

CHAPTER XVII

The Income Tax

"LEGALIZED CONFISCATION" IN THE WORDS OF A FORMER COMMISSIONER OF INTERNAL REVENUE.

As Commissioner of Internal Revenue I often thought how far we had gone toward consuming ourselves "through excessive and unjust taxation."

We have failed to realize, it seems to me, that through our tax system we have been playing right into the hands of the Marxists, who gleefully hail the income tax as the one sure instrument that will bring capitalism to its knees.

—T. COLEMAN ANDREWS
Former Commissioner of Internal Revenue

. . . the whole spirit of the Union and of its Constitution has been liquidated. Income taxation has made of the United States as completely centralized a nation as any that went before it; the very kind of establishment the Founding Fathers abhorred was set up by this simple change in the tax laws. This is no longer the "home of the free" and what bravery remains is traceable to a tradition that is fast losing ground . . . the Sixteenth Amendment must be repealed, nothing less will do.

—GOVERNOR J. BRACKEN LEE
Governor of Utah, in Foreword to
Income Tax, the Root of all Evil
by Chodoroff

WE NOW come to a most controversial question—the income tax. At every session of Congress it is debated, generally with a good deal of rancor. Year after year it is changed and amended, but seldom in a way satisfactory to anybody, for it has always been and probably always will be a bone of contention.

Now even the former Commissioner of Internal Revenue, T. Coleman Andrews, who was for years in charge of the administration of this tax and who certainly knows the subject from every angle, publishes an article entitled "Let's Abolish the Income Tax," expressing, from intimate and inside knowledge, his condemnation of what he well describes as "legalized confiscation." He shows up convincingly the many evils of this tax, unjust and inequitable. It is a mess of contradictions and confusion, hopelessly irreconcilable, totally unintelligible, and unenforceable, costly in collection, and a tool of corruption.

Our ideas may appear a bit extreme, but if you think so, we

suggest that you read the article by Mr. Andrews. He well shows how the tax is made up of iniquities and conflicting regulations and how it inevitably breeds dishonesty, litigation, and trickery. One of its worst features is that it opens to the government "a boundless field of power" with practically no limit on its exactions. Any discussion of this subject must bring dissent and disagreement, and we can hardly expect the reader to accept our position a hundred percent. However, we can do no more than to state the case as we see it, and we ask the reader to judge the case without prejudice.

The income tax is the most objectionable and dangerous of our taxes. Not only does it violate every sound principle of taxation, but it is utterly contrary to the spirit of our Constitution. It is true that an amendment permits it, but this amendment is opposed to the established principles of the Constitution and, in framing the law, we went far beyond what is authorized by this amendment. For it we can find no excuse, except perhaps in war time, when "necessity knows no law" and even the sacrifice of life may be demanded.

This tax marks our first definite acceptance of the communist principle of Marx: it is a denial of the right of the worker to the contents of his pay envelope, permitting seizure of the earnings of labor. Furthermore, the tax is a graded tax, the *rate* progressing with increasing income, making the wealthy man pay more—a great deal more—*per thousand dollars of income* than does his more humbly circumstanced neighbor. There are many who defend this principle, but it is utterly at variance with the requirement of the Constitution that "all taxes shall be uniform throughout the United States." Certainly there is no uniformity in taxing one man twenty dollars and another man ninety-one dollars on a hundred dollars of income, but that is exactly what we do today. In the opinion of many Constitutional scholars, neither the Constitution nor the amendment justifies such procedure.

Is "unconstitutional" too strong a word? Can we say that a law or a course of action is unconstitutional when the Supreme Court rules that it is not? One reader accepts such opinions as binding, but we recall the old saying attributed to Lincoln, that "Calling a dog's tail a leg does not make it a leg," nor give a dog five legs. We do not think a statement by anyone will make a law constitutional if it is in conflict with the Constitution.

This is a matter of definition and opinion, and a reader of our manuscript says that any law is constitutional if a court says

it is. If the reader holds this opinion, when we discuss these questions, let him interpolate "Says who?" and reject our opinion on these points.

Regardless of what others says, we believe that there is such a thing as common sense, and we see no reason for accepting as infallible a decision of the Supreme Court. We do not believe that the "general welfare" clause justifies privilege legislation, benefiting a few at the expense of others, on the argument that what benefits some will indirectly benefit all. We do not believe that interstate commerce includes travel within a state, because the traveler may decide to continue his trip beyond the state lines, or that the sale of letter-paper within the state becomes interstate commerce if a purchaser uses it in writing letters to go out of the state. We reject too the statement by the Collectors of Internal Revenue that they can search and seize without a warrant, regardless of Article IV of the Bill of Rights, designed expressly to protect us from such invasions of our liberty by government.

Consider the letter which President Roosevelt wrote to a congressman, expressing the hope that "your committee will not permit doubt as to the constitutionality, however reasonable, to block the suggested legislation." Consider too what Truman said regarding the duties of the President: "Our whole people look to him (the President) for leadership, not confined within the limits of a written document." The written document to which he referred was the Constitution of the United States, *which he was sworn to support*. We hope before rejecting our statement of the unconstitutionality of the income tax law the reader will give thought to these angles of the case.

Few realize how heavily the income tax bears on us, because of the multiplicity of ways it is imposed. As levied on corporate earnings, it is discussed in connection with the policy of taxing corporations, and it suffices to say here that, even in its simplest application, it is double taxation of the same earnings, first when earned in business, and again when they go into the pockets of the rightful owners of the business.

The oppressiveness of the tax is brought out by the president of Daystrom, Incorporated. Of \$1,000 of what is laxly called gross profits, which of course belong to the stockholders, the corporation pays \$520 in corporation income tax, leaving \$480. Then the excess profits tax takes \$144, and this is a federal income tax levied on the indefensible idea of confiscating earnings of successful companies. This leaves only \$336—about one-

third of the original sum—but this is not the end. When this small residue of his property is turned over to the stockholder, it is taxed again at from twenty percent to ninety-one percent, leaving him sometimes only thirty-three dollars and sixty cents of the original thousand dollars. This is only a trifle over three and one-half percent of the original sum, and Uncle Sam gobbles up ninety-six and four-tenths percent. On top of this, often a State Income Tax takes another slice.

The income tax, when first imposed, started at one percent plus surtaxes, meaning an additional levy increasing as the income increases. Originally the surtax was at seven percent: today it reaches ninety-one percent and, whereas it was first imposed only on incomes of over a half a million dollars, today the maximum rate applies to all incomes over \$200,000. The increase in personal income taxes is illustrated by figures (given to the nearest dollar) for the tax on a \$5,000 income of a married couple with no dependents: in 1930, \$39: twelve years later it had climbed to \$1052, or twenty-seven times as much. This shows the tendency of such a tax. Generally each jump hits only a relatively small minority, which can be ignored, for they control only a few votes. Then the tax can be edged up higher and higher, little by little. When imposed on a corporation, stockholders seldom realize that it actually comes out of their pockets.

If the government can seize ninety-six percent of our income with no real protest, there is no reason why it cannot gradually edge it up to 100%—the ideal of the communist state—making provision for the ruined stockholders by doles, pensions, and "handouts," always providing they are good subjects of their masters. We often think that the government does very well for us, by giving us "social security," and imagine we are getting something for nothing. Actually it is our own money which is doled out "unto each according to his needs," or according to the political support, which can be bought, and of course much of what we pay dribbles away in waste, graft, and in supporting a vast bureaucracy, engaged in operations forbidden by the Constitution.

This brings us to a consideration of the purposes for which the income tax is often designed. A graded tax at progressive rates, tending toward redistribution and equalization of wealth, is openly hailed by communists as a step toward acceptance of their program. Marx urged "a heavy progressive income tax," and President Roosevelt declared himself in favor of this policy

in a radio address of September 7, 1942, when he said, "I have told the Congress more than once that all net individual incomes should be limited effectively by further taxation, to a maximum net income of \$25,000 a year," although he was himself receiving a salary of \$75,000 plus a most liberal expense allowance. We do not, however, find any clause in the Constitution authorizing any tax for the purpose of setting a limit on progress, prosperity, earnings, or wealth, and remember that *what is not authorized is specifically forbidden*.

The framers of our government, purposely and with deliberation, restricted the taxing powers of the new government. Hamilton never dreamed that future generations would break down the barrier so painstakingly erected to safeguard our people. He said: "The abuse of the powers of taxation seems to have been provided against with guarded circumspection," having in mind, no doubt, the clause that "all direct taxes shall be apportioned among the several states according to their respective numbers," and, as if for further emphasis, "no capitation or other direct tax shall be laid, unless in proportion to the census or enumeration."

What we say may sound like an overdrawn and alarmist picture, but the communistic process is already well under way. Truly, by the income tax we "have entered a boundless field of power no longer susceptible of any definition," to use Jefferson's words, and have cast to the winds our old safeguards. It is this, in great measure, which has opened the way to limitless expansion of activities of the federal government, its usurpation of powers reserved by the Constitution to the States and to the people, and the consequent undermining of local government and personal liberty. Apparently, there are now, aside from the armed forces, about two and a half million civilian employees dependent upon the government for their jobs, and nearly ten times as many drawing social security in one form or another, taking no account of veterans and their dependents on relief. It is evident that already a large proportion of our people are looking to the government rather than to their own labor for support.

There are other serious menaces to our Constitutional government in this tax, as Vivien Kellems points out in *Toil, Taxes and Trouble*. The Constitution supposedly protects us from unreasonable search and seizure. Article IV of the Bill of Rights—those amendments insisted on by many of the States before they would accept the Constitution—reads: "The right of the people to be secure in their persons, houses, papers and effects, against

unreasonable searches and seizures, shall not be violated, and no warrants shall issue but upon probable cause, supported by oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized."

The income tax ferrets, however, have no scruples regarding the Constitution, which presumably they are sworn to support, but invade homes and offices without warrant, to rummage as they will, carrying off whatever books and records they please. Miss Kellems tells of four of them descending on her. They demanded all books and records, interviewed every employee, and then departed to the bank and seized \$1,685.40 of her money, all without warrant and with no court procedure. How does this conform to the Constitutional provisions that no person shall be "deprived of property without due process of law?" Their attitude to the basic law of the land is shown by their reply when the president of the bank requested proof of their authority—"We don't need proof: we are from the Bureau of Internal Revenue." The writer knows whereof he speaks, for he has had the experience of having a bank account seized without a warrant and in direct defiance of a ruling from Washington that no tax was due. The local office was required to restore the purloined funds, but even this was not honestly handled, for it was refunded as an "over-payment" of taxes—but no payment whatever had been made. Actually it was the return of stolen funds.

There is yet another point worth mentioning. The law requires an employer to withhold twenty percent of wages paid, to be turned over to the Revenue Department on account of the income tax of the employee. This compels the employer to act as a tax collector for the government without pay. Under many circumstances, this involves bookkeeping, calculating, and record-keeping, all of which cost money; *it compels him to violate his contract with his workers*, and sometimes leads to confusion in the minds of workers.

The income tax, as our personal experience shows, offers a very real danger to our freedom and to constitutional government. Unlimited, unrestricted, enforced with no regard to constitutional safeguards, it opens up the way to further inroads on the rights and liberties of the States and of the people, bringing closer every day that "absolute power," which, as Lord Acton says, "corrupts absolutely."

Whether a personal income tax is a deterrent to industry, discouraging a man from working to accumulate property, is an open question. The very fact that the government takes a big cut, some-

times makes us work harder and earn more, so that, after the tax collector gets through, there will still be enough left to support the family, but it does not always operate that way. A letter is received as this is written from a worker who finds that, after eking out her small income with overtime work, after paying her higher income tax, the added income does not pay for wear and tear on health and disposition and for the cost of a "baby sitter" necessitated by the job.

In the case of large incomes it is different, for it seems to be the custom in the large corporations for high-priced executives to figure the compensation which they receive in terms of "take-home pay," much as in the case of the "working man." As these men are in the higher income brackets, if their take-home pay is to be maintained at the level necessary to retain their services and keep them active in business, their salaries must be raised to cover the high tax and still leave them ample compensation. Actually, therefore, these taxes on salaries, like practically all taxes levied against corporations, are actually paid by the corporations out of the pockets of the stockholders. Taxes on such incomes, causing these raises, are inflationary, for they increase the costs of operation of business and thereby increase prices without adding anything to the value of the product. It is therefore probable that the income tax, as applied to incomes, generally has an inflationary effect.

Twice we have had first-hand reports of elderly men of ample means, so pestered by the income tax, that they refused to continue in their professional tasks, or even to keep money invested where it might give stimulus to production. Both men sold all their investments, put their money into safe-deposit boxes, and retired, living entirely on principal. They have no income and no income tax to file: and spend their money as they like.

All new industry, all the development of new enterprises, all taking of chances and developing of new inventions, demand what we call risk capital, meaning the investment of money in a way which may bring very large returns but which very likely will be lost. Only men who can afford to risk a loss are inclined to supply money for such enterprises, too hazardous for those dependent upon income for daily bread. We shall see how the income tax dries up the great source of this risk capital when we discuss taxation of corporations. What inducement is there to invest in a hazardous business when, even if it does succeed and earns abundantly, ninety-one percent will be taken by the tax collector? It just does not pay, and older men who have acquired a com-

petence are generally slow to put time or money into new enterprises.

A most objectionable element of the income tax law is the tax on capital gains which, in our opinion, are not income at all. Is there not something to be said for regarding only funds which are enjoyed, and which are used for ordinary expenses, as taxable income? Is it not an anomaly to class capital gains as income? What fun, what good does anyone get today from money which he invests or reinvests and which brings no immediate satisfaction? Of course, to save and invest is wise, and those who practice such a thrifty policy gain much in increased income, which will be taxed, but why tax the investment now? Why not tax only incomes received and enjoyed, if we must have an income tax, rather than an increase in the value of capital?

Should we do this, it would be necessary to have rigid definition of what is meant by investment, different from that of the economist. It would not be fair to consider as investment the automobile which a man buys and perhaps uses part of the time in his business, but from which he gets much pleasure. That money is practically spent for immediate satisfaction. So it is with many improvements around one's own home, the washing-machine, the dish-washer, the garbage disposal unit, the new electric range, the sleeping-porch, all of which are in the nature of capital investment but which nevertheless yield immediate satisfaction although seldom in the form of taxable income. We would not treat such expenditures as investments. An investment, to be tax exempt, should be confined to what in the language of everyday life and in the market places of the world, we regard as investments—bonds, stocks, interest-bearing loans, and negotiable papers which yield cash income, or investments of a true and profitable business nature on "one's own," such as real estate development.

On the capital gains tax this principle is applicable. We think of an investment which has been highly profitable because of increment of the capital but not because of high income, for it yields a very small return on present market price; but, if sold, the capital gains tax takes a big slice, for the principal has increased tremendously. One investor is not much interested in building for the future: he is along in years and has no dependents, but he does desire, and needs, a bigger day-by-day income. He sees a chance to sell this stock and to re-invest the money in another stock. The change would more than double his income were it not for the big cut which the capital gains tax would take, but

the investor has decided to let his investment stand as it is. The reason: the heavy capital gains tax will take so big a slice that the wisdom of the change is doubtful. What then is the result? No shift of investments will be made—*therefore no capital gains tax will be paid, and, as far as this case is concerned, the tax becomes a dead letter*, accomplishing nothing except to block the change. The investor's income will not increase and his tax will remain unchanged, whereas, were it not for this capital gains tax, there would be a material increase in his personal income tax, both because of a normal increase and because he would find himself in a higher bracket. There would also be stock transfer taxes, which now will not be paid, and no broker will benefit by a substantial commission. No one is better off: the capital gains tax, instead of bringing in public revenue, actually cuts down receipts materially below what they would be without that tax.

Who gains by putting obstacles in the way of a deal of this sort? Would it not be wise to provide that capital gains from the sale of securities such as this, if re-invested say within thirty days, should be exempt from all tax? Then the investor will benefit by an increased income, the government by increased taxable income, so long as we have an income tax, stockbrokers by the business and national and state governments from stock transfer taxes. Everybody will be better off; but as it is, everyone will suffer.

There is another slant to this question too. It is for the general interest that sales of securities be encouraged when prices are high and purchases be encouraged when prices are low. To sell this high-priced stock, now apparently over-valued, and to buy with the proceeds an under-valued stock, is in the public interest because it tends to stabilize the market. Selling the high-priced stock will have some influence in holding down further advance, and will perhaps depress the price a little, and buying the low-priced stock will tend to raise the price of that stock. Were everybody to follow such a course, the "swings" on the stock exchange would be far less marked, the peaks of the curve not going so high and the valleys not dropping so low. Our present policy leads the investor to continue to hold the over-priced stock and to sell the stock which is low, in order to take his losses. Prices on the stock market would be a truer index of values, and these policies would do much to stabilize markets and to prevent such excessive fluctuations as those which brought disaster in 1929. It is quite possible that, if trading of this type had been made a little easier by doing away with capital gains tax, the crash of

the market during those trying times would have been ameliorated.

To buy low and to sell high is the answer. We are reminded of an unco' Scot who, hearing the wifie crooning, 'Bye-low baby' to her bairn, called out: "It's na eneugh, lassie, teach the wee child to sell hie too: to sell hie is as guid as to buy low."

The income tax is open to other objections. Any taxpayer who has had experience realizes how difficult it often is to say what constitutes income, and even the government admits it by frequent change of rulings. It seems to be the general policy to say that if a man builds his own house, lives in it, and sells it at some profit and uses all the proceeds to build another house, the profit is not income; but if he builds houses as a business and sells them at a profit, the profit is income. There are all sorts of borderline cases open to frequent dispute and to honest misunderstanding, even with the best intentions.

The requirements that profits on the sale of an old homestead, lived in for many years, must pay a capital gains tax, unless all proceeds of the sale are reinvested in a new home, often works a real hardship. In these days, when ever-mounting inflation brings anxiety, especially to the elderly whose earnings, if any, don't keep pace with increasing costs, many find it imperative to cut expenses drastically. In these servantless times, stretching the family budget by selling, and living more simply in a smaller house, is an attractive possibility, but it is often defeated by the law. If the new home costs less than the old home sold for, taxes will take a large share of the profits, and there may be no economy in making such a change in our way of life.

As a practical matter, there are serious difficulties in the income tax law and its administration. Complexities in regulations and refusal of officials to make positive rulings on doubtful points, with conflicting and arbitrary rulings changed from time to time, all add to the difficulty of the taxpayer and increase the cost of a top-heavy inefficient, and sometimes corrupt administration. One year they hold that loss on investments, which have become worthless, cannot be deducted from income until the corporation has been declared insolvent: the next year, when these conditions are met, they say that the loss should have been taken the year before when the stock became worthless, and so, by reversing their rulings, they make it impossible to take the loss at all. There are endless difficulties, such as defining income, making proper allowance for losses, depreciation, and depletion, and a hundred questions of what constitutes business expenses and justifies de-

duction. The cost of administration and collection, both to taxpayer and government, is appalling, sometimes exceeding the amount of the tax, and checking and auditing is almost as bad. As we have seen recently, some tax offices are neither efficient nor honest. The innocent citizen is sometimes annoyed, pestered, and even blackmailed, as in the case where the "higher-ups" at Washington rule that there is no tax liability, and yet a local tax office assesses and collects, unwarranted seizure of a bank account.

It is generally impossible to get a definite, positive ruling, which will be adhered to, on any doubtful point. It certainly seems that there is no reason why the Revenue Department cannot make rulings, by which they expect to assess and collect the tax and then adhere to them, unless upset by court action. General efficiency and consideration of the taxpayer seem to be at a low ebb. It may be said that these are matters of administration and not of economics, but by its very nature the income tax, with its vast amount of detail, opportunities of collusion and uncertainty of rulings, almost inevitably provokes administrative difficulty.

To summarize, we say that the income tax has every fault which a tax can have. The tax penalizes industry and thrift; it is an attempt to equalize income and as such has been advocated by Marx and by President Roosevelt. It is based on the Marxist principle of taking according to ability to pay and using the proceeds to distribute benefits "according to needs," interpreted in the light of political expediency. It is inflationary, uncertain, uneven, and inequitable, applied in different ways by different districts and at different times. Its conditions, with which the taxpayer must comply, are difficult, uncertain, tricky, and constantly subject to change. It is inquisitorial and troublesome both to the taxpayer and to the government, and experience shows that it is open to collusion and fraud.

A common attitude on taxation is indicated by a letter appearing in one of our prominent newspapers, typical of much dangerous thinking. The writer is a clear and vigorous exponent of the ideas of Karl Marx, although it is doubtful if he realizes it. He says: "The income tax, based on ability to pay, is just and sound" —agreeing with Marx one hundred percent, for it is exactly upon this theory that Marx urged a graduated income tax. We wonder if the writer would accept the theory of paying debts to the government "according to ability," or in settling other debts and making purchases. Does he expect his gas or phone bills to be computed according to his income? If in business, does he charge

his customers that way? Is not the only just way, to pay fair price regardless of whether we wear a mink coat or overalls?

He speaks of the income tax as designed to prohibit accumulation of great personal fortunes, and to cut down drastically such as were then in existence. This too is in perfect accord with Marx, echoed by Franklin Roosevelt, who said: "Taxation is the only way of preventing the incomes and profits of individuals and corporations getting too high."

Note that neither Marx nor Roosevelt, nor the writer of this letter, gives a thought to the justice of the case or the merits of the individual. Doubtless, if Marx had given us the Parable of the Talents, they would have taken the money from the man who used his wisely and given it to the man who failed to use even his one talent.

The letter-writer also says: "These taxes are intended not only to provide revenue for the government but to effect a re-distribution of wealth." Again Karl Marx! This is a frank admission that the tax is levied to accomplish a purpose for which there is no justification in our Constitution. It would seem to a layman that even the amendment scarcely justifies a tax *for this purpose*, for it is a radical departure from the principles of our government. It can be defended on the grounds of the general welfare clause only if we go so far in the interpreting of general welfare as to mean that it justifies seeking the "greatest good of the greatest number," and involves the destruction of all minority rights. We doubt very much if any right-minded person would attempt to defend legislation on the argument that (1) the majority of our people have fewer worldly goods than the minority; (2) seeking the greatest good of the greatest number is the objective of the government; (3) it therefore follows that the government should despoil all who have more than the average wealth and distribute among those who have less than average.

Of course to some minds such an argument is defensible, but the average American would repudiate it, and we are sure that there was never any intention, on the part of those who framed the Constitution, of stretching the meaning of "general welfare" to this degree.

The letter-writer also urges the retention of the income tax "because it reduces not throttles—incentive, providing opportunities for others." This sentence is a model of misstatement and loose thinking. Does he realize that the multiple taxation of the earnings of stockholders often exceeds ninety percent, sometimes touches a hundred percent, and may even exceed a hundred per-

cent, if we take into account the taxes on corporate profits and state and local income taxes as well as federal? Such a policy cannot possibly provide "opportunities for others," as does the establishment of new industries, yielding profits to investors, paying good salaries, giving jobs to workers, and raising the standard of living to all.

QUESTIONS

Does a progressive tax, taxing a thousand dollars of income at different rates, accord with the Constitutional requirement that all taxes shall be uniform?

Do you believe that taxation in violation of the Constitution is justified?

Do you think a tax which takes ninety-six percent of income is oppressive?

Should taxation restrict incomes to a maximum of twenty-five thousand dollars a year or any other arbitrary figure?

Is it a legitimate function of the government, or of taxation, to keep our people from becoming wealthy and prosperous?

Is it better policy to tax capital gains or to exempt capital, taxing not the capital gains but only the incomes which they produce?

Is it a valid objection to the income tax that, after more than forty years' experience, it is generally agreed to be incapable of honest, impartial, uniform interpretation and enforcement?

Does the income tax lend itself readily to confusion, misunderstanding, collusion and corruption?

Is there any clause in the Constitution to justify the federal government in building houses, at the expense of all our people, to house families of selected groups in selected sections?