

## CHAPTER III.

### DIRECT TAXATION.

**§ 1. Direct taxation practicable.** Nature having made it perfectly clear that indirect taxation is not natural, by making the collection of such taxes impossible without gross inequality, fraud, hindrance to production, and general demoralization, it is absolutely necessary for those who care for justice, equality, and good morals, to select some form of direct taxation.

The principal objection raised against direct taxation is the alleged unwillingness of the people to pay such taxes, and the consequent difficulty and expense of collecting them. So strongly is this objection felt, that many persons, who favor direct taxation for old-established communities, assume as an indisputable fact that, in new and thinly settled countries, it would be impossible to raise an adequate revenue by direct taxes.

As invariably happens, in cases where economic laws are thrust aside by practical men, on the plea that they are sound in theory, but will not work in practice, all human experience contradicts this assumption.

The newest and most thinly settled communities invariably do raise their public revenue by direct taxation; and indirect taxation is impossible, until they have obtained a considerable degree of growth and an advanced social organization. Can any society be more new or any

country be more sparsely settled than were all the different territories of the United States, when first opened for settlement? Yet was there a single village or school district in them all, which raised its first revenues by indirect taxes? It may be said that this was only because the United States Constitution prohibited them from surrounding themselves with a tariff. But the history of mankind may be searched in vain for any absolutely new community, which raised its *first* taxes by means of a tariff on imports or on exports, by excise duties, or by any indirect taxes whatever. A moment's reflection will show that the very idea is absurd. Every new settlement is eager for imports; and it would rather offer a bounty for them than place a tax upon them. It clamors for production, manufactures, and trade; and it lays no taxes on production.

With this idea also falls the other idea, that direct taxes are necessarily more difficult of collection than others. *Some* forms of direct taxes are difficult of collection, and increasingly so as the community advances in wealth and civilization. This is because those particular taxes are not founded upon justice; and their injustice becomes more and more apparent with the growth of the community. But if it can be shown that there is a tax which men everywhere are willing to pay, partly because they feel that they receive full equivalent for the tax, and partly because the pressure for payment is practically irresistible, and if this tax can be collected with ease, equality, and justice, all these objections will fall to the ground.

As the only forms of direct taxation, now in use, by means of which an adequate public revenue could be obtained, are an Income Tax, a Succession Tax, and a tax upon the value of some part or all of real and per-

sonal property, usually called a General Property Tax, our attention may as well be confined to these taxes.

§ 2. **The general income tax.** The first impression of most students of taxation is probably in favor of a general income tax; that is, a tax upon incomes from earnings, as well as from investments. But this impression is soon dissipated by a careful study of the subject. Assuming this to be the only tax, it is manifestly unfair that a man who derives his income from accumulated wealth should pay no more than another, who earns all his income by hard personal labor. If the rate of taxation is uniform, it bears severely upon the poor, as compared with the rich. If it is graduated, increasing with increasing income, it cannot be efficiently collected; because the method of collection at the source of income, by authorizing corporations to deduct the tax from dividends and interest, and tenants to deduct the tax from their rents, would be impossible under a graduated tax; and the assessor would have no means of securing returns, except by the personal oath of the taxpayer, which long experience shows to be a very poor security. Under any system, an income tax upon earnings and profits has to be assessed largely in reliance upon such oaths; and the consequence is that, even under the rigid and honest administration of the law, which prevails in England and several European states, fully one third of this part of the tax is evaded by false returns. In the United States, during the ten years' existence of an income tax, the proportion of evasion was very much larger, averaging not less than half, for the entire period, and mounting up to more than two thirds at the close. In several States, there can be no doubt that nine tenths of the whole taxable income escaped from the tax. The general income tax is thus a fruitful source of perjury; and it cannot be a scientific or natural tax, for

that reason. Since perjurers would thus escape taxation, in whole or in part, it is manifest that the tax would be unequal in its operation and would bear twice as heavily upon the honest as upon the dishonest.

Furthermore, a strict income tax would collect nothing from property which is held out of use. The landlord who improved his land would be taxed; but the landlord who held it vacant would not be taxed at all. Thus a bounty would be put upon land speculation. It may be said that the annual rise in value might be assessed as income. But it would not really be income; and a tax upon that would not be in fact or in law an income tax. If such fictitious incomes were assessed, every taxpayer must obviously be allowed to deduct from his income, for purposes of taxation, any fall in the value of his land, without testing the market by a sale. Such allowances, it is evident, would leave a wide door for fraud and evasion.

§ 3. **Excuse for income taxes in America.** Under the peculiar political conditions of the United States, there is much excuse for an income tax, as a transitional measure of national taxation. The Federal Constitution requires all "direct taxes" to be apportioned among the States, according to population, with entire disregard of their wealth or land. A direct tax upon the value of real estate, under this provision, would exact from North Carolina about five dollars, and from South Carolina about seven dollars, on the same real-estate value which, in Rhode Island, would pay one dollar. It would exact from Missouri a larger tax than from Massachusetts and Rhode Island together; although the value of real estate in those two States is sixty per cent. greater than in Missouri. Each dollar's worth of land in Tennessee would be taxed more than twice as heavily as in Wisconsin. Taxes, even within New England, would be very

unequally distributed. Land in Vermont would be taxed 150 per cent. more than in Massachusetts or Rhode Island. If personal property were also taxed, the discrepancies would be still greater.

Until April, 1895, it was supposed to be settled law that an income tax was not such a "direct tax," as the framers of the Constitution had in mind, and therefore that it could be levied without regard to population or State lines.<sup>1</sup> Decisions to this effect made this tax in effect the only direct tax, in the scientific sense, which could be adopted in the United States, without great inequalities between the States, until the Constitution can be amended. The recent judgment of the Supreme Court, exempting rents from income tax and casting doubt upon the whole system, will probably stir up a movement for such an amendment, which can easily be obtained, whenever the people are resolved to abolish all indirect taxation. But without the support of a very strong public sentiment, amendments to the Federal Constitution are impossible, as two thirds of Congress and three fourths of the State legislatures must concur in their adoption. The taxation of incomes in general, while rents are entirely untaxed, is a monstrous anomaly, which will certainly be remedied at a comparatively early day.

But as the purpose of the present inquiry is to ascertain what ought to be done, without regard to questions of present practicability or temporary expediency, this political difficulty need not be further discussed. It may be noted, nevertheless, that an income tax, levied exclusively at the sources of income, could be made to reach, with great approximation to equality, all rents, dividends, corporate payments of interest, and perhaps mortgage interest. As will be hereafter shown, the same results can

<sup>1</sup> Springer v. United States, 102 U. S., 586.

be attained by much better methods, so far as they ought to be attainable. But until the better method can be introduced, a tax upon incomes, at their source only, is much better than any form of indirect taxation. Only incomes from invested wealth can thus be reached (certain classes of salaries alone excepted); but no other incomes ought to be taxed.

§ 4. **Income tax unfitted for local use.** Even as a temporary expedient, however, the income tax, in any form, is entirely unfitted for use in American States and municipalities. New York, New Jersey, and Connecticut, for example, will never adopt an absolutely uniform income tax or administer it on uniform principles. The possessors of large incomes, therefore, would change their residences from one State or county to another, so as to make their returns wherever the law or the assessor was most favorable to them. If some States undertook to tax incomes at their source, while other States persisted in the old-fashioned method of individual returns of income received, there would be a great amount of double taxation. Rents of New York property, due to a Bostonian, would be taxed in New York against the tenant, and again taxed in Boston against the landlord. Such injustice would soon give provocation and excuse for fraudulent returns. There is an income tax in Massachusetts; but it is an utter failure, only aggravating the evils of the bad system of taxation there in use.

§ 5. **Other objections to income tax.** An income tax upon interest is clearly not a direct tax. The burden will be largely, if not entirely, shifted upon the borrower. A tax upon rents will fall principally upon what is not "rent" at all, in economic science, that is, upon the annual price paid for the use of buildings and improvements. All of this tax must, in the long run, be paid by

the tenant. To this extent, therefore, it is an indirect tax; although not so easily shifted as are some other taxes. Upon the whole, not more than one third of any tax on incomes (other than earnings and profits) is strictly a direct tax.

The income tax can never be accepted as the only tax, for these and other reasons. It can be used only by national governments; and even in their hands it must be confined to subjects of taxation which can be much better reached by a straightforward tax upon values, instead of upon incomes. The general income tax, upon earnings and profits as well as upon fixed property, stands condemned by universal experience, as an incentive to perjury, a premium upon unproductive land, a special burden upon the honest, the simple, the widow, and the orphan. Nature shuts this door also in the face of honest men.

**§ 6. The succession tax.** The tax on successions, whether by legacy, devise, or inheritance, has lately become very popular. It is much more easily collected than the income tax, because it is paid by the administrators of dead men's estates, who have generally only a small interest in the estate, and whose conscience, if wounded by perjury, would not be soothed by the reflection that the profit was all their own. The ordinary human conscience becomes wonderfully tender, when asked to take a false oath for the benefit of some one else.

As a supplement to other taxes, the succession tax has been a fair success; because it has not become so heavy as to make living men willing to risk the loss of their property by schemes of evasion for the benefit of their heirs. But, if it became the sole method of taxation, it would be so heavy as to offer strong temptations to evasion. The highest estimate of the annual savings of the American people, added to the annual taxes, is not

more than 22 per cent. of their annual earnings. The lowest estimate of their taxes is 7 per cent. of those earnings. As the value of property passing by succession in each year cannot, upon the average, exceed the annual savings, the succession tax, if it were the only tax, would absorb one third of all estates of deceased persons, even if every article of such estates passed through the probate courts and were fully taxed. This, however, we all know to be impossible. At the very least, one third of the property of descendants never did and never will go through the courts or be reached by any such tax. It is held in parcels so small as not to be worth the expense of court proceedings; and it consists of furniture, clothing, tools, money in hand, and other articles, which are readily disposed of by the family, without dispute or publicity. Therefore the tax actually levied upon such estates as would be reached by the assessors, if it were the only tax, would exceed 50 per cent. of their whole value.<sup>1</sup> Executors would be named from among legatees only; and this enormous tax would breed evasion and perjury among them, just as certainly as does the smaller tax, now imposed upon personal property by the several States. As such evasions increased, the tax upon the unfortunate few, who could not or would not obtain relief in the same way, would constantly increase, until the government would need 75 per cent. of all property reported; by which time the whole system would collapse. The succession tax may have some merits, considered as a mere supplement to other forms of taxation; but it never can be accepted as the one natural tax.

**§ 7. Succession tax oppressive on widows, etc.** There are other objections to this tax. If it is collected

<sup>1</sup> In New York, the local taxes alone exceed 40 per cent. of the value of property now reported for the succession tax.



impartially from all, it is obviously very severe in its operation upon widows, young orphans, and aged parents, who are the principal beneficiaries of dying persons. Just at the time when they are deprived of the earning power of the head of the family and are left with nothing but the income from his savings for their support—an income averaging less than one third or one fourth of that to which they were accustomed,—the State steps in and cuts off a large portion of this. From her that hath not, shall be taken even the little which she hath. If collected only or mainly from collateral relatives or strangers, such benefactions, which are often among the most commendable portions of a will, are sure to become more and more rare. It would thus greatly increase the tendency to concentration of wealth. If the succession tax were to become the only form of taxation, it would be impossible to make this distinction; because it would then absorb almost the whole of collateral inheritances, and no one, who had a wife or children, would leave a dollar to any one else. Even under a very moderate tax it was speedily found, in the State of New York, that legacies to benevolent and philanthropic institutions were discouraged; and the legislature has exempted them from much of this taxation.

§ 8. **Succession tax leads to public waste.** Another objection to the succession tax, as a principal source of revenue, and one which ought to be conclusive against its adoption as the *only* source, is that it must be constantly maintained at about one uniform rate. It cannot be frequently changed without gross injustice. If it fluctuates according to the needs of government, the estate of one man, who died on December 31st, might be taxed twice as much as the estate of another, who died on January 1st. Wherever this tax exists, it is always

maintained at the same rate for a long series of years. If it were the only tax, it is obvious that it must be kept at a rate which would *always* produce a surplus revenue; for if it were not, it would often fall below the needs of government. It would therefore always lead to public extravagance and corruption. But even where it is only one of several taxes, as in the State of New York, experience already shows that it has the same effect, in a less degree. While at first it reduces the burden of other taxation, it soon tempts the government to increase expenditures to a point which will require as much other taxation as the people were accustomed to before. Accordingly, there has been a notable increase in the expenses of government in States which have an efficient succession tax; while the taxpayers are hoodwinked by a pretended reduction of their burdens.