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# The First National Income Tax, 1861–1872

SHELDON D. POLLACK\*

## ABSTRACT

During the first months of the American Civil War, an important political debate played out in the U.S. Congress over how to restructure the nation's system of public finance and taxation. The fiscal crisis occasioned by the military conflict forced Republican leaders (who dominated our national political institutions) to adopt drastic and controversial measures including the expansion of public borrowing, the issuance of a national paper currency (so-called Greenbacks), and the adoption of a national income tax. To be sure, there was widespread resistance within the Republican Party to all of these proposals—most particularly, the income tax. Unsurprisingly, conservative Republicans from the Northeast adamantly opposed the impost. Despite this opposition, a majority of Republicans eventually acquiesced to this “odious” tax based on the need to fund the Union war effort. A number of key Republican leaders in Congress preferred this impost over the alternatives (in particular, a national land tax), casting their arguments in favor of the income tax in terms of “equity,” “justice,” and “fairness.” Based on their support, Congress approved a national income tax, signed into law by President Lincoln on August 5, 1861. While the war effort was largely funded by public borrowing and increases to tariff rates, the income tax made a modest contribution to financing the Northern military campaign and emerged as an important component in the reconstituted wartime fiscal system. Although the impost was allowed to expire soon after the resolution of the military conflict, the Civil War income tax served as the model for the modern income tax enacted by Congress more than 40 years later. Likewise, in the debate over our nation's first income tax, we hear the first articulations of arguments resurrected during the debate over the income tax of 1913 as well as in contemporary political discourse over federal tax policy.

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## I. Introduction

Our first national income tax was enacted in 1861 soon after the outbreak of the American Civil War.<sup>1</sup> The nation was in the grip of a bloody civil war that threatened the very survival of the Union. The fiscal crisis occasioned by the war forced political leaders to take drastic and extreme measures with respect to fiscal and tax policy as the leadership of the Republican Party, which controlled Congress as well as the executive branch, faced the daunting task of raising massive funds for the war effort. It was quickly realized that public borrowing and increases to existing revenue sources (specifically, tariff rates and customs duties) would be insufficient to finance the creation of the powerful Union military force necessary to conduct the war. In response, a variety of new imposts were proposed in Congress—including a national land tax, inheritance tax, and income tax.<sup>2</sup> In the congressional debate that ensued, we hear varied and complex positions articulated both in favor of and in opposition to each proposal.

Representatives from the Northeast were generally hostile to all forms of wealth taxation.<sup>3</sup> At the same time, a number of prominent Republican congressional leaders made the case for a national income tax in 1861 in terms of “justice” and “fairness.”<sup>4</sup> In the debate over the Civil War income tax we hear the first expressions of contemporary American concerns over the “equity” of taxation. Invariably, such ethical concerns relate to the distribution of the tax—namely, who will bear the burden of the impost. This question is the fundamental political issue raised by *all* tax policies. In the 1860s, an “equitable” tax was commonly perceived as one that the wealthy could not escape or evade. Distributional issues similarly triggered conflict between geographical regions and economic sectors (*e.g.*, manufacturing versus agriculture) concerning the burden of taxation. While itself highly contentious, income taxation emerged as the preferred alternative to a national land tax or increased tariffs and customs duties.

## II. The Civil War and the Income Tax

During the first year of the War of 1812 with Britain, the administration of James Madison was forced to adopt a system of “internal” taxes similar to what the Federalists had previously enacted and the Jeffersonian-Republicans had denounced and repealed when they took control of Congress and the White House in 1801. During the summer of 1813, Congress enacted new taxes on land, dwellings, and slaves, as well as excise taxes on carriages, refined sugar, alcohol, and other “luxury” commodities (including a duty on

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<sup>1</sup>Joseph A. Hill, *The Civil War Income Tax*, 8 Q. J. ECON. 416, 416 (1894).

<sup>2</sup>*Id.* at 417.

<sup>3</sup>*Cf. id.* at 418.

<sup>4</sup>SHELDON D. POLLACK, *REFINANCING AMERICA: THE REPUBLICAN ANTITAX AGENDA* 22-23 (2003).

imported salt).<sup>5</sup> Thereafter, a national income tax was proposed in the United States by Treasury Secretary Alexander J. Dallas to raise additional revenue for the ongoing war. This impost would have been the nation's first national income tax, but Congress took no action on the proposal and the military conflict ended before the Treasury Secretary's plan was ever formally considered by the legislative branch.<sup>6</sup>

With the end of the war, the entire system of internal taxes was repealed and the nation returned to its traditional 19th century sources of revenue: customs duties, the tariff, and the sale of public land.<sup>7</sup> These proved more than adequate to finance the limited activities of the early 19th century national government during peacetime as well as to service the massive war debt, which was retired by the end of the second Jackson administration.<sup>8</sup> In the decades that followed, receipts from the tariff alone typically exceeded all governmental expenditures.<sup>9</sup> This pattern of fiscal stability and budget surplus—marred by periodic banking crises and economic recessions—prevailed throughout the antebellum period right up to the outbreak of the Civil War.

With the election of the Republican candidate Abraham Lincoln in November 1860, the congressional delegations of 11 states from the South departed Washington, leaving the Republican Party overwhelming majorities in both Houses of Congress in addition to control of the White House.<sup>10</sup> Declarations of secession by the Southern states were viewed with alarm in Washington, but when armed hostilities broke out at Fort Sumter in South Carolina on April 12, 1861, the sentiment was widespread in the North that the insurrection would be suppressed in a matter of months.<sup>11</sup> That confidence was shattered on July 21, when Confederate troops routed a disorganized and ill-prepared Union army on a battlefield near Manassas, Virginia. Following the Union debacle at what became known as the First Battle of Bull Run, national policymakers set about building a powerful fiscal-military

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<sup>5</sup>DONALD STABILE, *THE ORIGINS OF AMERICAN PUBLIC FINANCE: DEBATES OVER MONEY, DEBT, AND TAXES IN THE CONSTITUTIONAL ERA, 1776–1836*, at 160 (1998).

<sup>6</sup>STATE OF THE TREASURY, H.R. DOC. NO. 13-438 (3rd Sess. 1815), *reprinted in AMERICAN STATE PAPERS* 885-87 (Gales and Seaton 1832).

<sup>7</sup>See STABILE, *supra* note 5, at 162-66.

<sup>8</sup>*Id.* The national debt peaked at just over \$127.0 million in 1816 following the War of 1812 and stood at \$58.4 when Jackson took office in March 1829. Under fiscal policies pursued by the Treasury Department, the debt was officially retired as of January 1, 1835.

<sup>9</sup>See STABILE, *supra* note 5, at 162-66.

<sup>10</sup>CONG. GLOBE, 37th Cong., 1st Sess. 2-3 (1861) (composition of the 37th Congress). When the 37th Congress convened, two members of the Virginia delegation returned to the House of Representatives with the intent to join the delegations other states.

<sup>11</sup>Senator John Sherman (Republican from Ohio) would later recall that, "None of us appreciated the magnitude of the contest—the enormous armies demanded and the vast sums required." *Quoted in JANE FLAHERTY, THE REVENUE IMPERATIVE* 66 (2009).

state in the North.<sup>12</sup> To do so required a vast mobilization of the citizenry and the formation of a large standing army, as well as a centralized bureaucracy to supply and support the troops.<sup>13</sup> Such a massive undertaking necessitated new sources of revenue for the Union government. Treasury officials and the Republican leadership of Congress quickly realized that the demands of the war effort would exceed the national government's traditional sources of revenue (*i.e.*, customs duties) as well as its capacity to borrow.<sup>14</sup> Lincoln's new Treasury secretary, Salmon P. Chase, opened negotiations during the summer of 1861 with bankers in New York, Philadelphia, and Boston for massive new borrowing.<sup>15</sup> But Chase fully understood that new taxes also would be necessary. The only question was *which* new taxes.<sup>16</sup>

With expenditures for the war effort consistently surpassing federal receipts, government officials were forced to take more drastic measures to raise revenue. Thus, a debate was precipitated in the 37th Congress over wartime

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<sup>12</sup>The creation of the powerful Union government in the North is the subject of RICHARD F. BENSEL, *YANKEE LEVIATHAN: THE ORIGINS OF CENTRAL STATE AUTHORITY IN AMERICA, 1859–1877*, at 2 (1990). Republican fiscal and economic policy during the war is the subject of HEATHER COX RICHARDSON, *THE GREATEST NATION OF THE EARTH: REPUBLICAN ECONOMIC POLICIES DURING THE CIVIL WAR* 5 (1997).

<sup>13</sup>The story of the expansion of the procurement department and the support apparatus of the Union army is told in MARK R. WILSON, *THE BUSINESS OF THE CIVIL WAR: MILITARY MOBILIZATION AND THE STATE, 1861–1865*, at 1 (2006).

<sup>14</sup>In fact, federal receipts from customs duties declined in the first half of 1861 as trade slowed and it became impossible to collect duties from goods passing through Southern ports. Congress finally passed the Morrill Tariff Act on March 2 during the final weeks of the Buchanan administration. See FLAHERTY, *supra* note 11, at 44–45.

<sup>15</sup>Salmon P. Chase was originally an anti-slavery Whig, who then emerged as a leader of the Liberty Party and soon after as a leader of the Free Soil Party (drafting the party platform in 1848, which proclaimed “Free Soil, Free Labor, Free Men”). Chase was elected to the U.S. Senate from Ohio in 1849 under that party's banner. He was then elected the first Republican governor of Ohio in 1855. After failing to gain his party's presidential nomination in 1860, Chase was returned to the Senate as a Republican. He resigned three days after taking office in March 1861 to become Lincoln's first Secretary of the Treasury. Chase's role in organizing and selling government debt obligations to private bankers, who would then resell Treasury debt instruments to private investors, is described in FLAHERTY, *supra* note 11, at 81–82, 140–41; see also BENSEL, *supra* note 12, at 243–54. A comprehensive account of Chase's role in financing the first year of the war through the sale of bonds as well as his special relationship with financier Jay Cooke of Philadelphia is recounted in RICHARDSON, *supra* note 12, at 31–65.

<sup>16</sup>Scholars generally agree that war is the great stimulus for institutional development and the expansion of a state's revenue-extraction capacity (specifically, the power of taxation). See generally, *e.g.*, JOHN BREWER, *THE SINEWS OF POWER: WAR, MONEY AND THE ENGLISH STATE, 1688–1783* (1989); SHELDON D. POLLACK, *WAR, REVENUE, AND STATE BUILDING: FINANCING THE DEVELOPMENT OF THE AMERICAN STATE* (2009); CHARLES TILLY, *COERCION, CAPITAL, AND EUROPEAN STATES, AD 990–1990* (1990). But this begs the critical question of *which* new forms of revenue-extraction will a state adopt when subjected to the pressures of war. There are always choices (and likewise, certain options will be precluded), and why a particular state turns to one new tax as opposed to another is determined by numerous endogenous factors relating to the balance of social, political, and economic interests. Thus, the structure of the politics and economic conditions that prevailed in the United States during the 1860s helps to explain why a national income tax was adopted as opposed to the various alternative imposts.

fiscal policy. That debate took place *within* the ranks of the Republican Party because of that party's dominance of the Union's political arena. The issues were first framed when, in light of the impending fiscal crisis, Chase requested \$80.0 million in new tax revenue to supplement receipts from increased duties on imported goods as well as authorization for \$250.0 million in new borrowing.<sup>17</sup> Recognizing that higher tariffs were necessary but insufficient to make up the projected revenue shortfalls, Chase laid out a comprehensive plan for a new system of internal taxation (unknown in the United States since the War of 1812), including an *ad valorem* tax on real and personal property as well as excise taxes on a host of luxury goods (alcohol, tobacco, jewelry, and "legacies").<sup>18</sup> Treasury officials calculated that a land tax imposed at a rate of three-tenths of one percent on real property located within those states remaining under the authority of the Union government would alone raise nearly \$23.0 million.<sup>19</sup> The report indicated that state officials would make valuations of property.<sup>20</sup> The wartime revenue proposal also included an income tax of ten percent, although no details were offered.<sup>21</sup> Chase blithely dismissed constitutional objections against such an unapportioned "direct" tax, leaving it to "the superior wisdom of Congress" to decide the specific combination of new taxes.<sup>22</sup> In response, Congress opened a debate on the relative merits of the various elements of the plan, all of which were widely viewed as "odious" and undesirable by Republicans.<sup>23</sup>

Providing members with virtually no advance notice to read the text, the Republican leadership of the Committee on Ways and Means reported a revenue bill to the floor of the House for debate on July 24, 1861.<sup>24</sup> Directing the legislative measure was Thaddeus Stevens of Pennsylvania, the chairman of Ways and Means, who initially committed to Chase's proposal for a national land tax (to be apportioned among the states based on population) and new "internal taxes" levied only on specific personal property (luxury items such as carriages, horses, and watches) as well as increased excise taxes on liquors

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<sup>17</sup>REPORT OF THE SECRETARY OF THE TREASURY ON THE STATE OF THE FINANCES, *reprinted* in S. EXEC. DOC. NO. 37-2, at 7 (1861).

<sup>18</sup>*See id.* at 15-16.

<sup>19</sup>*Id.* at 9. In his report, Chase suggested that valuations of property would be made by state officials. He also dismissed constitutional objections against such an unapportioned "direct" tax.

<sup>20</sup>*Id.*

<sup>21</sup>*Id.* at 10.

<sup>22</sup>*Id.* at 9-10.

<sup>23</sup>The record of the debate on the income tax of 1861 is generally found at CONG. GLOBE, 37th Cong., 1st Sess. 246-55, 323-31, 415-16 (1861).

<sup>24</sup>As the debate progressed, it immediately became clear than many members had not read the bill. At one point, Thaddeus Stevens exclaims in exasperation: "I wish to make a suggestion to the House. It is evident that this bill has not been read; and I do not wonder of it, for the printed bill was only brought in this morning, and it is a very long bill. We cannot discuss it so as to understand each other at all until gentlemen have read it." CONG. GLOBE, 37th Cong., 1st Sess. 249 (1861) (statement of Rep. Thaddeus Stevens of Pa.).

and other luxury commodities.<sup>25</sup> Conceding the many “disagreeable” aspects of such taxes, Stevens justified them on the grounds that they were necessary to “sustain the Government” against the attacks by the “rebels, who are now destroying or attempting to destroy this Government.”<sup>26</sup> Acknowledging that a national land tax apportioned among the states based on population inevitably would be inequitable, given the variations in population and assessable land, which would result in unequal *per capita* rates in the several states, Stevens justified the impost in light of the seriousness of the financial situation. As he bluntly put it, “the annihilation of the Government is the alternative.”<sup>27</sup>

Fiscal crisis or not, the proposal for a national land tax was vehemently opposed by a number of influential Republicans in the House, most notably Roscoe Conkling of New York, who denounced the impost as “obnoxious” and warned that its collection would require an “army of [federal] officers.”<sup>28</sup> Schuyler Colfax (who was elected Speaker of the House the following year) likewise condemned the land tax as the “most odious tax of all we can levy.”<sup>29</sup> Expressing sentiments widely held among representatives from the West, Isaac N. Arnold of Illinois (an ardent Lincoln supporter who had migrated from the Democrat Party to the Free Soil Party in the 1840s and then to the Republican Party in the 1850s) complained that an apportioned land tax would be highly inequitable to resident landowners in the Western states. Arnold pledged that “the State of Illinois is willing, in this hour of peril to the country, to contribute the last man and the last dollar to crush out this wicked rebellion; but her people desire that this tax shall be apportioned fairly, justly, and equitably.”<sup>30</sup> Equally hostile to a national land tax, John McClernand (a Unionist from Illinois who would soon resign his seat in Congress to command a brigade of state militia volunteers on the battlefield) complained that the tax would “fall with very heavy, if not ruinous effect, upon the great agricultural States of the West and Southwest. . . . Why should land be thus burdened, and property of other sorts exempted from taxation?”<sup>31</sup> Owen Lovejoy, another Lincoln Republican from Illinois, opined that “the honest and just method is to lay the tax upon all products alike, and compel each person to pay a tax on all he is worth, whether it be real or personal estate.”<sup>32</sup>

At this critical juncture in the debate, sentiment in the House began to shift in favor of a more “equitable” system of taxation—one with a broader

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<sup>25</sup> *Id.* at 415.

<sup>26</sup> *Id.* at 247.

<sup>27</sup> *Id.* (statement of Rep. Thaddeus Stevens of Pa.).

<sup>28</sup> *Id.* (statement of Rep. Roscoe Conkling of N.Y.).

<sup>29</sup> *Id.* at 248 (statement of Rep. Schuyler Colfax of Ind.).

<sup>30</sup> CONG. GLOBE, 37th Cong., 1st Sess. 249 (1861) (statement of Rep. Isaac N. Arnold of Ill.).

<sup>31</sup> *Id.* at 248-49 (statement of Rep. John A. McClernand of Ill.).

<sup>32</sup> *Id.* at 248 (statement of Rep. Owen Lovejoy of Ill.).

base that would include *all* forms of property, not just land.<sup>33</sup> Thaddeus Stevens himself reconsidered limiting the tax base to real estate and, thereafter, raised the option of an income tax: “We [the members of the Committee on Ways and Means] have not gone into the question of an income tax. That question is a large one. . . . An income tax may be the most equitable that can be raised.”<sup>34</sup> Along these lines, Frederick A. Pike (freshman Republican congressman from Maine) praised the success of income taxation in England and recommended that Congress adopt a similar system of taxation for the United States.<sup>35</sup> Pike proposed a broad-based income tax that would reach inheritances as well as the profits derived from *both* personal property (*e.g.*, interest paid on bank notes and mortgages) and real property (*i.e.*, rental income from land).<sup>36</sup> Citing concerns over equity, William Kellogg (a friend of Lincoln from Illinois) argued in favor of a tax on *both* real and personal property. He defended such an impost on the grounds that it would neither discriminate in favor of nor against any particular interest or class (*e.g.*, neither landowners in the West nor the “moneyed” men and “capitalists” in the Northeast), but rather would fairly apportion the cost of government on landholders and the wealthy:

A taxation on real estate, as well as personal property, would be more just, more equitable, more reasonable. . . . I wish to equalize and make just the taxation which is necessary to carry on the war and to raise money for the support of the Government, and do not wish to screen any particular interest.<sup>37</sup>

To these Republican legislators, an “equitable” tax was one that the rich could not escape.

Justin Smith Morrill, an influential member of the Committee on Ways and Means, now joined the debate, recommending a national income tax

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<sup>33</sup>Today, economists and scholars of public finance and taxation commonly refer to the principle that all income should be taxed at the same rate as “horizontal” equity. This principle is often proclaimed a primary goal of “good” tax policy. See, *e.g.*, Boris I. Bittker, *A “Comprehensive Tax Base” as a Goal of Income Tax Reform*, 80 HARV. L. REV. 925, 925 (1967).

<sup>34</sup>CONG. GLOBE, 37th Cong., 1st Sess. 248 (1861) (statement of Rep. Thaddeus Stevens of Pa.).

<sup>35</sup>To finance its ongoing wars with France, the United Kingdom enacted an income tax in 1799 under the government of William Pitt the Younger. The tax was repealed in 1816. For an account of the enactment of the tax, see EDWIN R. A. SELIGMAN, *THE INCOME TAX: A STUDY OF THE HISTORY, THEORY AND PRACTICE OF INCOME TAXATION AT HOME AND ABROAD* 72-81 (1911). See also MARGARET LEVI, *OF RULE AND REVENUE* 122-44 (1988). In the subsequent debate in the Senate, James Simmons would similarly turn to the British income tax as a model. CONG. GLOBE, 37th Cong., 1st Sess. 315 (1861) (statement of Sen. James F. Simmons of R.I.).

<sup>36</sup>CONG. GLOBE, 37th Cong., 1st Sess. 251-52 (1861) (statement of Rep. Frederick A. Pike of Me.).

<sup>37</sup>*Id.* at 249 (statement of Rep. William Kellogg of Ill.); see also *id.* at 326.



over a land tax.<sup>38</sup> Morrill warned his fellow Republicans that if Congress failed to enact such an impost, it would be necessary to “giv[e] up this Government” (*i.e.*, the Union).<sup>39</sup> The revenue demands of the Union military campaign necessitated that Republicans accept some forms of taxation that otherwise would be objectionable—namely, some form of wealth taxation. Among the options, Morrill proclaimed an income tax with a broad base as the “most just and equitable” form of taxation. Moreover, Morrill predicted that such a tax would raise twice as much revenue as the land tax.<sup>40</sup> That would be a major advantage considering the severity of the financial crisis facing the Union government. A further advantage of a national income tax was that, as an “indirect” tax, it would not have to be apportioned among the states based on population—at least that was the position asserted by Morrill and other Republican leaders.<sup>41</sup> There was judicial authority for that position. The Supreme Court’s 1796 decision in *Hylton v. United States* helped foster the widely held belief that only capitation taxes and taxes on land were “direct” taxes for which apportionment was required under the U.S. Constitution.<sup>42</sup> After the war, this view was affirmed by the Supreme Court in *Springer v. United States* (1880).<sup>43</sup> Even so, many remained unconvinced of the necessity, desirability, or constitutionality of enacting a national income tax. In particular, representatives of manufacturing and financial interests in the Northeast and Midwest objected to an income tax, the burden of which

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<sup>38</sup>Justin Smith Morrill was an influential figure in the Congress for decades, beginning his political career in 1855 in the House as a Whig and continuing in the Senate from 1867 to 1898. Morrill was one of the founders of the Republican Party in Vermont. While himself lacking a university education, he was instrumental in securing the passage of the Land Grant College Act of 1862. Morrill also was the chief architect of Republican tariff policy during the war, codified in the so-called Morrill Tariff Act of March 2, 1861. For an account of the Morrill Tariff and Republican tariff policy during the Civil War, see RICHARDSON, *supra* note 12, at 103-11; F. W. TAUSSIG, *THE TARIFF HISTORY OF THE UNITED STATES* 155-70 (2d ed. 1896).

<sup>39</sup>CONG. GLOBE, 37th Cong., 1st Sess. 252 (1861) (statement of Rep. Justin Morrill of Vt.).

<sup>40</sup>*Id.* at 330.

<sup>41</sup>For a discussion of how and why Republican leaders denominated the income tax as an “indirect” tax, see FLAHERTY, *supra* note 11, at 70-71.

<sup>42</sup>U.S. CONST. art. 1, § 9 (“No capitation, or other direct, Tax shall be laid, unless in Proportion to the Census of Enumeration herein before directed to be taken.”); *Hylton v. United States*, 3 U.S. 171, 176, 179-80 (1796) (holding that a federal carriage tax enacted by the Federalists could not be a “direct” tax since it could not be apportioned without producing arbitrary and inequitable results and noting in dictum that capitation and land taxes were examples of direct taxes within the meaning of Article I, Section 9 of the Constitution).

<sup>43</sup>*Springer v. United States*, 102 U.S. 586, 602 (1880) (finding the Civil War income tax constitutional as an indirect tax that need not be apportioned among the states based on population), *overruled by* *Pollock v. Farmers’ Loan & Trust Co.*, 157 U.S. 429 (1895), *aff’d on reh’g*, 158 U.S. 601, 637 (1895) (holding that the unapportioned income tax on interest, dividends, and rents imposed by the Income Tax Act of 1894 was a direct tax, and hence unconstitutional as it violated Article I, Section 9 of the Constitution requiring that direct taxes be apportioned).

would fall directly on their constituents.<sup>44</sup> But in the end, a majority of House Republicans sided with Morrill and Pike, recognizing the seriousness of the financial crisis that necessitated some new form of taxation, and given the choice, preferring a national income tax over the land tax. A revenue bill that substituted an income tax for a portion of the “direct” land tax and luxury excise taxes was approved by the House on July 29 by a 77–60 vote.<sup>45</sup> Republicans were found on both sides of the vote.

In the Senate, an income tax was similarly viewed by Republicans as the least objectionable among the various “odious” and “obnoxious” options. Several influential Republican leaders were supportive of the proposal, arguing that an income tax was necessary to assure that the wealthy pay their “fair share” of the taxes necessary to fund the war effort. James F. Simmons of Rhode Island (a member of the Finance Committee who had served in the Senate from 1841 to 1847 as a Whig and was reelected in 1856 as a Republican) recommended an income tax with a high personal exemption of \$1,000 precisely on the grounds that it would affect *only* the wealthy, leaving the rest of the citizenry untouched—unlike the proposed land tax, which would impose a severe burden on cash-poor farmers who owned their own land. Simmons declared:

Let us tax property in the last resort, when we have to reach the poor as well as the rich, people of small means as well as those with large; but I do not believe this country has come to pass to be driven to a resource [the land tax] of such extreme measures.<sup>46</sup>

Such sentiments were widely shared in the Senate, which moved quickly to approve the income tax bill. The Senate version of the impost was less “burdensome” with an \$800 exemption—as opposed to the \$600 exemption provided for in the House bill.<sup>47</sup> Recognizing that only a “small number of persons in each state” would be subject to the tax, the conference committee recommended a barebones administrative apparatus that included just one assessor and one federal tax collector in each state to enforce the statute.<sup>48</sup> So much for Conkling’s ominous warning about an “army” of federal revenue collectors.

Without further debate, the bill reported by the conference committee was approved by both Houses, and President Lincoln signed the measure into law

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<sup>44</sup> CONG. GLOBE, 37th Cong., 1st Sess. 326-30 (1861).

<sup>45</sup> *Id.* at 331.

<sup>46</sup> *Id.* at 254 (statement of Sen. James F. Simmons of R.I.). Simmons served in the Senate from 1841 to 1847 as a Whig and was reelected in 1856 as a Republican. He resigned from the Senate in September 1862 to avoid expulsion for financial improprieties. *SIMMONS, James Fowler*, BIOGRAPHICAL DIRECTORY OF THE U.S. CONGRESS, last accessed Oct. 11, 2013, <http://bioguide.congress.gov/scripts/biodisplay.pl?index=S000417>.

<sup>47</sup> CONG. GLOBE, 37th Cong., 1st Sess. 415 (1861) (statement of Rep. Thaddeus Stevens of Pa.).

<sup>48</sup> *Id.*

on August 5, 1861.<sup>49</sup> This measure was the first national income tax for the United States. While no identifiable faction within the governing party was committed to income taxation as a matter of principle, a majority of Republicans were ultimately willing to accept the impost as a political necessity and the lesser among evils. Generally, the impost was justified in light of the military and fiscal crisis facing the Union. At the same time, the income tax was favorably viewed by a number of key Republican leaders as the most *equitable* form of taxation. As such, it was the least “odious” option for a majority of congressional Republicans.

The income tax of August 5, 1861, provided for a flat tax of three percent on annual income above the personal exemption of \$800.<sup>50</sup> Interest income from securities was taxed at a lower rate of one and a half percent.<sup>51</sup> Conversely, the income of citizens residing abroad during the war was taxed at a higher rate of five percent.<sup>52</sup> According to Thaddeus Stevens, this special rule was necessary so that such citizens would bear their equitable share of the financial burden of the war. As Stevens explained:

Where persons reside abroad who hold property in this country on which they derive an income, which they spend abroad, we have laid an income tax of five per cent. We thought it right that they should bear more of the burden of the country than those who spend their income in the United States.<sup>53</sup>

The notion was that because those citizens living abroad were untouched by the many restrictions on ordinary life experienced during wartime in the United States and otherwise contributing little to the war effort, equity demanded that they pay a *higher* percentage of their income to the Union government than their fellow countrymen.

It was widely understood that on account of the \$800 personal exemption, only the wealthy would be subject to the tax, with the vast majority of citizens exempt.<sup>54</sup> Collections under the tax were not scheduled to begin until June 1862.<sup>55</sup> In fact, no revenue was ever collected under the income tax of 1861. Treasury Secretary Chase questioned the wisdom of implementing a tax that

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<sup>49</sup> Act of Aug. 5, 1861, ch. 45, § 49, 12 Stat. 292, 309 (1861) [hereinafter *Revenue Act of 1861*] (repealed 1862).

<sup>50</sup> *Id.*

<sup>51</sup> John Witte refers to the special rate for interest paid on government bonds as the “first loophole” in the tax code. JOHN F. WITTE, *THE POLITICS AND DEVELOPMENT OF THE FEDERAL INCOME TAX* 68 (1985).

<sup>52</sup> Revenue Act of 1861, § 49, 12 Stat. at 309 (repealed 1862).

<sup>53</sup> CONG. GLOBE, 37th Cong., 1st Sess. 415 (1861) (statement of Rep. Thaddeus Stevens of Pa.).

<sup>54</sup> Estimates vary and comparisons of purchasing power are difficult to make, but \$800 in 1861 would be equivalent to anywhere from \$30,000 to \$40,000 today.

<sup>55</sup> Revenue Act of 1861, § 51, 12 Stat. at 310 (repealed 1862).

was projected to yield less in revenue than the cost of collection.<sup>56</sup> Compounding the problem, no collection apparatus had been provided under the statute.<sup>57</sup> Several months before the first payments of tax were due on June 30, 1862, Congress acquiesced to Chase's recommendation and postponed enforcement of the statute while they considered a revised (and more comprehensive) version of an income tax—one that would include a slightly graduated rate to bring in more revenue, as well as an administrative apparatus. These deliberations produced a more sophisticated statute, which was signed into law by President Lincoln on July 1, 1862.<sup>58</sup> Under the income tax of 1862, a tax of three percent was imposed on the “annual gains, profits or incomes” above \$600 of any person residing in the United States, “whether derived from any kind of property, rents, interest, dividends, salaries, or from any profession, trade, employment, or vocation carried on in the United States or elsewhere, or from any source whatever.”<sup>59</sup> The statute provided that the tax applied to the salary of every person in the “civil, military, naval, or other employment of the United States.”<sup>60</sup> This tax base included the salaries of “senators and representatives and delegates in the Congress.”<sup>61</sup> Whether the tax applied to the salary of the president or federal judges was unclear and subject to protracted dispute.<sup>62</sup>

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<sup>56</sup>REPORT OF THE SECRETARY OF THE TREASURY ON THE STATE OF THE FINANCES, *reprinted in* S. EXEC. DOC. NO. 37-2, at 15 (1861):

The Secretary is acquainted with no statistics which afford the means of a satisfactory estimate of the amount likely to be realized from the income tax. Considering, however, how large a proportion of incomes, after the deductions sanctioned by law, will fall within the exemption limit of \$800 a year; and considering also what numerous questions will certainly perplex its assessment and collection, he respectfully submits to consideration of Congress whether the probable revenue affords a sufficient reason for putting in operation, at great cost, the machinery of the act, with a view . . . to the collection of the income tax.

<sup>57</sup>“It did not provide for an enforcement mechanism. Consequently, the law generated little additional revenue.” *Featured Document: The Revenue Act of 1861*, U.S. SENATE, last accessed Oct. 10, 2013, [http://www.senate.gov/artandhistory/history/common/civil\\_war/Revenue-Act\\_FeaturedDoc.htm](http://www.senate.gov/artandhistory/history/common/civil_war/Revenue-Act_FeaturedDoc.htm).

<sup>58</sup>Revenue Act of 1862, ch. 119, 12 Stat. 432.

<sup>59</sup>Revenue Act of 1862, § 90, 12 Stat. at 473. Randolph Paul observed that the tax apparently did not reach capital gains other than gains from real property held for a short term—originally, less than one year, and later, two years. RANDOLPH E. PAUL, *TAXATION IN THE UNITED STATES* 13 (1954).

<sup>60</sup>Revenue Act of 1862, § 86, 12 Stat. at 472.

<sup>61</sup>*Id.*

<sup>62</sup>The story of how President Lincoln “voluntarily” paid the tax, which was subsequently refunded to his estate in 1872, is recounted in Joseph J. Thorndike, *Abraham Lincoln Paid Income Taxes—But He Didn't Have To*, 140 *TAX NOTES (TA)* 122, 122-23 (July 8, 2013). Chief Justice Roger Taney objected to the imposition of the tax on the salaries of federal judges, arguing that to do so would violate constitutional prohibitions against diminishing their compensation “during their continuance in office.” *Id.* at 123. Despite this objection, the tax continued to be withheld from the salaries of federal judges, although later was refunded. *Id.*

The statutory rate increased to five percent on income in excess of \$10,000.<sup>63</sup> These features led the editors of the *New York Times* to praise this impost, which was “levied upon a person’s purse,” as “probably one of the most equitable and bearable taxes that can be imposed.”<sup>64</sup> The income tax of 1862 was part of a broader revenue package that included a three percent *ad valorem* tax on manufactured goods, a stamp tax, a liquor tax, and a tax on the gross receipts of certain corporations—namely railroads, banks, trust companies, and insurance companies.<sup>65</sup> In addition, withholding at the sources was imposed on the tax on government salaries as well as interest and dividends paid by the aforementioned companies.<sup>66</sup> The revenue bill also included the first national inheritance tax.<sup>67</sup> These drastic measures were grudgingly accepted by the public in light of the dire financial circumstances of the Union government.

To collect the revenue from these new taxes (in particular, the income tax), Congress established the Office of the Commissioner of Internal Revenue as a bureau in the Department of Treasury.<sup>68</sup> The agency was charged with collecting taxes within 185 collection districts, each with one assessor and one collector (appointed with the consent of the Senate). George S. Boutwell of Massachusetts was recommended by Treasury Secretary Chase and appointed by Lincoln as the first Commissioner of Internal Revenue.<sup>69</sup> During the summer of 1862, he began the daunting task of collecting revenue under the new income tax with a staff of only three clerks. By January of the next year, he expanded his administrative staff to 3,882 civilian employees—most of them assessors and collectors who earned a commission on the taxes collected.<sup>70</sup>

For the next two years, the income tax made a modest but welcome contribution to the Treasury, which still relied largely on revenue from the tariff and public borrowing to finance the Union war effort as well as a new paper currency (Greenbacks) to facilitate the payment of the salaries of soldiers by the

<sup>63</sup>Revenue Act of 1862, § 90, 12 Stat. at 473.

<sup>64</sup>*The National Finances—The New Era of Taxation*, N.Y. TIMES, Jan. 8, 1862, at 4.

<sup>65</sup>Revenue Act of 1862, §§ 82-85, 12 Stat. at 470-71.

<sup>66</sup>Revenue Act of 1862, §§ 86, 91, 12 Stat. at 472, 473-74.

<sup>67</sup>The inheritance tax was imposed on estates in excess of \$1,000 at a rate of .75% on legacies to lineal descendants, reaching five percent on legacies to unrelated parties. Bequests to a spouse were exempt. Revenue Act of 1862 § 111, 12 Stat. at 485-86.

<sup>68</sup>Revenue Act of 1862, § 1, 12 Stat at 432.

<sup>69</sup>A former governor of Massachusetts who helped organize the Republican Party in that state, Boutwell later served in Congress and was subsequently appointed Secretary of Treasury by President Ulysses S. Grant. Years later, Boutwell recounted his experiences as the first Commissioner in organizing the Internal Revenue Office in GEORGE S. BOUTWELL, REMINISCENCES OF SIXTY YEARS IN PUBLIC AFFAIRS 303-15 (1902).

<sup>70</sup>GEORGE S. BOUTWELL, LETTER OF THE SECRETARY OF THE TREASURY, S. EXEC. DOC. NO. 37-20, at 1-2 (3d Sess. 1863). Collectors were paid a commission of four percent of the first \$100,000 collected and two percent on amounts in excess of \$100,000. Revenue Act of 1862, § 34, 12 Stat at 445. The administration of the Civil War income tax is discussed in HARRY EDWIN SMITH, THE UNITED STATES FEDERAL INTERNAL TAX HISTORY FROM 1861 TO 1871 271-91 (1914).

government and taxes to the government.<sup>71</sup> To be sure, the income tax raised only \$2.7 million in the fiscal year ending June 30, 1863, but revenue rose to a respectable \$20.3 million the next year.<sup>72</sup> At that time, Commissioner Boutwell proposed a more progressive rate structure to boost receipts.<sup>73</sup> This proposal turned out to be much more controversial than the original proposal in 1861 for an income tax. Spurning Boutwell's advice, the Committee on Ways and Means recommended a flat rate of five percent.<sup>74</sup> Thereafter, the House convened in April 1864 to debate the merits of the alternative rate structures. Augustus Frank, a banker and railroad man from New York, proposed a graduated rate structure that would begin at five percent on income over \$600, rise to seven and a half percent on income above \$10,000, and then hit ten percent on income above \$25,000. Frank declared: "I think it is just, right, and proper that those having a large amount of income shall pay a larger amount of tax."<sup>75</sup> Ironically, one of the strongest critics of the proposed graduated rate was Justin Morrill, who had been a leading advocate for the income tax only three years earlier. However, the income tax of 1861 was imposed at a modest flat rate of three percent.<sup>76</sup> In 1864, Congress was considering a graduated rate structure that would require the wealthy to pay income tax at significantly higher rates. Morrill objected to this change in unusually harsh terms, evoking the imagery of class warfare that would be a common theme of Republicans for the next 150 years. Morrill denounced the progressive rates as a manifestation of the "spirit of agrarianism" and hostile to

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<sup>71</sup>On February 25, 1862, Congress passed the first Legal Tender Act with the support of Chase and the Treasury. The new paper currency was used to pay the salaries owed Union soldiers and thereafter was freely tradable for goods and services. For an account of the campaign to issue a national paper currency during the Civil War, see BENSEL, *supra* note 12, at 162; LEONARD P. CURRY, *BLUEPRINT FOR MODERN AMERICA: NON-MILITARY LEGISLATION OF THE FIRST CIVIL WAR CONGRESS 188-96* (1968); FLAHERTY, *supra* note 11, at 82-88; RICHARDSON, *supra* note 12, at 75-102.

<sup>72</sup>U.S. DEP'T OF COMMERCE, *HISTORICAL STATISTICS OF THE UNITED STATES: COLONIAL TIMES TO 1970*, H.R. DOC. NO. 93-78, pt. 2, at 1091 (1st Sess. 1975). The Treasury Department reported just \$1.7 million in revenue collected from all forms of "direct taxation" for fiscal year ending June 30, 1862. U.S. DEP'T OF THE TREASURY, *REPORT OF THE SECRETARY OF TREASURY ON THE STATE OF THE FINANCES FOR THE YEAR ENDING JUNE 30, 1862*, S. EXEC. DOC. NO. 37-1, at 31 (3d Sess. 1862). For a fuller account of fiscal policy during the Civil War, see JAMES D. SAVAGE, *BALANCED BUDGETS AND AMERICAN POLITICS* 123-31 (1988).

<sup>73</sup>Boutwell recommended that Congress increase the tax rate to as high as 6.0% on annual income in excess of \$20,000. U.S. DEP'T OF THE TREASURY, *REPORT OF THE SECRETARY OF TREASURY ON THE STATE OF THE FINANCES FOR THE YEAR ENDING JUNE 30, 1863*, S. EXEC. DOC. NO. 38-1, at 70 (1863).

<sup>74</sup>DONALD R. KENNON & REBECCA M. ROGERS, *THE COMMITTEE ON WAYS AND MEANS: A BICENTENNIAL HISTORY 1789-1989*, H.R. DOC. NO. 100-244, at 163 (1989).

<sup>75</sup>CONG. GLOBE, 38th Cong., 1st Sess. 1876 (1864) (statement of Rep. Augustus Frank of N.Y.). Frank went on to make clear that his motivation was primarily revenue, and not an attack on the wealthy: "I believe, with the Secretary of the Treasury, that the larger tax that we pay at this time the safer we are and the better will be the securities of the Government. We are all interested in increasing the amount of taxation." *Id.*

<sup>76</sup>Revenue Act of 1861, ch. 45, § 49, 12 Stat. 292, 309 (repealed 1862).

the “very theory of our institutions,” which is “entire equality; that we make no distinction between the rich man and the poor man.”<sup>77</sup> To impose a *higher* rate of taxation on the rich man would violate this theory of “entire equality.” Equity demanded that the wealthy not escape the tax—not that they pay at a higher rate. Morrill objected that progressive tax rates “punish men because they are rich” and amount to nothing less than “seizing the property of men for the crime of having too much.”<sup>78</sup> For Morrill, a flat income tax of three percent provided an equitable balance to the regressive tariff while a tax with a graduated rate structure was “confiscatory.” Equally adamant in his opposition to the proposed graduated rates, Thaddeus Stevens lamented that this was a “strange way to punish men because they are rich.”<sup>79</sup>

Notwithstanding such ominous warnings, the fundamental motivation behind the progressive rates was neither the spirit of “agrarianism” nor the desire to “punish” the wealthy by seizing their property. After all, this was a Republican Congress dominated by Eastern interests. These were “Radical Republicans” with respect to policies toward the South, slavery, and reconstruction—not the redistribution of wealth in the United States. In 1864, progressive rates were not so much a reflection of populist ideology as a response to the Union government’s urgent need for revenue. To a majority of Republicans, the income tax was the most equitable mechanism for raising that vital revenue. Out of necessity, they were willing to accept a national income tax—even one with a modestly progressive rate structure. To be sure, there were a handful of proponents of progressive taxation who expressly based the case for progressive tax rates on principles of equity. Here we hear a precursor of the argument for progressive income taxation later advanced by Progressive Republicans early in the 20th century as well as liberal Democrats during the New Deal.

In the end, the House agreed that a new rate structure was necessary and approved a bill that would tax income above a \$600 exemption at a rate of five percent, rising to seven and a half percent on income above \$10,000 and topping out at ten percent on income above \$25,000.<sup>80</sup> Because \$25,000 was an extraordinary income in the 1860s, few (if any) taxpayers would actually

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<sup>77</sup> CONG. GLOBE, 38th Cong., 1st Sess. 1940 (1864) (statement of Rep. Justin Morrill of Vt.).

<sup>78</sup> *Id.*

<sup>79</sup> CONG. GLOBE, 38th Cong., 1st Sess. 1876 (1864) (statement of Rep. Thaddeus Stevens of Pa.). Stevens further claimed that a graduated rate amounted to “nothing more than a punishment of the rich man because he is rich.” *Id.*

<sup>80</sup> See KENNON & ROGERS, *supra* note 74, at 163.

face the ten percent rate.<sup>81</sup> That said, the progressive rate structure was a dramatic departure from the original Civil War income tax, which was initially imposed in 1861 at a flat rate of three percent and was amended the next year to include a second-tier bracket of five percent. The maximum rate proposed in 1864 would be *double* that.

The Senate bill initially followed the basic contours of the House proposal, although the rate structure of the income tax was modified slightly. Nevertheless, it remained a graduated rate structure that imposed a higher rate on those with greater income.<sup>82</sup> Thereafter, a compromise revenue bill that included the ten percent tax bracket was approved by both Houses of Congress in June and soon after signed into law by Lincoln on June 30th.<sup>83</sup> Under the 1864 statute, a tax of five percent was imposed on income above the \$600 personal exemption, seven and a half percent on income over \$5,000, and ten percent on income over \$10,000, rather than the \$25,000 provided for in the House bill.<sup>84</sup> With this graduated rate structure, the revenue collected under the income tax increased dramatically, reaching nearly \$61.0 million in 1865 and exceeding \$73.0 million in 1866—the latter constituting one-fifth of total receipts of the federal government for the year.<sup>85</sup> The legislation also increased the inheritance tax with respect to legacies of personal property and added a new tax on devises of real property.<sup>86</sup>

### III. The Income Tax After the Civil War

Overall, the Republican Party had dramatically restructured the nation's institutions of fiscal and tax policy during the course of the Civil War. As Heather Cox Richardson concludes: “[T]he Republicans tried to bolster a new national system, and most congressional Republicans were pleased

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<sup>81</sup>\$25,000 in 1864 would be equal to anywhere from \$500,000 to \$750,000 in current dollars. It is unknown how many taxpayers actually paid tax on income above \$25,000, nor do figures show how many taxpayers paid at the ten percent rate. However, we know that \$277,462 in tax was collected on incomes above \$10,000 in 1863 and \$6.86 million was collected in 1864. U.S. DEP'T OF THE TREASURY, ANNUAL REPORT OF THE COMMISSIONER OF INTERNAL REVENUE ON THE OPERATIONS OF THE INTERNAL REVENUE SYSTEM FOR THE YEAR 1872, H.R. EXEC. DOC. NO. 42-4, at 138 (3d Sess. 1872).

<sup>82</sup>See KENNON & ROGERS, *supra* note 74, at 163. Garrett Davis, a “War Democrat” from Kentucky who had opposed secession, argued that a graduated rate structure reflected the “general principle . . . that men shall pay [taxes] according to their ability to pay.” CONG. GLOBE, 38th Cong., 1st Sess. 2515 (1864) (statement of Sen. Garrett Davis of Ky.). Garrett defended the higher tax on the wealthy in light of their failure to contribute on the battlefield: “[T]he poor men do the fighting in the war” while few, if any, millionaires or men whose income was above \$25,000 had “gone to the field.” *Id.*

<sup>83</sup>Revenue Act of 1864, ch. 173, § 116, 13 Stat. 223.

<sup>84</sup>Revenue Act of 1864, § 116, 13 Stat. at 281.

<sup>85</sup>U.S. DEP'T OF COMMERCE, HISTORICAL STATISTICS OF THE UNITED STATES: COLONIAL TIMES TO 1970, H.R. DOC. NO. 93-78, pt. 2, at 1091 (1st Sess. 1975).

<sup>86</sup>The modifications to the inheritance tax, supported by Justin Morrill, are found in the Revenue Act of 1864, §§ 124-150, 13 Stat. at 285-91. See PAUL, *supra* note 59, at 16.



with their wartime tax and tariff legislation.<sup>87</sup> The income tax became an important source of revenue for the national government by the end of the war, although it still generated considerably less than customs duties, excise taxes, or the tariff. Significantly, the burden of the Civil War income tax fell disproportionately on the Northeast, which contributed nearly 75% of the revenue from the tax; three states alone (New York, Pennsylvania, and Massachusetts) contributed more than 61% of the revenue from the income tax.<sup>88</sup> Not surprisingly, regional opposition to the impost surfaced as soon as the war ended in 1865, and pressure mounted in Congress to repeal the tax.<sup>89</sup> But repeal was by no means a foregone conclusion. Influential Republicans in Congress favored retaining some form of income taxation during peacetime. The extraordinary fiscal crisis experienced during the Civil War explains the reluctant acceptance of a national income tax by Republicans *during* the war, but why did these Republican leaders support retention of an income tax *after* the conflict?

One major reason was financial. The Northern war effort left the nation \$2.3 billion in debt, and there was a widespread recognition that some of the extraordinary wartime revenue measures would have to be retained for some time to pay off that debt. For that reason, Thaddeus Stevens and Justin Morrill recommended retention of a modest income tax during peacetime.<sup>90</sup> Supporters in the Senate included William P. Fessenden of Maine and John Sherman of Ohio, who between them controlled the Committee on Finance during the critical period from 1861 to 1877.<sup>91</sup> From his vantage point on the Finance Committee, Senator Sherman played a critical role in counseling his Republican colleagues to retain the income tax as an important fiscal

<sup>87</sup>RICHARDSON, *supra* note 12, at 137.

<sup>88</sup>See U.S. DEP'T OF THE TREASURY, ANNUAL REPORT OF THE COMMISSIONER OF INTERNAL REVENUE ON THE OPERATIONS OF THE INTERNAL REVENUE SYSTEM FOR THE YEAR 1872, H.R. EXEC. DOC. NO. 42-4, at 115 (3d Sess. 1872). During the ten years it was in effect, the Civil War income tax raised a total of \$376.0 million. *See id.*

<sup>89</sup>See KENNON & ROGERS, *supra* note 74, at 198-204. Roscoe Conkling, by then in the Senate, complained that New York contributed one-third of total receipts collected under the income tax but had only one-eleventh of the population of the nation. *See* CONG. GLOBE, 41st Cong., 2nd Sess. 4760 (1870) (statement of Sen. Roscoe Conkling of N.Y.).

<sup>90</sup>See KENNON & ROGERS, *supra* note 74, at 203; Steven A. Bank, *Origins of a Flat Tax*, 73 DENV. U. L. REV. 329, 354-58 (1996).

<sup>91</sup>William P. Fessenden was elected to the Senate in 1854 as a Republican from Maine. He chaired the Committee on Finance from March 1861 to July 1864, at which time he served a brief stint as Treasury secretary (replacing Salomon Chase, Lincoln's first Treasury secretary). In March 1865, he returned to his Senate seat and resumed chairmanship of the Committee on Finance. From 1865 to 1867, he also chaired the Joint Committee on Reconstruction. John Sherman of Ohio was elected to the House as a Republican in 1854. He served as chairman of the House Committee on Ways and Means from 1860 to 1861 and thereafter was elected to the Senate in 1861 to fill the seat vacated by Salomon Chase, who had resigned to become Treasury secretary. Sherman served as chairman of the Committee on Finance during Fessenden's tenure at Treasury and returned to that position following Fessenden's retirement from the Senate in 1867. Sherman remained chairman of the Committee on Finance until 1877.

tool of government. The new Commissioner of Internal Revenue, Columbus Delano of Ohio, likewise counseled retaining the income tax for financial purposes.<sup>92</sup> For a number of years, a majority of Republicans heeded this advice as Congress temporarily renewed the income tax in 1866, 1867, and 1870.<sup>93</sup> Reflecting what would become a long-standing division within the Republican Party in the ensuing decades, moderates accepted a minor income tax in conjunction with modest reductions in tariff rates, while conservatives campaigned for repeal of the income tax and higher protective tariffs.<sup>94</sup>

As economic conditions improved, however, it became increasingly difficult to justify retention of an income tax during peacetime on financial grounds. Revenue from the income tax decreased while customs duties soared in the wake of the increased foreign trade that commenced following the war. Revenue from the income tax had already begun to decline after 1866.<sup>95</sup> The downward trend was exacerbated in 1867 when the graduated rate structure was repealed and replaced with a flat tax of five percent on income above the personal exemption, which was increased to \$1,000.<sup>96</sup> Under the Act of July 14, 1870, Congress further reduced rates for the income tax, raised the exemption to \$2,000, and provided that the impost would expire at the end of 1871.<sup>97</sup> On account of these changes (in particular, the higher exemption), less than 0.2% of the population was now subject to the tax.<sup>98</sup> As a consequence, revenue from the income tax amounted to just \$37.8 million in 1870.<sup>99</sup> As revenue declined, support further waned. The editors of the *New York Daily Tribune* lamented that the “House of Representatives has been at work . . . revising and codifying our Internal Revenue System, and has con-

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<sup>92</sup>Delano stated: “My opinion is that, so long as a large internal revenue is required by financial necessities of the government, a portion of that revenue should be collected from incomes . . .” U.S. DEP’T OF THE TREASURY, REPORT OF THE COMMISSIONER OF REVENUE, H.R. EXEC. DOC. NO. 41-4, at 14 (2d Sess. 1869).

<sup>93</sup>Revenue Act of 1866, ch. 184, 14 Stat. 98; Revenue Act of 1867, ch. 169, 14 Stat. 471; Revenue Act of 1870, ch. 255, 16 Stat. 256.

<sup>94</sup>CHRISTOPHER SHEPARD, THE CIVIL WAR INCOME TAX AND THE REPUBLICAN PARTY 1861-1872, at 73-93 (2010).

<sup>95</sup>See THE AMERICAN WAY IN TAXATION: INTERNAL REVENUE, 1862-1963, at 282 (Lillian Doris ed., 1963).

<sup>96</sup>Revenue Act of 1867, ch. 169, § 13, 14 Stat. 471, 477-80.

<sup>97</sup>Revenue Act of 1870, ch. 255, §§ 6-8, 16 Stat. 256, 257-58. Under the legislation, the inheritance tax was repealed altogether.

<sup>98</sup>With the exemption set at \$600 in 1866, an estimated 1.3% of the populace paid income tax. With an exemption of \$1,000 from 1867 to 1870, only 0.7% paid any income tax. With the exemption raised to \$2,000 for 1871 and 1872, only 74,775 persons paid any income tax in 1871 and 72,949 persons in 1872. This amounted to about 0.2% of the population. U.S. DEP’T OF THE TREASURY, ANNUAL REPORT OF THE COMMISSIONER OF INTERNAL REVENUE ON THE OPERATIONS OF THE INTERNAL REVENUE SYSTEM FOR THE YEAR 1872, H.R. EXEC. DOC. NO. 42-4, at vi (3d Sess. 1872); ROBERT STANLEY, DIMENSIONS OF LAW IN THE SERVICE OF ORDER: ORIGINS OF THE FEDERAL INCOME TAX, 1861-1913, at 40 (1993).

<sup>99</sup>U.S. DEP’T OF COMMERCE, HISTORICAL STATISTICS OF THE UNITED STATES: COLONIAL TIMES TO 1970, H.R. DOC. NO. 93-78, pt. 2, at 1091 (1st Sess. 1975).

cluded to let the Income Tax stand as it is.”<sup>100</sup> They further denounced the income tax as “the most odious, vexatious, inquisitional, and unequal of all our taxes.”<sup>101</sup> Likewise, the editors of the *New York Times* (who in 1862 had praised the income tax as one of the most “equitable” and “bearable” of taxes) urged repeal in 1871 in light of the limited revenue it raised and the “odium” of its collection:

The income tax has been unpopular from the moment of its enactment . . . It has been tolerated, just as various other obnoxious taxes were tolerated—because it was one of the inevitable burdens entailed upon us by a great war . . . We have reached the time when the income tax can be no further defended . . . [T]he income tax is not worth its cost . . . Let Congress redeem the session from utter barrenness by averting the vexation and unpopularity which will inevitably arise from the continued infliction of the impost.<sup>102</sup>

Forced to tolerate this odious tax on account of the fiscal crisis occasioned by the Civil War, the modest peacetime income tax brought in so little revenue that it simply was “not worth its cost.”<sup>103</sup> At the reduced rates, the income tax was withering as a source of federal revenue, and most Republicans were willing to let it die.

Proponents of a peacetime income tax, however, had a second argument beyond the enhancement of public finance. Most prominently, John Sherman acknowledged that the burden of the tariff (which began to generate budget surpluses as the nation enjoyed increased peacetime trade and economic prosperity) fell most heavily on laborers as well as farmers and rural communities in the South and West while the benefit was enjoyed by wealthy financial and manufacturing interests in urban areas in the Northeast and Midwest.<sup>104</sup> For that reason, a strong case could be made for retaining the income tax on the basis of “equity” and “fairness.” Again, the ethical argument for an income tax was based on the premise that such an impost on capital would partially offset the regressive impact of the system of high protective tariffs that Republicans themselves had erected over the course of the nineteenth century.<sup>105</sup> On this

<sup>100</sup> *The Income Tax*, N.Y. DAILY TRIBUNE, Feb. 5, 1869, at 4.

<sup>101</sup> *Id.* Later that year, the editors declared: “We do not believe there is a tax levied by the Government so onerous upon so large a class of people as the Income Tax. It is not equal—its exactions are unjust, and it discriminates against persons of limited means . . . [T]he law is not equal.” *The Income Tax*, N.Y. DAILY TRIBUNE, Dec. 10, 1869, at 4.

<sup>102</sup> *The Income Tax*, N.Y. TIMES, Jan. 19, 1871, at 4.

<sup>103</sup> *Id.*

<sup>104</sup> See CONG. GLOBE, 42d Cong., 2d Sess. 1700-10 (1872) (statement of Sen. John Sherman of Ohio); see also Stephanie Hunter McMahon, *A Law With a Life of Its Own: The Development of the Federal Income Tax Statutes Through World War I*, 7 PITT. TAX REV. 1, 10 (2009).

<sup>105</sup> The first protective tariff was enacted by Congress as the Tariff Act of 1816, which provided exemptions or reduced rates for articles that could not be produced in the United States. The best account of how the tariff was used to implement protectionist policies from 1816 through the Civil War is found in DALL W. FORSYTHE, *TAXATION AND POLITICAL CHANGE IN THE YOUNG NATION, 1781-1833*, at 62-106 (1977).

basis, Sherman advocated a broad system of internal revenue under which the wealthy would make their contribution to the Treasury through the income tax, rather than entirely avoiding the cost of government by shifting the burden of taxation to those of lesser means via the tariff and regressive excise taxes.<sup>106</sup> As Sherman put it:

The income tax expires with the collection of the tax of 1871 . . . . [A] few years of further experience will convince the body of our people that a system of national taxes which rests the whole burden of taxation on consumption, and not one cent on property or income, is intrinsically unjust. While the expenses of the national Government are largely caused by the protection of property, it is but right to require property to contribute to their payment.<sup>107</sup>

Notwithstanding the considerable influence that Sherman exerted in the Senate, he was unable to persuade a majority of his colleagues of the equity of retaining a peacetime income tax. Protectionists such as William D. Kelley of Pennsylvania favored reducing or eliminating the income tax while at the same time raising tariffs.<sup>108</sup> Joining the protectionists were the representatives of the “money interests” in the Northeast (a powerful constituency within the Republican Party), who were strongly opposed to extending the income tax.<sup>109</sup> Theirs was a determined and well-represented voice in the House. As Washington Townsend (a Republican from West Chester, Pennsylvania) lamented in response, the “clamor for the abolition of the income tax is . . . a manufactured cry. It does not come from the masses of the people,” but from “the men of gigantic capital . . . and men of colossal fortunes and extraordinary incomes.”<sup>110</sup>

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<sup>106</sup>Sherman complained that wealthy individuals (such as the son of the late John Jacob Astor of New York, the wealthiest man in the United States when he died in 1848) would bear a much lighter burden of the cost of government compared to the working man if the income tax was repealed altogether, leaving the government to rely on regressive consumption taxes. CONG. GLOBE, 41st Cong., 2d Sess. 4715 (1870) (statement of Sen. John Sherman of Ohio). “[W]e are afraid to touch the income of Mr. Astor. Is there any justice in that? Is there any propriety in that? Why, sir, the income tax is the only one that tends to equalize these burdens between the rich and the poor.” *Id.*

<sup>107</sup>CONG. GLOBE, 42d Cong., 2d Sess. 1708 (1872) (statement of Sen. John Sherman). In his speech, Sherman went on to predict: “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 . . . will become part of our system.” *Id.* While accurate, his prediction was off by 41 years.

<sup>108</sup>CONG. GLOBE, 41st Cong., 2d Sess. 3994-95 (1870) (statement of Rep. William D. Kelley of Pa.). William Darrah Kelley (known as “Pig Iron” Kelley) was a Republican from Philadelphia who was swept into office on Lincoln’s coattails and thereafter represented the state’s iron and steel industry for 35 years as an advocate of high protectionist tariffs.

<sup>109</sup>See CONG. GLOBE, 42d Cong., 2d Sess. 1734-35 (1872) (statement of Rep. Rice of Ky.).

<sup>110</sup>CONG. GLOBE, 41st Cong., 2d Sess. 4023 (1870) (statement of Rep. Washington Townsend of Pa.).

Taking the path of least resistance, Congress allowed the Civil War income tax to expire at the end of 1871 as scheduled.<sup>111</sup> At that time, the Republican Party (and with it, the national government) returned to its longstanding commitment to a system of public revenue based on high protective tariffs. The nation would not again have an income tax contributing to the Treasury for another 42 years.<sup>112</sup>

#### IV. Conclusion

The nation's first federal income tax was enacted by Republicans who faced a budgetary crisis soon after the outbreak of the Civil War. Republican policymakers in Congress and the Treasury Department were under great pressure to find new sources of public revenue. A national income tax was viewed by a majority of Republicans as the most equitable means to raise the additional revenue necessary to prosecute the war. The income tax was preferred over a national land tax, which imposed an "unjust" burden on farmers and landowners and allowed the wealthy owners of "capital" to escape the burden of wartime taxation altogether. Republicans were even willing to accept a modestly progressive rate structure for the income tax as the war dragged into its third and most costly year. Likewise, a national inheritance tax was adopted out of necessity over the objections of conservatives and the representatives of the "money men" in the Northeast.

The financial pressures from the prolonged military conflict created a serious fiscal crisis for the nation's political leaders. The war forced the ruling Republican majority to accept a national income tax, as distasteful and "odious" as it was. Within the context of the regressive system of federal excises and protective tariffs, several influential Republican leaders acknowledged that a national income tax would provide a measure of balance to a regressive system of public revenue that otherwise shifted the burden of taxation to farmers and laborers and allowed the wealthy to escape altogether the burden of wartime taxation. Soon after the war, regional differences reflecting divergent economic and regional interests resurfaced and increased demand to repeal the income tax. At that time, the governing Republican coalition returned to a national policy of high protective tariffs and left income taxation to the state governments for the next 40 years.

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<sup>111</sup>McMahon, *supra* note 104, at 17-18.

<sup>112</sup>The story of the politics behind the ratification of the 16th Amendment to the U.S. Constitution and the enactment of the modern income tax in 1913 is recounted in Sheldon D. Pollack, *Origins of the Modern Income Tax, 1894-1913*, 66 *Tax Law.* 295 (2013).