of wealthy New York merchants and importers who favored low tariffs, but opposed taxes on the profits from those tariffs. RATNER, *supra* note 108, at 178. At the same time, the movement professed concern for the plight of the poor. STANLEY, *supra* note 22, at 118.

342. 26 CONG. REC. app. 465 (1894). Cockran was responding to a flap created when Ward McAllister, the self-proclaimed leader of a group of wealthy individuals known as the "Four Hundred," wrote a letter to the *New York World* on January 7, 1894, in which he and the group threatened to leave the country if a 2% income tax was imposed. Bryan issued the famous retort, "I have never known [a man] so mean that I would be willing to say of him that his patriotism was less than two per cent deep. [Laughter and applause]." *Id.* at 1658.

It is quite ironic that, according to one investment analyst, a Japanese entrepreneur recently remarked that he would be tempted to relocate to the United States if current efforts to adopt a flat tax are successful. *See* Sam Nakagama, *Flat Tax Would Attract Foreign Investment and Spur the Dollar*, ECONOMIC PERSPECTIVES, July 21, 1995, at 2. The crucial difference in attitude is probably attributable to the fact that present efforts suggest the possibility that investment income will be completely exempt from taxation. By contrast, tax reform in 1894 was designed to bring in-

The actions of the rich, however, belied Cockran's statements. According to Hall, the doors to the Ways and Means Committee had been "almost battered down by representatives of the manufacturing interests of the country . . . [b]ecause they know that their wealth comes from taxation."[343]

Rather than seeking a redistribution of wealth, supporters sought an income tax that was designed, like a "handmaid of tariff reform," to compensate for the tariff's regressive effects.[344] The first step was to recognize that the proposed bill utilized a variety of methods of taxation to reach a variety of classes of people. Thus, Bryan pointed out the fatal mistake made by Representative Cockran in his speech:

> You who listened to his speech would have thought that the income tax was the only Federal tax proposed; you would have supposed that it was the object of this bill to collect the entire revenue from an income tax. The gentleman forgets that the pending tariff bill will collect upon imports more than one hundred and twenty millions of dollars—nearly ten times as much as we propose to collect from the individual income tax. Everybody knows that a tax upon consumption is an unequal tax, and that the poor man by means of it pays far out of proportion to the income which he enjoys.[345]

Supporters of the income tax intended that it only "supplement"[346] the tariff tax so as to "put some little of the burden on the wealth of this country."[347] According to McMillin, "that system which gathers the taxes from divers[e] sources and which places some of its burdens upon every form of wealth, not taxing any unjustly, will be considered in the end the fairest and most just that can be devised by our people."[348] Likewise, Uriel Hall noted that, if Congress rejected the income tax, it would be declaring its willingness to lay the burdens of the tariff upon the poor, but not "to lay a feather's weight upon the great wealth of this country, . . . an argument in favor of demagogery and socialism, without righteousness for its warp and woof, and it will come back and curse us in the future."[349]

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vestment income within the realm of taxation when it previously had gone untaxed. *See* 26 CONG. REC. 3397 (1894) (statement of Indiana Senator Daniel Voorhees, who introduced the bill in the Senate, on the theory that a propensity exists for income arising from the wealthy man's bonds and other investments to escape taxation altogether).

343. 26 CONG. REC. 1611 (1894).

344. *Id.* app. at 183 (Rep. Andrew J. Hunter) (D-Ill.) (quoting the Honorable Scott Wike).

345. *Id.* at 1656.

346. *Id.* app. at 415.

347. *Id.* at 1610.

348. *Id.* app. at 415.

349. *Id.* at 1609. Stanley suggests that this and other statements by Hall indicate that income tax supporters were motivated by a desire to acquiesce to the masses and thus avoid radical change. STANLEY, *supra* note 22, at 117. In the context of the debates, however, Hall's statement was a response to the opponents' charges that suggested the income tax was a friend of socialism. In the next sentence after the above-quoted passage, Hall said, "We are called demagogues and socialists, because we advocate this measure." 26 CONG. REC. 1609 (1894). This is not to discount the conservative tendency of most members of Congress. To suggest, though, that this rhetorical turn undercuts the honesty of Hall's support for the income tax is to ignore the tricks of debating and to give short shrift to the genuine pursuit of equality based upon a proportionate system of

In Congress, opponents of the income tax protested that the tax's exemption of the majority of the population instituted another inequality.[350] Under a compensatory theory, however, these apparent inequalities did not disrupt the overall proportionality. Hall explained, "The rule of proportionality is applicable only to the whole tax system and it may be necessary to have several partial inequalities in order to establish that final equality."[351] Since the poor "contribute more than their share to the maintenance of the state" through consumption taxes, an exemption was necessary.[352] In light of the substantial consumption tax imposed by the tariff, taxing incomes $4,000 or less, therefore, amounted to a form of "double taxation."[353] One Representative even suggested that a graduated income tax was necessary because the exemption alone would not compensate the poor for their burden under the regressive tariff tax.[354] Democrats argued that, as long as we assume that "the duties on articles of common consumption are productive," it is desirable to exempt altogether smaller incomes from the tax.[355]

Although some suggested that the exemption was itself a form of graduation,[356] more explicit graduation was rejected. With prices at their lowest levels since before the Civil War,[357] it was difficult to argue under the compensatory theory that the tariff taxes required a graduated tax. As Sherman predicted in 1870, the economic crisis of the 1890s focused people's attention on the inherent inequality of the regressive consumption tax system. There was not the same fervor for a graduated tax, however, as there had been under the rampant inflation during the war. The general impression was that an income tax with a healthy exemption was all that was required to counterbalance the regression in the system. This is not to say, though, that a graduated income tax was not advocated at all. For example, Representatives Lafe Pence from Colorado and Joseph C. Sibley from Pennsylvania both introduced amend-

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taxation.

350. Cockran, in a rhetorical twist born out of his Tammany leanings, argued, "I oppose this bill because I will not consent by any act of mine to place the humblest or the poorest of my fellow-citizens on a political plane one shade lower than that occupied by the richest and the proudest." 26 CONG. REC. app. 465 (1894); *see also* STANLEY, *supra* note 22, at 118.

351. 26 CONG. REC. 1612 (1894) (citation omitted).

352. *Id.*

353. *Id.* at 1791.

354. Representative Lane reached this conclusion through the following logic:

> All exemptions of incomes under $4,000 are assumed to be consumable incomes and will be used in the support of families. This being so, and the Wilson bill providing for a tariff tax of $130,000,000, which is a tax on consumption, the $4,000 exempted will be liable for its just proportion of the tariff duties under the Wilson bill, which still averages 30 per cent. So even under the income tax, wealth does not yet bear its fair proportion of taxation. We should have a graduated income tax that would yield yearly nearly $100,000,000 and not $30,000,000, as is provided in the bill which we are about to pass.

Id. at 1755.

355. *Id.* at 1612 (citation omitted).

356. *Id.* at 1611. Responding to charges that he was not in favor of the principal of a graduated tax, Hall stated, "I believe that this tax is a graduated income tax. If a man has $5,000 a year he pays a tax on $1,000, or $20; if he has an income of $10,000 he pays on $6,000, or $120; and the gentleman will see that that is a graduated tax." *Id.*

357. According to the Federal Reserve Bank of New York, the cost-of-living index was at 61 in 1860, 103 in 1866, and back down to 73 in 1894. HISTORICAL STATISTICS, *supra* note 157, at 212 (Series E 183-186).

ments to graduate the income tax.[358] Others also spoke in support of a graduated tax in various forms. Income tax supporters balked, however, when they saw that the proposals were intended to redistribute rather than compensate. Hall asked of Sibley "whether he believes it is a safe principle of national legislation for us to declare that we will use the taxing power not for purposes of revenue, but for the purpose of preventing men from accumulating wealth?"[359] In the end, all amendments proposing a graduated income tax were defeated handily and the motion to adopt the income tax as an amendment to the tariff bill passed 175 to 56.[360]

When the tariff bill itself was put up to a vote, advocates of the income tax based their support on the compensatory theory. Wilson defended the income tax against charges of class legislation "by declaring that the income tax was simply an honest first effort to balance the weight of taxation so that it would not be carried exclusively by the poor consumers of the country who had hitherto borne it all."[361] Thus, support for both the tariff bill, with its attempt to reduce the burdens on the poor, and for the income tax, with its attempt to impose some burdens on the rich, was consistent with the desire to nudge the country further towards a proportionate system of taxation. Not surprisingly, Stanley found in his analysis of the roll call votes that support for these two measures "went hand in hand."[362] The income tax proponents had simply switched allies from the pro-tariff forces in the 1870s to the tariff reform forces of the 1890s. Hence, both the consumption tax, and the tariff, or internal tax, were now susceptible to attack.[363] In both cases, however, the House perceived the income tax as a critical part of the overall makeup of the federal revenue system.

When debate in the Senate commenced in March 1894, opponents of the income tax quickly sought to rebut the notion that the income tax was needed to counterbalance the effects of the tariff. Nevertheless, the force of the compensatory theory's logic prevailed. On April 2, 1894, Senator Daniel Voorhees

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358. Pence proposed a tax which went up to 5% on incomes exceeding $100,000. 26 CONG. REC. 1730 (1894). Sibley proposed a substitute for Pence's amendment which raised the exemption to $10,000 and imposed a upper rate of 10% on incomes above $200,000. *Id.* For expressions of support, see *id.* at 1656, 1664, 1731, 1733, 1755; *id.* app. at 183 (Rep. Andrew J. Hunter) (D-Ill.).

359. *Id.* at 1730.

360. Pence's motion was defeated 112 to 66. *Id.* at 1739; RATNER, *supra* note 108, at 179-80.

361. RATNER, *supra* note 108, at 180.

362. STANLEY, *supra* note 22, at 129.

363. *See* Scott A. Taylor, *Corporate Integration in the Federal Income Tax: Lessons from the Past and a Proposal for the Future*, 10 VA. TAX REV. 237, 268 (1990). Given the fact that the pro-free-trade Democrats secured simultaneous control of the Presidency and Congress in 1892 for the first time since the Civil War, it was not surprising that income tax paired with tariff reform this time around. *See* V.O. KEY, JR., POLITICS, PARTIES, & PRESSURE GROUPS 170 (5th ed. 1964). Seligman reported that members of Congress initially looked to the prospect of increasing internal taxes to compensate for the reduction in revenues from tariff reform. SELIGMAN, *supra* note 30, at 505-06. That, however, would have left Democrats without the considerable benefit of an alliance with income tax supporters. This did not mean, however, that the Democratic supporters of the income tax did so only for revenue purposes. Quite the contrary, "correcting inequalities in the tax system" was their true goal. *Id.* at 506.

of Indiana began his introduction of the bill in the Senate in much the same manner as the bill had left the House. He explained:

> On all the wants and necessaries of life the man of wealth, with a heavy income, pays less rates of tariff tax under existing laws than the laboring man or laboring woman. . . . His bonds, his accumulated riches of all kinds, and all incomes arising from them, are exempt from all Government burdens, remaining not only undiminished and unmolested amidst darkened homes and flagrant distress, but growing fatter, stronger, and more defiant as the days and the years go by.[364]

Voorhees asked, "What is there in our system of government, or in the democratic principles on which it is founded, that exempts the rich from contributing to its support according to their means?"[365] As in the House, opponents of the income tax argued the inequality of the tax's exemption. New York Senator David B. Hill, the governor of New York from 1885 to 1891 and the chief power in the New York Democratic machine,[366] argued, "If incomes are properly taxable, then all incomes should be taxed, of whatever amount, taxed proportionally, without favoritism to any individual or class."[367] Hill argued further that a consumption tax is "the least injurious point of taxation" since consumption taxes are "self-assessed."[368] Finally, in an attempt to turn the compensatory theory against the income tax, Hill applied it to reach a different conclusion than that reached by income tax supporters. Hill reasoned that at the state and local level it was the poor, not the rich, who were escaping their due share of taxation.

> [T]he poor man who owns no real estate or personal property pays nothing directly toward State, county, or municipal taxation . . . if it were not for custom-house taxation, [the poor] would pay not a farthing toward the support of the Government which protects him and under which he enjoys the blessings and privileges of a free and independent citizen. It is through this much-abused system of tariff taxation . . . that we are enabled to equalize somewhat the burdens of government.[369]

In a similar fashion, Senator Sherman, still active twenty-five years after his service during the Civil War, attempted to justify his rejection of the income tax.[370] Sherman focused on the state's ability to levy an income tax, rather than its use of a property tax. Thus, he did "not deny that on general principles of equality and justice the incomes of the rich should contribute their full

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364. 26 CONG. REC. 3397 (1894).
365. *Id.* at 3398.
366. RATNER, *supra* note 108, at 185.
367. 26 CONG. REC. 3559 (1894).
368. *Id.* at 3565.
369. *Id.*
370. Many members of Congress in both the House and Senate eagerly quoted Sherman's famous defenses of the income tax after the Civil War to support their arguments and to take jabs at one of the Senate's fiercest supporters of the tariff. *See id.* at 1612, 1618, 1791, 5381; *id.* app. at 183. What likely accounts for Sherman's change of heart is that the tariff fell in disfavor during the interim.

share of taxes."[371] Absent a national crisis requiring an increase in revenue, however, Sherman suggested that the states, rather than the federal government, should institute an income tax to equalize these burdens.[372]

The fallacy in these arguments was easily exposed. As Seligman later explained, "In theory the system of state and local taxation is calculated to reach the respective abilities of the property-owners; but in practice, as has repeatedly been pointed out, the general property tax has broken down completely; and, especially so far as personal property is concerned . . . ."[373] Moreover, state income taxes, championed by Sherman as the best solution, were far from realistic. With a few exceptions, most Civil War income taxes in the states were "allowed to lapse after the close of the war," not to be revived until after 1895.[374] Moreover, "because of the historically poor record of income tax administration by a number of states,"[375] few advocated state income taxes. Given these realities, and the notion that the real evil was the tariff,[376] the Senate was unwilling to dispense with the compensatory theory as support for the income tax. Georgia Democrat Patrick Walsh added to these doubts, noting that the poor already contributed their fair share to state and local governments through indirect taxes.[377] Thus, at the conclusion of the Senate debates, the Senate accepted the income tax provision, although the tariff plan was practically amended to death.[378]

Like the House, the Senate refused to adopt the proposals to graduate the tax. Populist Senators William A. Peffer of Kansas and James H. Kyle of South Dakota each proposed a graduated income tax. Peffer suggested an income tax ranging from 1% on incomes over $2,000 to 5% on incomes over $100,000.[379] Neither Peffer nor Kyle's suggestion received much consideration, however. Peffer's motion was tabled by the overwhelming vote of 45 to 5, with only Populists opposing the motion to table.[380] Stanley suggests that

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371. *Id.* at 6694.

372. *Id.*

373. SELIGMAN, *supra* note 30, at 640.

374. *Id.* at 414.

375. CLARA PENNIMAN, STATE INCOME TAXATION 6 (1980).

376. Sherman stated, "The pretext for this measure is that some faults are found in the McKinley act." 26 CONG. REC. 6694 (1894).

377. *Id.* at 5382. This was a reference to the common suggestion that all taxes, save the income tax, were easily shifted to someone else, usually the poor, through their eventual inclusion in the price. Thus, a farmer or merchant's prices reflected his property taxes. *See* EDWIN R.A. SELIGMAN, ON THE SHIFTING AND INCIDENCE OF TAXATION (1899); Herbert Hovenkamp, *The First Great Law & Economics Movement*, 42 STAN. L. REV. 993, 1006-07 (1990) (collecting citations). In the House, Representative McDannold noted, "This is the lesson that the people have learned of the incidence of taxation. They want a tax that will stay put. [Laughter.]" 26 CONG. REC. 1616 (1894).

378. Wilson-Gorman Tariff Act, ch. 349, § 32, 28 Stat. 509, 556-57 (1894). In a display of special interest politics which would astonish even modern politicians, the Senate made no less than 634 amendments to the tariff portion of the bill, raising rates on many items. To show his displeasure, President Cleveland permitted it to become law without signing it. KOENIG, *supra* note 315, at 132-33; RATNER, *supra* note 108, at 189. By foregoing the veto, Cleveland prevented the McKinley Tariff Act from remaining in place. STANLEY, *supra* note 22, at 136.

379. *See* 26 CONG. REC. app. 666 (1894) (Rep. William A. Peffer) (Populist-Kan.); *id.* at 6689 (Rep. James H. Kyle) (Indep.-S.D.).

380. STANLEY, *supra* note 22, at 131.

the rejection of a graduated tax indicates that Democrats thought the income tax a rhetorical ploy.[381] Taking a more neutral tone, Blum and Kalven conclude that graduation was rejected in 1894 because it had not won "widespread public acceptance" after the Civil War experiment.[382] Neither of these analyses, however, is accurate. Instead, the rejection of a graduated income tax is best understood by considering the economic conditions at the time. This perceived change in economic conditions from 1864 to 1894 led most Democrats to believe that a flat income tax compensated for the burdens of the tariff during this sustained period of deflation. Hence, the income tax was principally designed to reach a class of the population which was virtually escaping taxation altogether. It elevated the overall tax rates of those who, under the consumption tax system, had paid a much lower percentage of their incomes to the government than the poor. Seligman, in discussing the 1894 Act, reminded his readers of this fact with regard to the income tax's relatively large exemption:

> It must indeed not be forgotten that we should look at the income tax as a branch of the whole revenue system. Much may accordingly be said in mitigation of this seeming injustice. As we pointed out above, the burden of taxation—that is, of the tariff and the local property tax—is borne primarily by the lower middle class, more especially by the farmers. Even though $4,000 be not a minimum of subsistence, it nevertheless represents in large part the income of a class which is on the whole unfairly treated at present.[383]

It is revealing that Stanley provides no evidence that income tax supporters, other than the Populists, signalled a commitment to explicit wealth redistribution, as opposed to burden redistribution, in their advocacy of the income tax.[384]

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381. *Id.*

382. BLUM & KALVEN, *supra* note 33, at 12.

383. SELIGMAN, *supra* note 30, at 524. While Seligman concluded that the exemption was indeed too high, he pointed out that the exemption in England was even higher. *Id.*

384. *See* Joseph Bankman, *The Politics of the Income Tax*, 92 MICH. L. REV. 1684, 1689 (1994) (reviewing Stanley's *Dimensions of Law*) ("Stanley presents no evidence, however, to suggest that the public perceived the income tax to be anything other than it was . . . . It seems unlikely that the masses saw redistribution of wealth as an intended purpose or probable effect of the tax."). Thus, Stanley's frequent complaint that the 1894 Act, and the acts which preceded and followed it, contributed only minimally to revenues, is a bit off the mark. *See* STANLEY, *supra* note 22, at 134. The tax was not a revenue measure per se. In fact, coupled with the original reductions in the tariff, the measure could not have been expected to increase overall revenues much at all. However, when viewed as an attempt to require those 85,000 people with incomes over $4,000 to begin paying a more proportionate share of the burden, it elevates in significance. *See* 26 CONG. REC. 3398 (1894) (Sen. Daniel Voorhees) (D-Ind.) (citing an estimate of the Commissioner of Internal Revenue on the number of individuals with incomes above $4,000 out of the 65,000,000 then in the U.S.). In fact, according to Stanley's estimate, under the 1894 Act, .13% of the population was supposed to account for 3.97% of the government's overall revenues. *See* STANLEY, *supra* note 22, at 133 (Table 3-7) (Stanley cites an even lower percentage of the population, only .1%, rather than the .13% one arrives at using Senator Voorhees's numbers). If we assume that everyone contributes an equal amount under a consumption tax (which errs in Stanley's favor since many argued that the poor's goods were taxed more heavily and that the poor had larger families), then those 85,000 had their tax burdens increased substantially. As Bankman notes, "[D]ue to high exemption levels, the taxes were quite progressive and were large

Moreover, it is hard to imagine, especially when given the relative popularity of the compensatory theory, that the flat income tax was just a rhetorical ploy. Indeed, employing the income tax as a counterweight for the regressive effects of the tariff appeared to coincide with proponents' understanding of the income tax's role in the federal revenue system. According to Stanley, the *Atlanta Constitution*, for example, argued in June 1893 that the income tax "is in direct contrast with most of our tariff taxes which fall heavier on the poor than the rich, the taxes on necessaries being proportionately much heavier than those on luxuries;" the paper aptly noted that the income tax "is like a border to a carpet, . . . it completes the equipment."[385] Similarly, Representative Kyle read an article on the floor of Congress from the *Chicago Times* of April 18, 1894, which reported that "[i]t is characteristic that the attack upon the income tax was coupled with an attack upon free trade."[386] The *New York World*, and a host of other papers, agreed with this analysis. The *World* argued that "the humbler classes have at last discovered the secret of the extortion, and they demand a readjustment of burdens, adapting the share of each more nearly to the benefits received and the ability to pay."[387]

After having been prominent during the country's last debates, the compensatory theory was also undergoing a revival of sorts in academia.[388] In fact, Columbia's Edwin R.A. Seligman, said to be "the most imposing intellectual edifice in favor of graduated taxation,"[389] wrote many of his most prominent works during this period.[390] In June 1893, as the country edged closer to an income tax, Seligman wrote an article in the *Political Science Quarterly* on "The Theory of Progressive Taxation" in which he argued that a graduated income tax would "help round out the existing tax system in the direction of greater justice."[391] As he later said, the progressive income tax acts as "an engine of reparation" in the overall system.[392] Seligman was not alone in his recognition of the value of this theory. An 1891 essay contest sponsored by the journal *Public Opinion* revealed the compensatory theory's currency in the

enough, relative to other taxes, to alter the distribution of the aggregate tax burden." Bankman, *supra*, at 1689-90.

385. STANLEY, *supra* note 22, at 120 (citation omitted).

386. 26 CONG. REC. 6689 (1894) (Rep. Kyle) (citation omitted). Thus, according to Kyle, the *Times* predicted that the income tax in the United States "will be even more popular than in England, because under our system of raising the bulk of our revenues by tariff duties the inequalities of taxation are more glaring." *Id.*

387. STANLEY, *supra* note 22, at 120 (citation omitted).

388. *Id.* at 121.

389. *Id.* at 126. Herbert Hovenkamp has called Seligman, "the most prominent public finance economist of his day," and "[t]he Progressive Era economist with the greatest explicit influence on judicial policymaking." Hovenkamp, *supra* note 377, at 1004.

390. Joseph Dorfman, *Edwin Robert Anderson Seligman*, *in* DICTIONARY OF AMERICAN BIOGRAPHY 606, 607 (Robert L. Schuyler & Edward T. James eds., 1958).

391. Edwin R.A. Seligman, *The Theory of Progressive Taxation*, 8 POL. SCI. Q. 220, 222 (1893), *quoted in* STANLEY, *supra* note 22, at 127. It is often said, quite correctly, that Seligman subscribed to a justification of progression for its own sake based upon what he called the "faculty" theory, a variant of the sacrifice theory, which found that, on balance, people valued luxuries more than comforts, and comforts more than necessities. Taxation should thus be graduated to take into account this logic. *See* SELIGMAN, *supra* note 30, at 638; Hovenkamp, *supra* note 377, at 1005.

392. SELIGMAN, *supra* note 64, at 708.

field. The top two essays each utilized the compensatory theory in fashioning a plan for tax reform. The first prize winner, a 19-year old Wharton student, argued that "the nearest approach to equality will result from a coordination of the systems of federal, state, and local taxation, in order by this compensatory method to minimize injustice."[393] On the question of the progression principle, he noted that "the American people would not easily be reconciled to any other than a proportional income tax with an exemption of the smaller incomes."[394] The second prize winner, a 29-year old author and journalist, argued for a graduated income tax "as an offset to the disadvantages of the poor from all taxation measured by consumption."[395]

Despite its sound basis in economic theory, the 1894 income tax law was defeated by constitutional law principles. Although the tax was scheduled to take effect on January 1, 1895 and continue until January 1, 1900,[396] it was never implemented. Almost immediately after its scheduled start, two shareholder suits were filed in federal court in New York to prevent their respective corporations from paying the tax.[397] The case, *Pollock v. Farmers' Loan and Trust Co.*, was argued by some of the most prominent corporate lawyers of the day, including William D. Guthrie, Clarence A. Seward, and Joseph H. Choate.[398] *Pollack* involved a replay of many of the same issues discussed during the enactment of the income tax in Congress. Guthrie claimed that the Act was unconstitutional in one of two ways: If it was a direct tax, it was not apportioned among the states, and if it was an indirect tax like a duty, impost or excise, it was not uniform because of many discriminations, including the exemption for incomes less than $4,000.[399] Assistant Attorney General Edward B. Whitney grounded his defense of the Act upon the compensatory theory:

> It is impossible to construe this law and discuss its constitutionality or application without understanding its underlying principle. This principle is one of compensation. Certain principles of taxation are well settled, and almost universally recognized: first, that taxes on consumption bear unduly hard upon the poor and upon what is called by the economists the lower middle class, financially speaking, because the comparatively poor consume all or nearly all of their income; second, that the fairest method of equalizing taxation is by an income tax with an exemption of all incomes below a certain amount. . . . This exemption approximately represents the incomes which, prior to

393. Walter E. Weyl, *in* EQUITABLE TAXATION 28 (T.Y. Crowell & Co. 1892).

394. *Id.* at 29.

395. Robert Luce, *in* EQUITABLE TAXATION, *supra* note 393, at 44.

396. RATNER, *supra* note 108, at 191.

397. The cases were consolidated before the Supreme Court under the name Pollock v. Farmers' Loan & Trust Co., 157 U.S. 429 (1895). As originally filed, the other case was *Hyde v. Continental Trust Co. See* WITTE, *supra* note 79, at 73 n.14.

398. BUENKER, *supra* note 45, at 16. Guthrie, called the "lion of Wall Street," raised the money for the lawsuit among his clients and found a willing litigant in Charles Pollock. FRIEDMAN, *supra* note 108, at 566.

399. *Pollock*, 157 U.S. at 448. In addition to the explicit discrimination between individuals above and below $4,000, individuals only paid on the excess over $4,000 while corporations paid a tax on the whole amount. *Id.*

> the establishment of the income tax, bore more than their fair share of taxation.[400]

Thus, Whitney continued,

> [t]he whole attack on the justice of this minimum feature is based upon a fundamental fallacy; upon the notion that the income tax stands alone instead of forming a part of a general fiscal system, the different parts of which are set to balance each other in approximation to that equality which in its perfection is "a baseless dream."[401]

Similarly, James C. Carter, attorney for the Continental Trust Company, which was the only private party defending the income tax, argued that the Act's "object was to redress in some degree the flagrant inequality by which the great mass of the people were made to furnish nearly all the revenue, and leave the very wealthy classes to furnish very little of it in comparison with their means."[402] It was clear that the compensatory theory inundated the legal understanding of equality in taxation in these arguments.

Despite the Attorney General's observation that the plaintiffs' "main reliance" was upon the Act's lack of uniform application,[403] the Court by a 6-2 vote[404] held the Act unconstitutional on the ground that it was an unapportioned direct tax.[405] On rehearing, the Court made clear that the ability of an income tax to reduce the burden on consumption was not properly the concern of the judiciary.[406] Thus, despite the vigorous dissent of four justices,[407] as

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400. *Id.* at 475-76 (argument of Mr. Whitney).

401. *Id.* at 476 (argument of Mr. Whitney) (quoting *Head Money Cases*, 112 U.S. 580, 595 (1884)).

402. *Id.* at 517 (argument of Mr. Carter).

403. *Id.* at 504.

404. Justice Howell Jackson was absent from this first decision. BUENKER, *supra* note 45, at 19.

405. *Pollock*, 157 U.S. at 572. Article I of the Constitution provides, "No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken." U.S. CONST. art. I, § 9. The rule of apportionment, a compromise borne in part out of the divide between small and large states and in part out of the question of how to count slaves, requires that direct taxes such as poll or property taxes be apportioned between the states according to each state's population. SELIGMAN, *supra* note 30, at 594. In this manner, large and powerful states are prevented from imposing all the taxes on the smaller states. Indirect taxes, though, like the carriage tax in Hylton v. United States, 3 U.S. (3 Dall.) 171 (1796), were not subject to the rule of apportionment as part of the state's compromise in ceding the right to tax directly. Today, the concept of apportionment in taxation arises most frequently in the related matter of state taxation of interstate commerce. *See, e.g.*, Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 115 S. Ct. 1331, 1337 (1995).

406. Pollock v. Farmers' Loan & Trust Co., 158 U.S. 601, 634 (1895). Justice Field, in his concurrence to the original opinion, had compared the $4,000 exemption to an "arbitrary discrimination" against Catholics and Jews. *Pollock*, 157 U.S. at 596 (Field, J., concurring). In perhaps a fit of self-interest, Field also had taken a shot at the Act's authorization of a tax upon the salaries of federal judges. *Id.* at 604.

407. The dissenting justices were Harlan, Jackson, Brown, and White. Jackson wrote that the decision had the effect of "relieving the citizens having the greater ability, while the burdens of taxation are made to fall most heavily and oppressively upon those having the least ability." *Pollock*, 158 U.S. at 705 (Jackson, J., dissenting). Harlan, in perhaps the most impassioned of the dissents, wrote:

> [U]ndue and disproportioned burdens are placed upon the many, while the few, safely entrenched behind the rule of apportionment among the states on the basis of numbers,

well as seemingly controlling authority in five prior cases,[408] the Court struck down the income tax on May 20, 1895. In a letter to his sons four days later, dissenting Justice John Marshall Harlan wrote that *Pollock* "will become as hateful with the American people as the *Dred Scott* case was when it was decided. . . . [It will] make the freeman of America the slaves of accumulated wealth."[409]

The enactment and demise of the 1894 Act reveals a solidification of the compensatory theory. The perceived need to compensate for consumption taxes, ever-present since the end of Reconstruction, was magnified when the apparent improprieties of the wealthy combined with the Panic of 1893 to highlight the lopsided distribution of the tax burden. Unlike the Civil War taxes, which were graduated to compensate for the high prices induced by the tariff and other consumption taxes, the 1894 Act was a flat tax designed to ensure that the wealthy suffered their proportionate share of the burden. While there is much discussion about the causes for the income tax's repeal in *Pollock*,[410] what is clear is that, despite the invitation of the plaintiffs' attorneys, the case did not question Congress's authority to balance the burdens of taxation through a progressive income tax.

III. THE SIXTEENTH AMENDMENT AND THE ACT OF 1913

A combination of factors led to the re-emergence of the income tax as a desirable method of taxation in the decade-and-a-half after *Pollock*. Starting around 1897, there was a gradual but significant increase in the cost-of-living to the highest levels since the Civil War, an increase for which the tariff received the primary blame. A second factor was the Panic of 1907, after which the tariff-reform Democrats, pro-income tax Progressives, and Insurgent Republicans ascended to positions of control and influence. The result was the enactment of the Sixteenth Amendment and the graduated income tax in the Underwood/Simmons Tariff Act of 1913. Much like the Civil War income taxes, the progressive rates were a response to the perception that the tariff was burdening the poor, in the form of higher prices, with more than their fair share of taxes. Thus, consistent with the country's tradition, the income tax in the Act of 1913 was used to achieve the goal of a flat or proportionate rate tax system.

> are permitted to evade their share of responsibility for the support of the government ordained for the protection of the rights of all.

Id. at 685 (Harlan, J., dissenting).

408. Justice White cited five cases for the proposition that the phrase "direct taxes" in the Constitution was intended to refer only to land: Hylton v. United States, 3 U.S. (3 Dall.) 171 (1796) (carriage tax); Pacific Insurance Co. v. Soule, 74 U.S. (7 Wall.) 433 (1868) (insurance company receipts tax); Veazie Bank v. Fenno, 75 U.S. (8 Wall.) 533 (1869) (bank notes tax); Scholey v. Rew, 90 U.S. (23 Wall.) 331 (1874) (inheritance tax); and Springer v. United States, 102 U.S. 586 (1880), which held that a Civil War income tax was not a direct tax and therefore did not need to be apportioned. *See Pollock*, 158 U.S. at 711.

409. Kornhauser, *supra* note 297, at 141 (citing David G. Farrelly, *Justice Harlan's Dissent in the* Pollock *Case*, 24 S. CAL. L. REV. 175, 180 (1950)).

410. *See, e.g.*, BUENKER, *supra* note 45, at 18-22; FRIEDMAN, *supra* note 108, at 566-67; RATNER, *supra* note 108, at 193; STANLEY, *supra* note 22, at 138.

Although deflation characterized the period before the 1894 Act, the nation saw the beginning of sharp price increases at the end of the century. It is estimated that prices increased nearly 33% between 1897 and 1913, an average of 2.3% annually.[411] The rise was more dramatic for necessities. Staples such as lard, linseed oil, flour, and butter increased in price from 45% to 184%.[412] As a result, the cost-of-living index rose from 73 in 1894 to 102 in 1912, its highest level since the Civil War.[413] More important than any actual rise in the cost-of-living, though, was the fact that Congress saw the need to respond. The Senate Select Committee on Wages and Prices of Commodities, chaired by staunch Republican Standpatter Henry Cabot Lodge of Massachusetts, wrote that "retail prices in the United States in the spring of 1910 were for many articles at the highest point recorded for many years."[414] The House Ways and Means Committee acknowledged even more dramatic concern in 1913, stating that "probably the most striking economic change since 1897 has been the tremendous increase in the cost of living—a situation which has attracted the anxious attention of economists the world over."[415]

Compounding this problem was the failure of wages to keep pace with the rise in the cost-of-living. Union wages, for example, increased by 14% from 1898 to 1907, while the cost of living rose by between 20% and 25% in the same period. One study concluded that "the purchasing power of wages increased only about sixteen percent while prices rose 36.8 percent."[416] The Senate Select Committee found that "wages have not advanced as rapidly as have prices and practically all labor difficulties which have been the subject of mediation in the United States during the past few years have had as their basis the advanced cost of living."[417]

Many blamed this inflation on the reinstitution of highly protective tariffs after the 1896 elections. Although tariff reform could not have been responsible for the Panic of 1893, Republicans seized on the Panic's lingering effects as a consequence of the declared retreat from protectionism.[418] In this man-

411. BUENKER, *supra* note 45, at 33.

412. *Id.* at 33-34.

413. HISTORICAL STATISTICS, *supra* note 157, at 212. Other indexes showed a similar rise. According to Burgess's index, the cost-of-living rose from 63.9 in 1897 to 100 in 1913; according to Douglas's index, it rose from 97 in 1894 to 137 in 1913; and according to Rees's index, it rose from 83 in 1897 to 99 in 1913. *Id.*

414. BUENKER, *supra* note 45, at 34 (quoting the Senate Select Committee on Wages and Prices, chaired by Standpat Republican Henry Cabot Lodge of Massachusetts) (citation omitted).

415. *Id.* With the House Ways and Means Committee under Democratic control by 1913, it is likely that the more dramatic rhetoric was motivated by partisan interests. *See* George E. Mowry, *Election of 1912, in* THE COMING TO POWER 264, 292 (Arthur M. Schlesinger, Jr. et al. eds., 1971).

416. BUENKER, *supra* note 45, at 34; HISTORICAL STATISTICS, *supra* note 157, at 212 (Series E 183-186). Although Albert Rees disproved the commonly held belief that wages remained stagnant between 1890 and 1914, it is clear that the rise in wages which did occur failed to increase workers' purchasing power appreciably. *See* RATNER ET AL., *supra* note 70, at 309 (citing ALBERT REES, REAL WAGES IN MANUFACTURING, 1890-1914 (Princeton 1961)).

417. S. REP. NO. 912, 61st Cong., 2d Sess., pt. 2, at 28 (1910), The number of strikes had indeed increased during the period, although the success rate had dropped from 50% to 36%. There were 3,100 strikes between 1911 and 1915, while there were only 530 strikes during the much longer period between 1881 and 1895. RATNER ET AL., *supra* note 70, at 317.

418. ASHLEY, *supra* note 85, at 219; KEY, *supra* note 363, at 170-71.

ner, the Republicans regained control of both houses of Congress during the midterm elections of 1894, and, with the election of William McKinley, took back the Presidency in 1896.[419] The Republicans viewed their victory as a "mandate for a high protective tariff."[420] As such, McKinley made good on his promise to erect a protective tariff in 1897 with the passage of the "strongly restrictive" Dingley Tariff Act.[421] The resulting high tariff rates came back to haunt Republicans, however, when prices began their ascent. Democrats, who capitalized on the perception that the protective tariff was to blame for high prices, called for, in their 1912 platform, "downward revision of tariff duties on grounds that existing rates made 'the rich richer and the poor poorer,' and accounted for 'the high cost of living' that plagued American families."[422] Although protectionists attempted to turn the blame against the poor and dismiss their woes as "the cost of high living,"[423] the weight of the blame fell on the tariff.[424] Moreover, despite Republican denials, leaders in both parties "agreed that the electorate's association of the rising cost of living with Republican insistence upon a high protective tariff was the single most important political issue of the day."[425]

This long-term discontent leaped to the forefront of the public's mind after the Panic of 1907.[426] This panic, which was triggered initially by the

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419. Fite, *supra* note 310, at 225, 256.

420. RATNER ET AL., *supra* note 70, at 390.

421. BENDER'S FEDERAL REVENUE LAW, *supra* note 85, at 357; KEY, *supra* note 363, at 174. The Act instituted an average rate on dutiable goods, 52%, which was the second-highest in American history. RATNER ET AL., *supra* note 70, at 390.

422. LEROY ASHBY, WILLIAM JENNINGS BRYAN: CHAMPION OF DEMOCRACY 138 (1987); BUENKER, *supra* note 45, at 35.

423. John Buenker attributes this phrase to James J. Hill. BUENKER, *supra* note 45, at 35. Lodge's Committee similarly attempted to evade this link, contending "that 'the tariff seems to have been no national factor in causing the advance in prices during the past decade,' blaming it on the desire to 'keep up with the changing styles in clothing and shoes.'" *Id.* (quoting the Lodge Committee) (citation omitted). Obviously, it is difficult to win over allies to protectionism by insulting their spending habits.

424. Economic historians Paul Studenski and Herman Krooss note, "Rightly or wrongly, the urban population blamed the tariff for the current rise in prices." *See* BUENKER, *supra* note 45, at 37-38 (citing PAUL STUDENSKI & HERMAN E. KROOSS, FINANCIAL HISTORY OF THE UNITED STATES 270-71 (1963)).

425. *Id.* at 37.

426. Stanley dismissed the long-term discontent and focused exclusively on the action taken after the Panic of 1907. Noting the cyclical nature of the bills introduced and articles written on the income tax, he argued that the primary impetus behind the Sixteenth Amendment and the Revenue Act of 1913 was the desire to quell the depression's ensuing social instability. STANLEY, *supra* note 22, at 183. While I agree with Stanley that this refutes the traditional understanding that the Amendment was exclusively the result of a Progressive movement after *Pollock*, I think it ascribes too much force to the Panic itself. Stanley himself admits that President Theodore Roosevelt expressed his support for an income and inheritance tax in 1906, well before any sign of instability. *Id.* at 186. The American Federation of Labor Convention in 1906 also called for an income tax as a way to more equitably share the burdens of taxation, and the Democrats had called for an income tax in their party platform in every year but 1904, when they instead strengthened their antitrust provisions. BUENKER, *supra* note 45, at 42, 45. Furthermore, while the continuing high cost of living was still a source of tension in 1913, the nation's overall return to prosperity and drop in unemployment hardly resembles the conditions of the violent Pullman strikes in 1894. *See* Mowry, *supra* note 415, at 264. The Panic was important for its effect of sharply focusing attention on the inequality of the tax system which had been a nagging undercurrent since the 1890s.

failure of the Knickerbocker Trust Company and the Trust Company of America, extended through 1909.[427] During this period, relief applications increased five-fold in some cities and the manufacturing and construction industries severely cut back their labor forces.[428] Perhaps the greatest impact of the Panic, though, was its function as a vehicle for reform. The Aldrich-Vreeland Act of 1908 and the Federal Reserve Act of 1913 were proposed because of concern for the system's inability to provide adequate capital markets due to monetary inelasticity—a principal worry of the Populists during the 1890s.[429] The tariff reform area underwent similar changes, as both parties pledged support for tariff reform in the 1908 elections, and the Republicans promised to hold a special session of Congress on the subject during the next term.[430] Moreover, presidential candidates William Jennings Bryan and William Howard Taft expressed their support for an income tax, with the eventual victor, Taft, declaring in his acceptance speech that it was both constitutionally permissible and potentially desirable to have an income tax in conditions of urgent need.[431] The issues of tariff reform and the income tax were once again inextricably linked.

On March 4, 1909, Taft formally called a special session of Congress dedicated to the issue of tariff reform.[432] Later termed "one of the most contentious and significant special sessions in the history of the national Legislature," it illustrated the political breakdown which had arisen from the income tax's seeming unavailability as a method of compensation for the tariff.[433] Republicans ostensibly dominated both houses of Congress,[434] but a rift was growing in their ranks. Regular Republicans, or "Standpatters," followed the traditional party line of high protectionism. A small group of Republicans in Congress, however, were straying from this stance. Known as "Insurgent" Republicans, these primarily Western Representatives and Senators believed in

427. STANLEY, *supra* note 22, at 184.

428. *Id.* at 185.

429. GOODWYN, *supra* note 297, at 518-19. The Aldrich-Vreeland Act authorized groups of banks threatened by depositor panic to issue a form of emergency currency backed by certain types of their loan and investment assets. It also provided for the establishment of a National Monetary Commission to study and recommend more permanent changes, which eventually included the Federal Reserve Act. *See* RATNER ET AL., *supra* note 70, at 366.

430. Republicans offered tariff "revision" without promising reductions, while the Democrats explicitly promised tariff reductions. STANLEY, *supra* note 22, at 185-86. *See* BLAKEY & BLAKEY, *supra* note 337, at 23-24. Representative James, a Kentucky Democrat, later offered his explanation for the Republicans' promise of a special session rather than immediate action:

> The reason the Republican party would not reform the tariff before the election was they knew if they did reform it in the interests of the people, the corruption fund, which they were so used to receiving, would be denied them by the favored few with whom they were in partnership. They knew if the legislation was in the interests of monopolies, as it now is, the people would rebuke them, so they put it off until after the election.

44 CONG. REC. 4399 (1909).

431. BUENKER, *supra* note 45, at 54; STANLEY, *supra* note 22, at 186-87. For Taft, even this minimal concession was a break from most Republicans and had not been a part of the party platform. *See* Hobbs, *supra* note 179, at 453.

432. STANLEY, *supra* note 22, at 190.

433. BUENKER, *supra* note 45, at 57.

434. In the 61st Congress, Republicans held a 214-175 majority in the House and 60-32 majority in the Senate. *Id.* at 58.

a more popularly-centered focus of government, free of special perks and favors for big business. On the tariff, Insurgents sought a more "scientifically" drawn tariff policy which pinpointed protection for "legitimate" industries.[435] Although the Insurgents did not endorse a tariff for revenue only, they were allied with the Democrats in their support of an income tax on grounds of "tax equity."[436]

Given this changing political landscape, Republicans could not avoid the income tax issue when House Ways and Means Chair Sereno Payne of New York introduced a tariff bill coupled with an inheritance tax.[437] Democratic Senator Joseph W. Bailey of Texas, who was faced with tariff bills which failed to meaningfully address the cost of living issue and an inheritance tax which duplicated state programs but satisfied no one, introduced an amendment to the tariff bill proposing a flat income tax of 3% on incomes above $5,000.[438] It was, "in the main, the same as the law of 1894."[439] Bailey implied that nothing short of an income tax could serve to compensate for the tariff, and openly contested the judiciary's power to strike down the tax. In this regard, Bailey admitted that he was not attempting to conform the amendment to the Court's *Pollack*'s decision, but instead was offering an amendment that distinctly, and directly, challenged that decision.[440] Two days later the Democratic caucus adopted Bailey's proposal as a party measure.[441] In response, the Insurgents proffered an income tax bill introduced by Albert Cummins of Iowa. Cummins proposed a graduated tax ranging from 2% on incomes not exceeding $10,000 to 6% on those exceeding $100,000.[442] When twenty-one Republicans announced their support for the Cummins bill, a majority of the Senate had now registered its support for some form of an income tax.[443] Forced to confront the issue, Republican Norris Brown submitted a proposal for a Constitutional amendment granting Congress the power to collect taxes on incomes and inheritances. Brown declared he was "in full accord with the proposition of laying some of the burdens of taxation upon the incomes of the country," but was against flouting the Supreme Court's authority with the futile gesture of submitting a virtual reproduction of the 1894

435. *See id.* at 67. The call for a scientific tariff was a typical reform measure designed to remove some of the lobbyist's influence from the revenue arena. Instead of determining rates based on conjecture or political pressure, the rates would be objectively based upon data concerning the relative costs of production. Thus, cheap labor abroad would be compensated for by a tariff equal to the difference between foreign and domestic labor costs in a particular industry. *See id.* at 359; Kornhauser, *supra* note 297, at 75 n.82; Tarullo, *supra* note 73, at 292-93. One suspects that a politician's notion of a "scientifically targeted" tariff often translated into one which "protects my industries rather than yours."

436. BUENKER, *supra* note 45, at 90.

437. STANLEY, *supra* note 22, at 191-92.

438. *See* SELIGMAN, *supra* note 30, at 592 (citing 44 CONG. REC. 1351 (1909)).

439. 44 CONG. REC. 1351 (1909); *see* STANLEY, *supra* note 22, at 192-93. The inheritance tax had not even satisfied Regular Republicans, since Senate Finance Committee Chair Nelson Aldrich (R-R.I.) eliminated the tax from his version of the tariff bill submitted by the House. BUENKER, *supra* note 45, at 100.

440. 44 CONG. REC. 1351 (1909).

441. BUENKER, *supra* note 45, at 100.

442. 44 CONG. REC. 1420 (1909).

443. BUENKER, *supra* note 45, at 101.

Act.[444] Even if the Court were to reverse itself on this occasion, Brown asked, "how long will that decision stand?"[445]

The ensuing debate over these measures illustrate Congress's acceptance of the compensatory theory. On May 4, Insurgent William Borah of Idaho stood to defend Cummins' proposal. Arguing that the issue could safely be resubmitted to the Court, Borah declared that the Framers did not intend "that all taxes of this Government should be placed upon the backs of those who toil, upon consumption, while the accumulated wealth of the Nation should stand exempt."[446] Regular Republican Elihu Root, corporate counsel to such financial giants as Jay Gould, Thomas Fortune Ryan, and E.H. Harriman, took great pains to explain that the states had already adequately compensated for the tariff's regressive effects:[447]

> It is not a fact that in this Republic property does not now bear a very great proportion of the burden of taxation. . . . [T]he property in the United States upon which the ad valorem taxes for the support of the Government, county, municipal, and other local governments, were levied amounted at a true value to $97,810,000,000; that ad valorem taxes were levied upon that property at the rate of seventy-four one-hundredths of 1 per cent; that is, in round numbers, three-fourths of 1 per cent; and that would amount in round numbers to the equivalent of an income tax of 15 per cent upon all property in the United States.[448]

Of course, much like Bourne Cockran's attempt in 1894, Root's argument was open to attack. Borah asked him, "[W]ho at last pays the large portion of the real estate tax in this country, the real-estate owner or the renter?"[449] More importantly, however, income tax opponents were once again accepting most supporters' understanding of a just and equitable tax system based on flat or proportional rate taxation.

Sensing the strength of the pro-income tax position, the Democrats and Insurgents aligned to create the Bailey-Cummins bill, a compromise which proposed to ignore *Pollock* and enact a flat 2% tax on individual and corporate incomes exceeding $5,000.[450] Nelson Aldrich, the GOP's powerful leader in

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444. 44 CONG. REC. 1568 (1909). Brown is called a "halfway Insurgent" by Sidney Ratner, although he does not define the term. He is probably "halfway" there because of his underlying support for an income tax as a supplement to the tariff, since most Regular Republicans, especially Nelson Aldrich, believed the tariff alone could provide sufficient revenue. RATNER, *supra* note 108, at 298; *see* BUENKER, *supra* note 45, at 83, 100.

445. 44 CONG. REC. 1568 (1909).

446. *Id.* at 1701.

447. BUENKER, *supra* note 45, at 60.

448. 44 CONG. REC. 1701 (1909).

449. *Id.* Borah is referencing the shifting incidence of taxation to which the income tax was allegedly not subject. *See supra* note 22. Another weakness in Root's conclusion is that he does not compare his figures with those for consumption taxes. Even if the wealthy were already subject to a 23% effective tax on their incomes, the consumption tax was historically thought by some to take 70 to 90% of the poor's income while extracting only 3 to 10% of the wealthy's income. *See* KOENIG, *supra* note 315, at 130. Thus, the property tax could not have served as a complete compensation.

450. BUENKER, *supra* note 45, at 101; STANLEY, *supra* note 22, at 195.

the Senate, succeeded in delaying the bill's introduction until the tariff issues had been resolved.[451] In the meantime, Regular Republicans, in search of a solution, approached President Taft. As Standpatter Henry Cabot Lodge explained, "they had the votes" to pass the Bailey-Cummins bill and directly challenge the Court's interpretation in *Pollock*.[452] Thus, Republican leaders adopted a compromise: a proposed amendment to the Constitution, much like Norris Brown's, but one which replaced the inheritance tax with a corporation excise tax. The compromise allowed Regular Republicans to forestall the income tax, permanently they hoped, while providing a source of revenue to replace income lost through the tariff revisions.[453] After succeeding in delaying a vote on the Bailey-Cummins bill, Aldrich managed to overcome the Democrat-Insurgent alliance's resistance and force consideration of both the amendment and corporation tax.[454]

Some suggest that the success of the compromise indicates that the income tax alliance was never on firm grounds.[455] Rather than illustrating a lack of "true" support for the income tax, though, the compromise demonstrated that the income tax's support was a function of the makeup of the entire revenue system. The tariff issue had dominated the 1908 election and Congress could not return from the special session without resolving it. Since Aldrich still had the votes and influence to control the tariff schedules, many income tax supporters acceded to the proposed solution.[456] Thus, the success of the compromise reflected the reality that this special session was focused on the burdens placed on the poor due to the tariff, rather than the lack of contribution from the rich due to the absence of the income tax. Furthermore, supporters of the compromise did not perceive that the corporation tax abandoned the goal of proportionate taxation under the compensatory theory.[457] As Borah pointed out:

> [It] has been somewhat extensively assumed, that this is another means of placing a tax upon the wealth of the country; that by this process of singling out corporations we will reach the wealth of the land rather than to place a tax upon consumers, or that great body of American citizenship which now bears its undue proportion of the taxes of the country.[458]

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451. BUENKER, *supra* note 45, at 102; STANLEY, *supra* note 22, at 195.

452. STANLEY, *supra* note 22, at 194-95.

453. *See id.* at 199-200 (arguing that the possibility that the compromise served any other purpose than to delay the income tax, such as to raise revenues, was small given the total revenues raised from the measure).

454. BUENKER, *supra* note 45, at 105; RATNER, *supra* note 108, at 300; STANLEY, *supra* note 22, at 195.

455. *See* STANLEY, *supra* note 22, at 196. Stanley argues that if the Democrat-Insurgent alliance had enough votes to pass the income tax measure and to force the Regular Republicans to meet with Taft, it should have had enough votes to avoid the compromise altogether. *Id.* This assumes that support for the income tax was independent of the goal of tariff reform.

456. *Id.* at 195.

457. Sidney Ratner suggests that Taft's selection of a corporation excise tax after previously espousing an inheritance tax demonstrates that his support of an income tax amendment was a sham designed to hinder the Democrat-Insurgent alliance. RATNER, *supra* note 108, at 288, 291. *But see* Kornhauser, *supra* note 297, at 54 (arguing that Taft genuinely supported the corporation excise tax as a method of corporate regulation).

458. 44 CONG. REC. 3985 (1909). Borah went on to note that "the interested American people

Even if, as Borah contended, this position was a "thin guise" for truly shifting the burden back on consumers,[459] it illustrates the resonance of the compensatory theory.[460] Aldrich had always maintained that no additional revenues were needed besides the tariff, but had his view prevailed, Republicans would have had little need to justify the corporation tax as a method of equalizing the burdens of taxation.[461] As Marjorie Kornhauser has stated, rhetoric "must reflect deeply and widely held views or else it will lack the power it needs to persuade."[462] Supporters' reliance on the compensatory theory to justify the compromise demonstrates acceptance of flat or proportional rate taxation as the most just distribution of the burdens of taxation. During the debate in the House, one Republican admitted that for the wealthy, "an income tax must bear a proportionately great share of the government taxes."[463] Finally, support of a constitutional amendment was consistent with the goal of securing an income tax. In this respect, the Democratic platform in 1908 had called for the submission of a constitutional amendment to ensure the presence of "an income tax as part of our revenue system."[464] Even William Jennings Bryan had conceded in a speech in 1908 that the President should push for an income tax amendment "since it seemed improbable that Congress could design a tax which would be acceptable to the Court."[465] To a supporter of the income tax, a defeat at the hands of the Court was no better than a defeat at the hands of the state legislatures.

Debate over the wording of the amendment, although minimal, demonstrated that graduated rates were not seen as essential to achieve the goals of an income tax. On July 5, Bailey proposed that the amendment allow for ratification by popular convention and explicitly permit Congress to "grade" any income tax.[466] This latter consideration was prompted by Justice Brewer's dissent in *Knowlton v. Moore*,[467] in which the Court approved a graduated inheritance tax emerging from the Spanish-American War's revenue acts.[468] Bailey noted that if Brewer's view prevailed, and Congress was with-

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are looking on, thinking that we are trying to get a tax upon wealth" with the corporation tax measure. *Id.* at 3986.

459. *Id.* at 3985.

460. Income tax supporters charged that the corporation tax was a "subterfuge" to defeat the income tax. *Id.* at 3929.

461. Aldrich essentially admitted that his support for the corporation tax was contrary to his views, declaring, "I shall vote for a corporation tax as a means to defeat the income tax." *Id.* He argued that it would be better to reduce expenses if the tariff did not meet needed revenues. This view, however, was not in the majority as indicated by the support for the income tax measures.

462. Kornhauser, *supra* note 297, at 138.

463. 44 CONG. REC. 4399-40 (1909) (Rep. Keifer) (R-Ohio).

464. SELIGMAN, *supra* note 30, at 591.

465. BUENKER, *supra* note 45, at 55.

466. 44 CONG. REC. 4108 (1909). The proposal for submission to popular conventions, as opposed to the state legislatures, was an attempt to assure passage was not affected by "local issues" or "change" in the representatives' opinions since the last election. *Id.* This proposal was defeated 46-30 in a vote which mirrored the vote on the substitution of the corporation tax for the income tax. BUENKER, *supra* note 45, at 131.

467. 178 U.S. 41, 110 (1900) (Brewer, J., dissenting in part and concurring in part).

468. 44 CONG. REC. 4108 (1909). The Court held that concerns about the progressive feature of the tax was a legislative rather than judicial question. *Knowlton*, 178 U.S. at 109. Brewer's

out power to grade an inheritance tax, it would also be without power, even under the amendment, to grade an income tax.[469] Senator Anselm J. McLaurin, a Democrat from Mississippi, proposed instead to remove the direct tax clauses from the Constitution altogether. He noted that this would "eliminate from the Constitution every cause of contention over the question of the authority of Congress to levy an income tax, except as to the power of Congress to grade an income tax."[470] It was clear that Bailey did not have the support in Congress to explicitly authorize a graduation of the income tax, and he withdrew the proposal, stating, "I am satisfied that this amendment will be voted down; and voting it down would warrant the Supreme Court in hereafter saying that a proposition to authorize Congress to levy a graduated income tax was rejected."[471] At a minimum, the resistance to Bailey's proposal suggests that Congress believed an income tax could exist in a meaningful sense without graduated rates. If redistribution of wealth had been the goal, there should have been at least some defense of graduation by income tax supporters. Thus, it is difficult to support the notion that the states thought they were ratifying "a predictably progressive—that is, a redistributive—income tax" when presented with the Sixteenth Amendment.[472]

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dissent in *Knowlton* followed from his dissent in Magoun v. Illinois Trust & Sav. Bank, 170 U.S. 283, 300-01 (1898), in which the Court held that Illinois' graduated inheritance tax was constitutional. Brewer dissented on the ground that the Constitution would not permit such arbitrary discrimination. *Id.* at 303 (Brewer, J., dissenting).

An inheritance tax was often viewed differently than a tax on property or income since the former was a tax on the right of succession, a right of legislative creation, while the latter was a tax on property rights more akin to "natural" rights. *Id.* at 288. Thus, a graduated tax was not susceptible to attack under the Due Process Clause. Recognizing this, the petitioner in *Magoun* attempted to argue the case under the Equal Protection Clause. But, as one commentator noted:

> The phrase "equal protection of the laws" is so evidently intended to be indefinite that the court has never attempted to fix its meaning. They have often declared, however, that almost no classification of persons for purposes of taxation can be held to interfere with this provision of the Constitution, so long as all within a class are treated alike. Only a discrimination obviously based on grounds wholly foreign to the proper ends of government could be held unconstitutional.

Case Comment, *Illinois Inheritance Tax*, 12 HARV. L. REV. 127, 128 (1898).

In Wisconsin, for example, an inheritance tax was supported on explicitly redistributive grounds while an income tax was justified as distributing the burdens of taxation more equally. *See* Joseph A. Ranney, *Law and the Progressive Era, Part 2: The Transformation of Wisconsin's Tax System, 1897-1925*, WIS. LAW., Aug. 1994, at 22, 23 & n.16. Despite this difference in rhetoric, inheritance taxes were often flat, and were generally not steeply progressive. FRIEDMAN, *supra* note 108, at 570. Where a progressive inheritance tax was invalidated by a state supreme court, it was usually on the basis that a classification, while permissible, was arbitrary and unreasonable when made purely on a quantitative basis. *See In re* Cope's Estate, 43 A. 79, 81 (Pa. 1899); Judson A. Crane, *Progressive Income Taxes and Constitutional Uniformity of Taxation*, 2 U. PITT. L. REV. 44, 47 (1935).

An inheritance tax is also viewed differently on the moral ground that earned income may be kept while unearned income is available for redistribution. *See* Kornhauser, *supra* note 297, at 142; *see also* James K. Glassman, *The Rich Already Pay Plenty*, WASH. POST, July 11, 1995, at A17 (arguing that a flat tax is fair to the rich, but conceding that he would "be in favor of hiking estate taxes to minimize the luck of birth" in creating wealth).

469. 44 CONG. REC. 4108 (1909).

470. *Id.* at 4109.

471. *Id.* at 4120.

472. Amar, *supra* note 23, at 291. The Senate truly "agreed" on the wording of the proposed amendment, approving it 77-0 with fifteen abstentions. Certainly the goals differed, with Democrats and Insurgents voting for it "because they believed in it as the fairest form of taxation, the

From the history of ratification, it appears that the Sixteenth Amendment was more a response to the tariff than a call to redistribute wealth.[473] On August 5, 1909, Congress passed the Payne-Aldrich Tariff Act. Although it was intended to be a concession to the demand for tariff reduction, the Act maintained the high rate structure of 1897.[474] It "brought no essential change in our tariff system," with "no downward revision of any serious consequence."[475] This failure to respond to the public outcry over the tariff was fatal to the Republican Party. As Representative Adam M. Byrd, a Mississippi Democrat, warned during the debate over the compromise proposal in the House, consumers could not possibly be helped by either the Amendment or the corporation tax "unless the tax burden imposed by the tariff is decreased in proportion to the amount of revenue derived by the income and corporation taxes."[476] Thus, the tariff again assumed heightened significance during the elections of 1910 and the ensuing ratification process.[477] Consider that two-thirds of the states had not even considered the proposed amendment before 1910 and its elections.[478] These elections not only ushered in significant victories for Democrats and Insurgents, based primarily on the issue of the tariff, but also succeeded in further dividing the Republican party.[479] Democrats gained control of the governorship and both houses of Congress in New York, Ohio, Indiana, and Maine. Democrats also captured one house of the legislature and the governor's seat in both Connecticut and New Jersey, the latter electing Woodrow Wilson. Moreover, for the first time since 1890, Democrats gained control of the U.S. House of Representatives. The *New York Times*' post-election headline read, "the Democratic Party carried the Union yesterday."[480] Then, in the election of 1912, not only did Woodrow Wilson beat

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Standpatters because it was part of the 'deal' Aldrich had agreed to and because they hoped to defeat ratification in the future." BUENKER, *supra* note 45, at 131, (quoting THOMAS R. ROSS, JONATHAN PRENTISS DOLLIVER 259-60 (1958)). The House was similarly in favor, voting 318 to 14 to approve the resolution. RATNER, *supra* note 108, at 302. Many income tax supporters no doubt felt as Representative Ollie M. James (D-Ky.) felt when he declared, "I shall vote, Mr. Speaker, to submit this constitutional amendment to the States; but when I do so, I do not concede, nor does the Democratic Party concede, that Congress has not now the power to impose such a tax." 44 CONG. REC. 4398 (1909). Representative Charles L. Bartlett (D-Ga.) expressed similar feelings, declaring his intent to vote for the resolution "because in no other way am I permitted to show my approval of this method of taxation." *Id.* at 4410.

473. For a state-by-state discussion of the ratification of the amendment, see BUENKER, *supra* note 45, at 143-58. Of course, discerning intent from the ratification of an amendment is nearly impossible in light of the many political entities involved. *See* Marjorie E. Kornhauser, *Constitutional Meaning of Income and the Income Taxation of Gifts*, 25 CONN. L. REV. 1, 11 (1992). However, the rhetoric during the process is especially revealing of the key issues.

474. BENDER'S FEDERAL REVENUE LAW, *supra* note 85, at 358; RATNER, *supra* note 70, at 390; STANLEY, *supra* note 22, at 199. Although it did little to mitigate the hostile attitude toward the tariff, the average ad valorem duty on dutiable goods went down to 42% from a high of 52% under the Dingley Tariff Act of 1897. *Id.*

475. STANLEY, *supra* note 22, at 199 (citation omitted).

476. 44 CONG. REC. 4417 (1909).

477. ASHLEY, *supra* note 85, at 252-53.

478. BUENKER, *supra* note 45, at 147.

479. *Id.* at 148-49; Mowry, *supra* note 415, at 269. In an effort to purge the party of Insurgents and Progressives, Taft had campaigned against the more radical members of his party up for re-election. Failing miserably, Taft assured himself of a sizeable group of enemies in the future. *See* KEY, *supra* note 363, at 178; Mowry, *supra* note 415, at 267.

480. BUENKER, *supra* note 45, at 148-49; Mowry, *supra* note 415, at 271.

out Taft and Roosevelt for the Presidency, but the Democrats also secured a seventy-three seat edge in the House and a six seat margin in the Senate.[481] "[M]ost analysts found the major cause of this political upheaval to be the widespread desire of voters to 'punish the Republican Party' for its belief, rational or irrational, that the high protective tariff was responsible for the escalating cost of living and for the construction of trusts."[482] Perhaps in light of this fact, almost one-half of Wilson's acceptance speech at the nominating convention "was devoted to an analysis of the protective tariff as a breeder of special privileges and special favors."[483] Similarly, in one of Taft's last messages to Congress after his defeat, he admitted that "a new Congress has been elected on a platform of a tariff for revenue only rather than a protective tariff."[484] Thus, as a reaction to the tariff, the election returned to power individuals, whether Democrat, Republican, Insurgent, or Progressive, who were willing to work toward removing some of the burden on the poor and distributing it to the wealthy. John Buenker observed that "[t]he nation's voters had rendered as clear a judgment as the vagaries of the American political process permit against the party that they associated with the high cost of living and with favoritism toward the organized and the affluent, conditions that a federal income tax was purportedly designed to counteract."[485] Ratification, achieved when Delaware voted to accept the amendment on February 3, 1913, signalled a commitment to change the Nation's overall revenue policy, not just its use of the income tax.[486] Supporters

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481. BUENKER, *supra* note 45, at 152; Mowry, *supra* note 415, at 292. Progressives and some Insurgents, flush with their recent victories in state and federal elections, had attempted to win the Republican nomination away from Taft with Wisconsin Senator Robert La Follette as their choice for nominee. Unsuccessful, they drafted Theodore Roosevelt as their candidate and formed the Bull Moose Party. JOHN A. GABLE, THE BULL MOOSE YEARS: THEODORE ROOSEVELT AND THE PROGRESSIVE PARTY 12 (1978); WITTE, *supra* note 79, at 76. After 1912, Progressives in major offices included one governor, two senators, and 16 representatives. Mowry, *supra* note 415, at 293. Most significantly, however, was that Roosevelt outdistanced Taft for second, pulling in 88 electoral college votes to Taft's 11. GABLE, *supra*, at 131. Such impressive first-time performances led the chair of the Progressive Party, Senator Joseph Dixon of Montana, to predict that the Republicans had become a third party. BUENKER, *supra* note 45, at 153.

482. BUENKER, *supra* note 45, at 149; STANLEY, *supra* note 22, at 219. *The Nation* reported that Maine's Republican congressmen who had voted for Payne-Aldrich were "savagely heckled by the most direct and awkward questions" relating to the tariff's effect on prices. BUENKER, *supra* note 45, at 149.

483. Mowry, *supra* note 415, at 290.

484. William H. Taft (Dec. 6, 1912), *in* 3 UNION MESSAGES, *supra* note 303, at 2515.

485. BUENKER, *supra* note 45, at 154. The historic connection between the tariff and the income tax under the compensatory theory explains why the income tax itself was not a major issue, yet the election helped to spur ratification. *But see* STANLEY, *supra* note 22, at 216 (suggesting that the income tax's lack of publicity during the election proves the amendment's merely symbolic function).

486. STANLEY, *supra* note 22, at 225. Philander C. Knox, Taft's Secretary of State, formally certified the Sixteenth Amendment's adoption on February 25, 1913. RATNER, *supra* note 108, at 324; Roberts & Stratton, *supra* note 131, at 42-43. It is a bit of a red herring to imply that the time it took to ratify the amendment is a meaningful gauge of support. *See* STANLEY, *supra* note 22, at 237. The four-year delay is as much due to the infrequent meetings of the legislatures as anything else. Few legislatures were in session in 1909 after Congress passed its resolution for a constitutional amendment. The most critical year was 1911, since all but four of the states' legislatures had scheduled a session during that year. Emerging from that year lacking only eight states, ratification was again delayed since few states were in session in 1912. Moreover, New Mexico had only been recently admitted and some states, such as New York and Georgia, voted on the

claimed that "the way is now open to relieve the overladen shoulders of the poor and take the tax burdens off the necessaries of life."[487] The *New York Evening Post* predicted that "the prospect of many millions of new revenue should give the tariff-makers a much freer hand in so readjusting duties as to produce the greatest possible benefit to the consumer."[488] Perhaps heeding this advice, newly-elected President Wilson called for the twin reforms of tariff reduction and an income tax during his inaugural address in March, 1913.[489] Within a month, during an emergency session of Congress called to enact Wilson's reforms, House Ways and Means Chair Oscar Underwood (D-Ala.) introduced a tariff reform bill containing an income tax section providing for explicitly graduated rates. Drafted by Cordell Hull of Tennessee, the proposed income tax contained a "normal" rate of 1% on incomes between $4,000 and $20,000, with "surcharges" of 1% on incomes between $20,000 and $50,000, 2% on incomes between $50,000 and $100,000, and 3% on incomes greater than $100,000.[490] Hull and Underwood originally had wanted to introduce a flat tax to ensure judicial approval, but pressure from other Democrats, including future Vice-President John Nance Garner of Texas, forced the Democratic leadership to incorporate the surcharges in the rates.[491]

The ensuing debates indicate a battle between the dominant majority espousing a proportionate overall tax burden under the compensatory theory, and the small minority of Progressives and Insurgents advocating a progressive overall tax burden under the redistributive rationale. A fundamental misunderstanding of the context and underlying theories in these debates has led observers to suggest that the principle of progression had become accepted by this point. Sidney Ratner, for example, concluded that "unlike debates in previous years, [the 1913 Act] involved no dispute concerning the desirability of an income tax or even the principle of progression. The climate of public and congressional opinion had changed remarkably since 1894 and 1909."[492] Blum and Kalven, perhaps relying upon Ratner, found a similar paucity of

issue more than once. *See id.* at 211 (table charting the chronology of ratification); BUENKER, *supra* note 45, at 143-54; RATNER, *supra* note 108, at 306. Thus, the amendment was actually ratified after two years of meaningful consideration by the states, a swift response by most measures.

487. STANLEY, *supra* note 22, at 226.

488. *Id.* (quoting 46 LITERARY DIGEST 325-36 (1913)).

489. PAUL, *supra* note 84, at 101; WITTE, *supra* note 79, at 76.

490. BUENKER, *supra* note 45, at 368; RATNER, *supra* note 108, at 326; WITTE, *supra* note 79, at 76-77. Today, the use of a "surtax" or "surcharge" in place of an explicit rate is often disdained because it tends to hide the increase in payments. *See* Martin J. McMahon, *Renewing Progressive Taxation*, 60 TAX NOTES 109, 115 n.27 (1993). In 1913, however, the surcharge was designed to ease the administrative burden involved in collecting income taxes "at the source," or before money was paid to an individual. Although "stoppage at the source" prevented the problem of self-assessment, and thus improved collections, it created its own difficulties since a company had no way of determining a shareholder's rate bracket before making a dividend distribution. Thus, only the "normal" tax was subject to stoppage at the source, while the surcharges were collected under the traditional system of self-assessment. *See* WALTMAN, *supra* note 63, at 29.

491. BUENKER, *supra* note 45, at 361; PAUL, *supra* note 84, at 102; RATNER, *supra* note 108, at 325; WITTE, *supra* note 79, at 76. Adolph Sabath, a Chicago Democrat, had introduced a graduated income tax proposal on April 7th, 1913, which never emerged from Committee. 50 CONG. REC. 87 (1913).

492. RATNER, *supra* note 108, at 327.

conflict, stating, "Whatever the reasons, it seems that between 1894 and 1913 the deadline for sharp political debate over the progression principle had somehow passed."[493] Ironically, these analyses of the debates have it exactly backwards. Progressive income taxation in 1913 can only be understood in the context of Congress's desire to compensate for a regressive tariff which was perceived to have manifested itself in higher prices. It was not the principle of progression which had become accepted by this point, but the principle of flat or proportionate taxation.

The Democrats began the debates under a united front. With evidence of the Republican party's disintegration all around them, Democrats hoped to prevent factionalism from interfering with their first opportunity in two decades to control both Congress and the Presidency. This was not an insubstantial risk. In the Senate their margin was slim, allowing little room for crossover votes. Democrats had a significant majority in the House, but a large number in their ranks were first-termers. Thus, the Democrats chose to iron out all decisions regarding both the tariff and the income tax in a party caucus in which each member pledged to support the party's decisions on the floor.[494] With the battle lines thus drawn, three positions emerged. Insurgents and Progressives favored significantly graduated rates, often on explicitly redistributive grounds. Regular Republicans, forced to concede that some form of income tax would be adopted, but unwilling to connect it to the tariff, attempted to push for lower exemptions and proportionate taxation so as to prevent it from becoming "class legislation." Finally, Democrats favored a moderately graduated income tax to compensate for the regressivity of consumption taxes. Once free trade could be established, however, and consumption taxes reduced to a bare minimum, the Democrats were in favor of flat or proportionate income taxation.

Soon after the bill was introduced in the House, the Progressives revealed their strategy. Ira C. Copley, a newspaper publisher from Illinois, and one of 19 Progressives in the House, proposed an amendment for steeply graduated surcharges ranging from 1% on incomes between $10,000 and $15,000 to 68% on incomes exceeding $1 million.[495] Copley left little doubt that his underly-

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493. BLUM & KALVEN, *supra* note 33, at 12.

494. BUENKER, *supra* note 45, at 359; *see* RATNER, *supra* note 108, at 325, 328. Representative Rayburn applauded the unity of the Democrats:

> This bill was submitted to the Democratic caucus, and there every Democrat had a chance to have his say and to offer his amendment to the bill. We settled our party differences in that caucus and have come into this House and before the country with a united front, and this seems to pain our Republican brethren keenly, for they know that every amendment that they offer will be met with a solid Democratic majority and sent to the scrap heap, where it will justly repose.

50 CONG. REC. 1249 (1913) (Rep. Samuel T. Rayburn) (D-Tex.). Senator Williams observed:

> This is the first tariff bill in the history of this country where the bill was submitted to a full and free and fair discussion of every one of the dominant party in a free and fair caucus, where every man could be heard and where they merely obeyed the will of the party.

Id. at 3810 (statement of Sen. Williams).

495. 50 CONG. REC. 1246 (1913); RATNER, *supra* note 108, at 328 n.15.

ing motivation was to reduce the wealth "that is a menace to the institutions of this country":

> I have introduced this amendment for several reasons, the principal one being that I believe it to be the best way of equalizing the opportunities which society in this country offers to certain men in securing more than their fair share of the benefits derived from the labors of other men.[496]

Recognizing that his amendment would produce more revenue than the federal government could possibly use, Copley suggested that it be returned to the states "to be used by them in lightening the burdens of taxation of the poor."[497] Others followed Copley's lead, albeit with somewhat less radical proposals. Melville C. Kelly, a Pennsylvania Progressive, proposed to increase the bill's top effective rate from 4% to 9% on incomes exceeding $100,000.[498] Kansas Insurgent Victor Murdock and Washington Progressive Jacob Falconer each offered the same amendment as Kelly, but with smaller increases to 7% and 6% top effective rates respectively.[499] Although these proposals were markedly less drastic than Copley's, they were clearly cut from the same cloth. As Representative Murdock explained in introducing his proposal, "[T]he great problem remains. . . . [T]he very rich of this country succeed in doing one thing. They continue to grow richer."[500] Representative Falconer concurred, explaining that "a man can not legitimately spend $100,000 a year."[501] Each of those proposals, however, was rejected without the taking of any roll-call votes.

The approach of the Standpatters was opposite that of the Progressives. Rather than seeking to raise the top rate, the Standpatters moved to lower the bottom rate. Since they did not concede that the tariff was a tax, Regular Republicans viewed the income tax as the poor's only contribution to the government. Thus, Frederick H. Gillett, a Republican lawyer from Massachusetts, proposed to amend the bill by lowering the exemption limit to $1,000 so as to tax those with incomes between $1,000 and $4,000 at ½%.[502] According to Gillett, an income tax would permit "the great mass of the people" to "have a little feeling in their pockets as to whether the Government was economical or extravagant."[503] Representative Foster, among several Democrats "bitterly opposed" to Gillett's proposed amendment,[504] immediately contested this logic:

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496. 50 CONG. REC. 1246 (1913).
497. *Id.*
498. *Id.* at 1251. Kelly was much less obvious than his Progressive colleague. He declared, "I would not think of attempting to outlaw all the forces which make for inequality of wealth in this nation." *Id.*
499. *Id.* at 1252 (Rep. Victor Murdock) (Kan.); *id.* at 1257 (Rep. Jacob Falconer) (Wash.).
500. *Id.* at 1252.
501. *Id.* at 1257.
502. *Id.* at 1247; RATNER, *supra* note 108, at 328.
503. 50 CONG. REC. 1247 (1913).
504. *Id.* at 1249 (Rep. Hiram R. Fowler) (D-Ill.); *see also id.* at 1247 (Rayburn); *id.* at 1250 (Rep. Alexander M. Palmer) (D-Pa.).

> The man of family, whose income is small, has usually paid a consumption tax in the way of a tariff, and has contributed his fair share of taxes to the Government, and now, if his small income is again taxed, it is more than he should be expected to bear at this time.[505]

Representative Clyde H. Tavenner (D-Ill.), responding to the charge of "the standpatters and protectionists" that the exemption is "class legislation," argued that "the present system of taxing the necessaries of life while permitting wealth to go untaxed is class legislation of the grossest sort."[506] Thus, Gillett's proposed amendment was also defeated.

For Democrats, a graduated income tax above a certain amount, and tariff reform on necessities, would together further their goal of proportionate taxation. Tavenner explained that

> the income tax is part of the Democratic plan to reduce the ever-increasing cost of living in this country. It means the carrying out of the program promised in the pre-election campaign last fall, namely, to take some of the tax off the necessaries of life, such as sugar, woolens, cottons, beef, and lumber, and to make up for the loss of revenue thus sustained by the Government by placing a tax upon incomes.[507]

Democrat Alexander M. Palmer of Pennsylvania succinctly stated that the rates had to be graduated as long as the consumption tax was still regressive: "The present consumption taxes bear most heavily upon the poor; it is right that the income tax should bear most heavily upon the rich."[508]

Eventually, however, Democrats expected that the tariff tax would be removed altogether. Representative William Murray, an Oklahoma Democrat, predicted that "we are just entering upon a policy for the support of this Government which, in a very few years, will be the only method of taxation for the support of the American Republic, and the days for protective-tariff favoritism will be over. [Applause on the Democratic side]."[509] At this time, Democrats agreed, men would be taxed "in accordance with their ability to pay instead of because of their necessity to eat and to wear clothing."[510] Because the system of property taxation was woefully inadequate to accomplish this goal, an income tax was necessary, as "the fairest and cheapest of all taxes, in order to secure to the largest extent equality of tax burdens, an adjustable system of revenue, and in all respects a modernized fiscal system."[511] Under that system, everyone would pay in proportion to his or her respective incomes.

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505. *Id.* at 1249.
506. *Id.* at 1253.
507. *Id.*
508. *Id.* at 1250; BUENKER, *supra* note 45, at 366.
509. 50 CONG. REC. 1252 (1913); *see id.* at 1248 (Rep. Samuel Rayburn) (D-Tex.) ("[W]hen the time comes that money to defray the expenses of the Government can be raised from the income tax and other legitimate sources of direct taxation, that the tariff should be entirely removed and that free trade should come in its stead.").
510. *Id.* at 1254 (Rep. Clyde Tavenner) (D-Ill.).
511. *Id.* at 1253; BUENKER, *supra* note 45, at 369.

In the Senate, Progressives and Insurgents again attempted to increase the graduation of the rates so as to achieve truly progressive, rather than proportional, taxation.[512] William Borah of Idaho proposed to raise the top effective rate to 4% on incomes over $100,000.[513] Joseph Bristow of Kansas proposed to graduate the rates 1% for each $10,000 increase in income to a maximum effective rate of 11%.[514] Wisconsin's Robert La Follette, a Progressive Party candidate for President in 1924, also proposed a top effective rate of 11%, but suggested ½% steps from $10,000 to $40,000.[515] Finally, Miles Poindexter of Washington proposed to extend the graduation to 10% on incomes exceeding $500,000, and 20% on incomes exceeding $1 million.[516] While each of these proposals was rejected by nearly identical votes,[517] the attempt to persuade the other senators to accept a somewhat higher graduation was made with greater effect than in the House. This effect did not seem to be premised, however, on any concession toward adopting the goal of overall progression in the tax system. Although several Progressives and Insurgents did argue for explicit progression under rationales other than compensation, their arguments were fiercely opposed. Senator Poindexter argued that great wealth must be taxed at a high rate under both the benefit and sacrifice theories—that the wealth was accumulated through "special privileges" and government benefits, and that "luxuries should be taxed more heavily than necessities; that superfluity should bear a heavier portion of the burdens of the Government than mere sufficiency."[518] Senator John D. Works, a California Insurgent, boldly asserted that this great wealth had become "a positive burden to them rather than a benefit," suggesting that more steeply graduated rates would be "doing them a favor rather than an injury."[519] Senator La Follette, pointing out that most people accepted a graduated inheritance tax, asked, "instead of awaiting the opportunity to reach after death that great accumulation of wealth which the Senator has admitted is a menace, why not diminish it by a system of taxation that is constitutional, legitimate and proper?"[520] This latter argument

512. A few changes were made to the House bill by the Senate Finance Committee before introducing it on the floor for consideration by the entire chamber. The exemption was reduced to $3,000 for single persons while allowing $4,000 for married couples. The committee, after "countrywide protest," also exempted mutual life insurance companies from taxation. *See* BUENKER, *supra* note 45, at 370; RATNER, *supra* note 108, at 329.

513. 50 CONG. REC. 3771 (1913).

514. *Id.* at 3805.

515. *Id.* at 3819; *see* KEY, *supra* note 363, at 172 (Table 7.1).

516. 50 CONG. REC. 3835 (1913).

517. Borah's amendment was defeated 47-17. *Id.* at 3773. Bristow's was defeated 46-16. *Id.* at 3818. La Follette's was defeated 43-17. *Id.* at 3830. Poindexter's was defeated 41-12. *Id.* at 3836.

518. *Id.* at 3835, 4613.

519. *Id.* at 3812.

520. *Id.* at 3821. La Follette conveniently ignores that this same distinction was made in his own state of Wisconsin, which is credited as one of the models for the 1913 income tax provisions. Joseph Ranney, in surveying the debate in Wisconsin over the two measures, noted that

> [m]any supporters of property tax reform and of an income tax viewed their causes primarily as a means of distributing the obligation to support the government fairly among all classes of people. Supporters of the inheritance tax went a step further, and explicitly promoted their tax as a means of redistributing wealth from the rich to the remainder of the population.

finally provoked a heated response from Senator John Sharp Williams of Mississippi, appointed by the caucus to be one of two Democratic defenders of the income tax section in the Senate.[521]

> No honest man can make war upon great fortunes per se. The Democratic Party never has done it; and when the Democratic Party begins to do it, it will cease to be the Democratic Party and become the socialistic party of the United States; or, better expressed, the communistic party, or quasi communistic party, of the United States . . . I am not going to attempt to make this tariff bill a great panacea for all the inequalities of fortune existing in this country; nor would it do any good if we did, because we would be doctoring the symptoms and not the cause of the disease.[522]

If there was any doubt as to Williams' rejection of the redistributive rationale, he resolved them by declaring, "The object of taxation is not to leave men with equal incomes after you have taxed them."[523]

Progressives and Insurgents did make headway on their quest for steeper graduation, however, when they expressed their sentiments in terms of the compensatory theory. Senator La Follette, in introducing his proposed amendment, commented on the experience of Wisconsin and its income tax law enacted only two years earlier. He recounted the stories of individuals who had sworn that their income from personal property such as investments was no more than $5,000, when later investigation revealed incomes between $300,000 and $1 million.[524] Senator Borah remarked that this supported an argument he had voiced earlier, namely that "in order to reach proportionately the large incomes it is absolutely necessary that an almost exaggerated rate be put upon them because they do escape taxation."[525] This was a justification for graduated rates to which Williams had expressed his agreement:

Ranney, *supra* note 468, at 22. For a discussion of the possible causes for this distinction, see *supra* note 20.

521. The other was William Hughes of New Jersey, the leader of a group opposed to mandatory adherence to measures emerging from the caucus. RATNER, *supra* note 108, at 330. Williams was often thought of as a conservative Southern Democrat. *See* KOENIG, *supra* note 315, at 415 (grouping Williams with a number of southern Democrats who were against Bryan and in favor of Wilson); RATNER, *supra* note 108, at 331. However, his credentials on the income tax were impressive. According to Williams, he voted for the income tax in 1894 and introduced a joint resolution proposing an amendment to the Constitution to permit an income tax during each of his subsequent years in the House. 50 CONG. REC. 3821 (1913).

522. 50 CONG. REC. 3821 (1913). Williams issued a similar response to Senator Bristow's proposed amendment: "The motive behind the amendment offered by the Senator from Kansas is not revenue. It is a punitive, vindictive motive. It is to punish and take from those who have large incomes, not because the Government needs the money, but because the Government has the power to do it." *Id.* at 3806.

523. *Id.* at 3807.

524. *Id.* at 3820.

525. *Id.* The previous day, Borah had remarked:

> [W]e ought to bear in mind that which is proven to be well founded in experience, and that is that the man with a small income always pays more completely upon his income than the man with a large income . . . . Therefore, if we are going to reach proportionately the men with large incomes, it seems to me we must raise the grade of taxation more than is here specified.

Id. at 3771.

> So this is a graded income tax, and it does attempt to equalize things with a view to correcting what the Senator from Idaho [Mr. Borah] referred to yesterday, and which is absolutely true—the greater opportunity of men of greater income, whose incomes are generally drawn from bonds, stocks, bills receivable, and various things of that sort, to hide their incomes, as compared with the ordinary man, whose property is in a visible shape and form, and whose income is known to all his neighbors.[526]

Williams explained:

> During times of peace, you have a slight tax upon incomes, graduated not with a view of punishing those who have large incomes, but with a view of equalizing the taxes, because of the greater opportunities that people of large incomes have to escape taxation than people of small incomes have.[527]

Thus, La Follette pleaded with Democrats to "take this provision of the bill and the amendment which I have offered back to their committee room and give it consideration, to the end that these enormous incomes may be compelled at last to pay the tax they have heretofore evaded."[528]

La Follette's arguments did not fall upon deaf ears. The strength of the Democratic caucus in the Senate had been weakened from the beginning when six senators, led by William Hughes, announced they were opposed to being bound to support the measure as drafted.[529] One of these upstarts, Senator James K. Vardaman (D-Miss.), precipitated a mini-revolt by voting for La Follette's proposed amendment. Three Democrats announced the next day that they had withheld their votes on La Follette's amendment in the expectation that the Finance Committee would agree to raise its rates.[530] The Democratic caucus reconvened and reached a compromise which added three brackets so that the rates rose to 3% on incomes over $75,000, 4% on incomes over $100,000, 5% on incomes over $250,000, and a top rate of 6% on incomes over $500,000.[531] This was clearly not a victory for explicit progression, however, as the rates were much lower than those advocated by the Progressives and Insurgents, or even the radical Democrats. Furthermore, later proposals by Bristow, La Follette, and Poindexter to increase the rate of graduation on redistributive grounds were soundly defeated.[532]

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526. *Id.* at 3807.
527. *Id.* at 3806.
528. *Id.* at 3821.
529. BUENKER, *supra* note 45, at 371; RATNER, *supra* note 108, at 330 n.24.
530. The three were Senators Eugene Reed of New Hampshire, William Thompson of Kansas, and Henry Ashurst of Arizona. BUENKER, *supra* note 45, at 374; RATNER, *supra* note 108, at 332 n.31.
531. See CONG. REC. 4611 (1913) (Sen. Joseph Little Bristow) (R-N.Y.) (explaining the Senate Finance Committee's amendments to the bill); RATNER, *supra* note 108, at 332; WITTE, *supra* note 79, at 78.
532. 50 CONG. REC. 4611 (1913) (Sen. Bristow); *id.* at 4612 (Sen. La Follette); *id.* at 4613 (Sen. Poindexter).

Meanwhile, Regular Republicans proceeded much as they had in the House. Although they believed that a protective tariff created rather than reduced income, they conceded defeat on this point.[533] On the question of the income tax, they clearly "prefer[red] that all pay proportionately and that no class be introduced."[534] Absent that, they sought a lower exemption because of the "danger to the Republic"[535] when Government is only supported by a few. Michigan Senator Charles E. Townsend pleaded, "Increase the rate if you wish on the larger incomes, but make the class of men who pay the tax as large as you can."[536] He proposed to lower the effective rate to ¼% on all incomes regardless of how small.[537] Porter McCumber of North Dakota and Elihu Root of New York both proposed to lower the exemption to $1,000, McCumber starting at the minuscule rate of one-tenth of 1%.[538] In all cases, however, these proposals were rejected. As Senator Borah explained, "So long as we have the mixed system of indirect taxation and the direct tax," we need not be concerned about those below the exemption not paying their fair share.[539]

Ultimately, the view which prevailed supported the overall goal of flat or proportionate income taxation. This understanding is best illustrated by an exchange between Regular Republican Henry Cabot Lodge, Progressive William Borah, and Democrat John Sharp Williams. Lodge argued that a high exemption was "vicious in principle" since it meant that not everyone paid his share of taxes.[540] Thus, Lodge argued, "I would not set a class apart and say they are to be pillaged, their property is to be confiscated."[541] Borah, using quotations from Seligman's *The Income Tax* to bolster his point, argued that "so long as we raise seven-eighths of our revenue by another method and only one-eighth by direct taxation, it can not be said that any man is escaping taxation."[542] Thus, Borah concluded, "When we shall adopt a system of direct taxation, exclusively and alone, I will join the Senator from Massachusetts in putting the exemptions down to a very low figure."[543] Williams then entered the fray to resolve what he termed "a purely academical discussion."[544] He explained in no uncertain terms that when the country no longer relied upon consumption taxes for its revenue, the government would embark upon flat or proportional income taxation with no exemption at all:

> There may be great merit in the argument of the Senator from Massachusetts some of these days, but not now. The reason why there is not great merit in it now is because while it taxes these people with

533. *Id* at 3811 (Sen. Townsend) (R-Mich.).
534. *Id.* at 3801 (Sen. Lawrence Y. Sherman) (R-Ill.); *see id.* at 3810 (Sen. Townsend); *id.* at 3834 (Sen. Porter McCumber) (R-N.D.).
535. *Id.* at 3810 (Sen. Townsend).
536. *Id.* at 3811.
537. *Id.* at 4067.
538. *Id.* at 3834 (Sen. Porter McCumber) (R-N.D.); *id.* at 4067-68 (Sen. Elihu Root) (R-N.Y.).
539. *Id.* at 3835.
540. *Id.* at 3839.
541. *Id.* at 3840.
542. *Id.* at 3841.
543. *Id.*
544. *Id.*

> indirect taxes of various sorts these things should be left for some day, when the good day comes—the golden day—when there will be no taxes upon consumption at all except upon whisky and tobacco and wine and beer and things that are considered harmful, and no import duties at all except countervailing duties to offset them, and when everybody will pay in proportion to his income.[545]

Lest anyone misunderstand what he meant by that final phrase, Williams offered an example of the relative tax burdens under a proportionate income tax of 1%:

> It might then be well to reduce the exemption or to do away with it, so that a man with $5,000 would pay his $50, or whatever it was, and the man with $500 would pay his $5, and the man with $50 would pay his 5 cents, and the man who got but 5 cents would pay his 1 cent, and call it the people's pence, like Peter's pence, and let everybody pay his share.[546]

Thus, when Democrats used the term "ability to pay," they were not referring to an equality of sacrifice sometimes used to justify steeply graduated rates. Instead, they were discussing the expected transition from a system where consumption taxes accounted for all the revenues to one where taxes rose proportionately, not progressively, according to income.[547]

When the Underwood/Simmons Tariff Act went into effect on October 3, 1913, the Democrats were true to their word in pushing for gradual but significant reductions in the customs duties. Average rates were reduced from 40% to 28% with ad valorem rates lowered from 18.5% to 9.7%.[548] Similarly, the income tax compensated for the consumption taxes which remained, but did not attempt to change the distribution of wealth. As John Buenker concluded, "the original income tax was designed to promote tax equity and to produce additional revenues to allow for tariff reduction, not to redistribute wealth or income."[549] Consistent with this view, the Supreme Court, in *Brushaber v. Union Pacific R.R. Co.*,[550] upheld the tax without being asked to decide whether a redistributive tax scheme was constitutional.[551]

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545. *Id.* As Williams had previously explained to Borah, the Democrats had not already done this because "you can not all at once remove all taxes upon consumption" where a "false and artificial fiscal system exists." *Id.* at 3808.

546. *Id.* Although the lowest figure in Williams's example amounts to a 20% rate, his reference to a "Peter's pence" indicates an intention to refer to the smallest monetary denomination feasible under that income. The phrase, derived from the notion of giving to the Church, is designed to indicate that each person should contribute what he or she is able.

547. *Id.* at 3772 (Sen. Williams) ("The time may come, and I hope will come some day, when all taxes for the Government will be raised by taxing the citizens in proportion to their ability to pay.").

548. BENDER'S FEDERAL REVENUE LAW, *supra* note 85, at 397.

549. BUENKER, *supra* note 45, at 396-97.

550. 240 U.S. 1 (1916).

551. *Brushaber*, 240 U.S. at 24-25. The Court merely decided, based on the country's prior experience with progressive income and inheritance tax rates, that it did not "transcend the conception of all taxation" so as "to be a mere arbitrary abuse of power which must be treated as wanting in due process." *Id.* at 25. At least one commentator criticized the decision. *See* Frank W. Hackett, *The Constitutionality of the Graduated Income Tax Law*, 25 YALE L.J. 427 (1916).

Although the 1913 Act instituted only mildly progressive income tax rates, it was still a significantly "progressive" reform. It was a step toward remedying an imbalance in taxation which had favored the wealthy. The period between the Civil War and the adoption of the Sixteenth Amendment was highlighted by a change in the form of wealth from real property, such as land and buildings, to intangible wealth, such as stocks and bonds. Combined with the advent of protectionism as a national policy, the poor began to view themselves as increasingly burdened by taxation while the growing fortunes of the rich largely escaped the supposedly compensatory measure of property taxation. This inequity sparked pro-income tax movements during periods of economic crisis. The resort to an income tax, however, was not designed to address the concentration of wealth itself, or even to protect the nation from instability in protest against the concentration of wealth. Instead, the income tax, with its progressive features, was adopted "to redress the inequity of taxation which was the predominant feature of the American fiscal system as a whole."[552] Thus, the history of income taxation in this country before and immediately after the ratification of the Sixteenth Amendment describes an essentially successful transformation from a regressive consumption tax-based system to a proportional or flat tax-based system.

IV. TRANSLATING 1913 INTO TODAY'S DEBATE

An understanding that the Sixteenth Amendment was ratified against the backdrop of a half-century's push toward proportionate taxation is extremely instructive for modern efforts to reform the tax system. In one sense, it undermines the notion that there is authority under the Sixteenth Amendment for an explicitly redistributive tax system, and leads to the question of why "progression today is immune from constitutional attack."[553] In a broader and more practical sense, however, the history is instructive for the lessons it provides. The current debate has directed little attention toward the overall tax burden in American society.[554] It may be that, unwittingly, we have remained faithful

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Hackett relied to some extent, however, upon *In re* Cope's Estate, 43 A. 79 (Pa. 1899), a state inheritance tax case. It is not difficult to understand how the Court concluded that the progression was not completely arbitrary given Congress's compensatory rationale. On the other hand, it might have been a closer call if Congress had adopted Representative Copley's proposed 68% top rate based upon an explicitly redistributive rationale.

552. SELIGMAN, *supra* note 30, at 676.

553. BLUM & KALVEN, *supra* note 33, at 10. Blum and Kalven's statement is as true now as it was when written in 1952. *See, e.g.*, Thomas C. Grey, *The Malthusian Constitution*, 41 U. MIAMI L. REV. 21, 23 (1986) (reviewing Richard Epstein's *Takings* and suggesting that the Sixteenth Amendment "prevents a responsible court from demanding that Congress not increase the levels of progressivity in future years"); Joseph L. Sax, *Takings*, 53 U. CHI. L. REV. 279, 281 n.10 (1986) (reviewing RICHARD A. EPSTEIN, TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN (1985)) (contending that the Sixteenth Amendment sanctioned progressivity in the tax system).

554. The attention directed toward the effects of other taxes in the system has come only recently and from relatively obscure sources. *See* Mark Adkins, Letter to the Editor, *Superrich Already Enjoy Comprehensive Federal Flat Tax*, ARIZ. REPUBLIC, Aug. 4, 1995, at B8; Norman J. Ornstein, *Congress Inside Out Taxing Thoughts on Reform: It's Not Just About Income*, ROLL CALL, Aug. 7, 1995, *available on* LEXIS, Nexis Library, CURNWS file. Few politicians have recognized this aspect of the debate.

to the original understanding of an equitable overall tax system based on flat or proportional rates. It also may be, however, that current proposals' emphasis on taxation of consumption, rather than savings and investment income, is a recipe for a repeat of the conditions leading up to the adoption of the Sixteenth Amendment. This is surely avoidable, but it has not received the focus it deserves to this point. Ultimately, no matter how consistent the theory of a flat tax is with our early history of taxation, the current debate should not be divorced from the considerations underlying that early history of taxation, including the existence of multiple points of taxation and sources of wealth.

In 1913, customs duties supplied 47% of federal tax revenues, excise taxes supplied 46%, and income taxes provided only 2%.[555] Thus, consumption taxes accounted for over 90% of total federal revenues. Currently, less than 5% of federal revenues come from excise taxes, and revenue from customs duties is minuscule.[556] While there have been some recent efforts by both Bush and Clinton to tap into these sources, their overall effect has been negligible.[557] Even when state and local taxes are included in the mix, consumption taxes still account for only 17% of all government revenues.[558] This does not mean, however, that income taxes are the only form of taxation which need concern us.

Federal revenue sources in addition to the income tax, excise tax, and customs duties include the corporate income tax, estate and gift taxes, "miscellaneous receipts," and the all-important payroll taxes for social security and medicare.[559] First established in 1935 as part of the Social Security Act, payroll taxes now account for an increasing percentage of an individual's income and have been politically insulated from attack. The social security tax rate of 3% in 1950 has increased over five-fold to the 15.3% rate we have today.[560] Since payroll taxes are assuredly not progressive, they can alter the overall character of the federal revenue system.[561] The generous exemptions proposed by many flat tax plans appear to provide a means of compensating for this regression, but, as yet, no one has attempted to explicitly justify the existence or size of the exemptions on these grounds.

Thus, if our concern is fairness, any attempt to achieve flat or proportionate taxation must take into account these other revenue sources.[562] Over the

555. RATNER ET AL., *supra* note 70, at 516, 518.

556. *Hearings*, *supra* note 38 (statement of Michael J. Graetz, Professor of Law, Yale University). In 1976, around 6% of federal revenues came from excise taxes and less than 1% came from customs duties. RATNER ET AL., *supra* note 70, at 516.

557. *See* John Lee, *"Death and Taxes" and Hypocrisy*, 60 TAX NOTES 1393, 1399 (1993).

558. *Hearings*, *supra* note 38.

559. Scott Burns, *U.S. System Taxes Our Patience*, DALLAS MORNING NEWS, July 9, 1995, at 12H.

560. Gene Steuerle, *Can Flat Taxes Be Progressive?*, 68 TAX NOTES 887 (1995).

561. RATNER ET AL., *supra* note 70, at 517; Gene Steuerle, *Postwar Changes in the Overall Tax System*, 54 TAX NOTES 1163, 1164 (1992) [hereinafter Steuerle, *Postwar Changes*]; Gene Steuerle, *The Debate over Tax Progressivity*, 47 TAX NOTES 865, 866 (1990); *see also* Burns, *supra* note 559, at 12H. Payroll taxes take 15.3% of an individual's wages. *Id.*

562. I qualify this statement because there are certainly economic reasons why income taxes may be more worrisome than other taxes due to their visibility, influence on economic decisions, and other factors.

years, several studies have concluded that our overall tax system, including all government revenues, is proportionate. Blum and Kalven cite a 1948 study which found that the overall tax system was proportionate, with only a mild element of progression at the upper end.[563] More recent studies have come to similar conclusions.[564] These studies suggest that the progression in our income taxes compensates for regression elsewhere, just as it did in 1913. Social security taxes are certainly one possible target of compensation, since they are considered "ultra-regressive" given their proportional levy up to a $61,200 ceiling of income.[565]

We should not be quick, though, to write off tax reform based on estimates of the current distribution of tax burdens. The estimates' usefulness depends upon our assumptions regarding the direction of a particular tax burden, and our understanding of the appropriate tax universe against which to measure an income tax's effects. Payroll taxes, for instance, ostensibly fund progressive redistributive programs. Perhaps these taxes should be subtracted from the mix altogether in calculating the overall tax burden.[566] Furthermore, state sales taxes, which have traditionally been thought to inject a significant degree of regressivity into the overall system,[567] have recently been to be looked at more favorably. General sales taxes often exempt consumption goods and thus have a more progressive effect, according to some studies.[568] It may also be useful to consider state and local taxes separately. State and local governments used to rely almost exclusively on property taxation and each unit of government—federal, state, or local—was seen as occupying its own sphere of taxation. It was often said that the federal government agreed to apportion its direct taxation as part of its deal with the states to acquire exclusive rights for control of customs duties, a major source of indirect taxation.[569] In such a compartmentalized tax universe, it was appropriate to consider all units of government together in determining the overall tax burden. Today, however, most states have adopted some form of income tax, and it may be valuable to consider whether each governmental unit should be evaluated separately in determining the proper distribution of tax burdens.[570] Thus,

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563. BLUM & KALVEN, *supra* note 33, at 5 n.11 (citing R.A. Musgrave et al., *Distribution of Tax Payments by Income Groups: A Case Study for 1948*, 4 NAT'L TAX J. 1, 28 (1951)). Another study cited by Blum and Kalven, however, found that the tax system was "highly progressive" during the same year. *Id.* at 5 n.12 (citing Rufus S. Tucker, *Distribution of Tax Burdens in 1948*, 4 NAT'L TAX J. 269, 283 (1951)).

564. DAVID F. BRADFORD, UNTANGLING THE INCOME TAX 139-41 (1986) (citing a study by Joseph Pechman); *see* Allen D. Manvel, *The Pre-Reform Pattern of Tax Burdens for U.S. Families*, 35 TAX NOTES 805, 807 (1987).

565. BRADFORD, *supra* note 564, at 141; Jacob Weisberg, *Flat-Tax Fever*, N.Y. MAG., May 1, 1995, at 22.

566. Andrew J. Hoerner, *Economists Examine Whether Progressivity Has Regressed*, 56 TAX NOTES 1520 (1992); Steurele, *supra* note 560, at 888 ("Even a tax with declining rates—for instance, the U.S. social security tax that eventually imposes a zero rate on earnings above a maximum tax base—can be progressives if on net there is redistribution to lower-income individuals.").

567. *See e.g.*, Manvel, *supra* note 564, at 807.

568. Hoerner, *supra* note 566, at 1522.

569. *See, e.g.*, 26 CONG. REC. 6694 (1894) (Sen. Sherman).

570. PENNIMAN, *supra* note 375, at 8-9; RATNER ET AL., *supra* note 70, at 517; Steuerle, *Postwar Changes*, *supra* note 561, at 1164. Dan R. Bucks, executive director of the Multistate

more study is required on the overall distribution of tax burdens in our tax system. We may have a proportionate system by accident rather than design. An explicit recognition of this goal might allow us to pursue more efficient methods of achieving it.

Even if a flat or proportionate income tax should be a part of the overall mix of revenue sources, its viability still depends upon what is taxed. Most of the recent proposals, which are essentially variants on the "consumption" tax theme, exempt savings and investment income entirely.[571] Some suggest that such a tax system rewards the rich over the poor and thus "fail[s] the 'sniff test' of fairness for those who do not receive that sort of income."[572] As discussed earlier, the exemption of the rich through the nontaxation of investment income was a significant impetus to reform in both 1894 and 1913. Wealthy individuals were able to live off their investments and contribute almost nothing toward the expense of the government. It is little wonder that opponents of the current tax reform plans are conjuring up images of the Gilded Age in an attempt to demonstrate the plans' favoritism toward the rich. One commentator warns that the status quo's complexity is "a reasonable cost to retrieve the financial destiny of the nation from the voracious greed of the robber barons. Since Teddy Roosevelt, those policies have generally produced unparalleled economic vitality and a more equitable distribution of that prosperity for the American people."[573] Richard Gephardt argues that his five-rate income tax

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Tax Commission, warned that state income tax systems are so dependent upon the national income tax that efforts to abolish or abandon the national tax would require similar action at the state level. *MTC Urges Congress to Consider Impact of Tax Reform on States*, DAILY REPORT FOR EXECUTIVES, July 31, 1995, at G146. Thus, it may be impossible to separate state and federal tax systems in considering the overall distribution of tax burdens under present and future plans.

571. Susan Dentzer, *Trial Balloons on Tax Reform*, U.S. NEWS & WORLD REP., July 31, 1995, at 43. Michael Graetz pointed out in his testimony before the Senate Committee on Finance that although flat tax proposals characterize themselves as "income" taxes, they are generally "wage" taxes which only tax the amount people consume and not the amount they save. *Hearings*, *supra* note 38.

The exemption for investment and savings income is designed to bolster the U.S.'s anemic savings rate. While "economists disagree as to whether in fact an income tax does discourage saving," and "a consumption-based tax would not necessarily eliminate all distortions in favor of consumption," politicians have latched on to tax reform as a solution to the perceived problem. JOINT COMMITTEE ON TAXATION, *supra* note 1, at 5.

572. John Godfrey, *Flat Tax Backers Stress Simplicity, but Devil Remains in the Details*, 67 TAX NOTES 167, 168 (1995) (quoting University of Michigan economist Joel Slemrod). Some of the more vocal opponents to the flat tax have highlighted this problem in writing to area newspapers. *See* S.E. Clarke, *Exploding Myths of Flat-Tax Proposals*, L.A. TIMES, July 30, 1995, at D6; Austin M. Wright, *Flat Tax Proposal Another Giveaway to the Wealthy*, CIN. ENQUIRER, Aug. 7, 1995, at A11; *see also* Tony Barga, *Flat Tax Sets Up the Middle Class*, CIN. ENQUIRER, July 26, 1995, at A9 (arguing that if double taxation of investment income is a problem, the solution is to eliminate taxation at the corporate level and make sure "we tax all income when it reaches the pocket of a human being").

Even graduated consumption tax proposals such as the Domenici-Nunn USA tax do not solve this real or perceived inequity. Joseph Isenbergh explains that, no matter how steeply graduated the rates, a graduated tax on consumed incomes would never reach the unconsumed income. Since we value wealth even before it is consumed, this creates the appearance that the wealthy are evading taxes altogether, especially, as Isenbergh graphically illustrates, "when the wealth takes the form of ancestral manors and old master paintings that produce a stream of imputed income." Joseph Isenbergh, *The End of Income Taxation*, 45 TAX L. REV. 283, 349, 354 (1990).

573. Tommy Denton, *Let's Be Fair*, BALTIMORE SUN, July 19, 1995, at 15A.

proposal "is an effort to defend working families and the middle class against the greatest, most regressive redistribution of income since the days of the Robber Barons—the Armey 17 percent flat tax."[574] Several commentators predict that the exemption of investment income from taxation will be the political undoing of the various proposals.[575] The potential rejection of this provision of current proposals, however, does not mean that the concept of a flat income tax is impossible. A "pure, unamended" flat tax applies to all income, including investment income.[576] Moreover, some observers recommend combining a value-added tax with a broad-based income tax to encourage savings and investment while maintaining the kind of vertical equity that a flat or proportionate tax system is geared to provide.[577] Coupling a consumption tax with healthy rebates for lower-income individuals could also conceivably preserve an exemption for investment income.

Moving toward a goal of flat or proportionate taxation in our revenue system should not be confused with rejecting the notion of progressivity itself. Robert Eisner proposes a tax system which would include investment income and expand credits and subsidies for earned income, health care, education, research, and owner-occupied housing, resulting in what he calls "a really progressive 'flat tax.'"[578] Others, perhaps more genuinely concerned with the reputed gains in efficiency from radical reform, advocate a flat tax with progressive credits for lower-income individuals.[579] The point is that the tax system should have little to do with the welfare system or the safety net enacted during the New Deal. Taxes should redistribute money from the private sector

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574. Letter to the Editor, *The Rich Should Pay Plenty*, WASH. POST, July 22, 1995, at A20 (responding to James Glassman, *The Rich Already Pay Plenty*, WASH. POST, July 11, 1995, at A17).

575. *See* Robert Kuttner, *Dueling Tax Plans: One Adds Up, the Other Doesn't*, BUS. WK., May 15, 1995, at 28; *What Should Be Taxed Will Be the Key Issue*, WALL ST. J., May 1, 1995, at A1. The public's disgruntlement with the evasion of taxes by the wealthy was not limited to the turn of the century. Michael Graetz testified that he "remember[ed] well the outrage generated in 1969 by Treasury Secretary Joe Barr's revelation that 154 people that year had more than $200,000 in adjusted gross income and paid no taxes, the beating taken by Mrs. Dodge, in particular, who had $1 million of tax-exempt interest and no tax liability." Graetz also recalled "the expressions of outrage generated in 1986 when the laborers on General Electric's assembly line paid more taxes than the company." *Hearings*, *supra* note 38.

576. Editorial, *Reformers Really Want a Flat Tax with Wrinkles*, PALM BEACH POST, July 15, 1995, at 14A; Howard Gleckman, *Tax Reform Is Coming, Sure. But What Kind?*, BUS. WK., June 12, 1995, at 84.

577. Supporters of this idea include Yale Law professor Michael Graetz, former Treasury Secretary Nicholas Brady, and former Senators Danforth and Boren. *See Hearings*, *supra* note 38; Edward J. McCaffrey, *Tax Policy Under a Hybrid Income-Consumption Tax*, 70 TEX. L. REV. 1145, 1148 (1992). Isenbergh advocates a similar approach designed to achieve progressivity, but his approach is easily modified to approximate proportionate taxation and his commitment to progressive rates is merely a concession to the political popularity of the concept. Isenbergh, *supra* note 572, at 350. Ironically, this solution essentially replicates the hybrid consumption-income tax system instituted in 1913.

Vertical equity represents the notion that taxpayers with larger amounts of income should contribute larger amounts of tax. Jay M. Howard, 32 WASHBURN L.J. 43 (1992). These amounts could be proportionately or progressively larger depending upon the goals of the overall tax system.

578. Robert Eisner, *Make Taxes Fair, Not Flat*, WALL ST. J., Apr. 11, 1995, at A20.

579. *See* Bankman and Griffith, *supra* note 34, at 1966; Howard J. Gensler, *The Secret History of the U.S. Flat Tax*, 56 TAX NOTES 1657 (1992).

to the public sector, "the government can then spend the money as progressively as it wants."[580] As Charles Galvin points out, many "institutional arrangements" in our society redistribute wealth much more effectively than the tax system.[581]

CONCLUSION

John Sharp Williams declared in 1913 that advocates of a tax system geared toward progression and redistribution "are always considering something in a tax besides the tax; something in a tax besides the revenue."[582] This observation still holds true today. The current system is encrusted with the conflicting social goals of generations of policymakers. Moreover, the total tax burden has been affected in ways which may be contrary to the announced intentions of Congressional enactments. Proponents of radical tax reform should now strive to ensure, as their intellectual forefathers did from the Civil War through the ratification of the Sixteenth Amendment, that the tax system does not introduce its own inequities into the system while raising sufficient revenue to operate the government. That goal is difficult enough.

580. *Should America Keep Its "Progressive" Tax System?*, INVESTOR'S BUS. DAILY, July 24, 1995, at B1 (quoting economist Arthur Laffer).

581. Charles O. Galvin, *Would Haig-Simons Plus a Flat Tax Be the Best U.S. Tax System?*, 60 TAX NOTES 540 (1993).

582. 50 CONG. REC. 3821 (1913).