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A Cultural Perspective on American Tax Policy

*Sharon C. Nantell**

I view the role of this article as that of a “warm-up act.” The subsequent articles in this journal either raise issues regarding revising the current tax code, or present arguments for or against alternative forms of federal taxation in the new millennium. However, in order to fully appreciate these proposed revisions and alternatives, I believe we need to truly understand and appreciate our current federal income tax system, and, as importantly, how we arrived at where we are today.

I have always been a firm believer in the fact that we cannot truly understand where we are going if we do not understand and appreciate how we got where we are today. A cultural perspective will tell us more than “just the facts.” Hopefully, it will illuminate some of the “whys” behind the current federal income tax system. That analysis, in turn, will assist us in determining what paths to take in the future.

I. INTRODUCTION: A PERSONAL PERSPECTIVE

Let me begin with a story. It was 1978. I was 27 years old and had just been accepted into the Masters of Law in Taxation program at Georgetown University Law Center. Washington, D.C., was a new experience for me. Viewing the constant stream of busses to the Capitol, however, I realized that I was apparently the only living person who had never taken a grade school or high school field trip to D.C. So, at 27, I set out to see the sights.

Before I describe what I did on my first self-directed sightseeing trip, I must inform you of my personal historical perspective. By the age of 27, I had already worked for the Internal Revenue Service for three years while attending law school in Cleveland, Ohio.¹ I had also worked in corporate America, in the tax depart-

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¹ My three-year stint with the Internal Revenue Service while I attended law school has forever earned me the Scarlet Letter “I” in the eyes of my law students (despite more than two decades of service in the name of the taxpayer).

ment of the Sherwin-Williams Company at the corporate headquarters office. Tax was basically my life. Much to my mother's dismay, I was leaving my Fortune 500 job for the life of a poor law student, to steep myself in the intricacies of the Internal Revenue Code, and I was actually excited about it!

So, where did I go? Not to the Washington Monument, nor the Lincoln Memorial, nor the Capitol Building. Instead, I drove through the nightmarish D.C. traffic to the main Internal Revenue Service Building, not motivated by a belief in the IRS as an institution, but rather by intrigue for the role that taxes played in our American society. Perhaps still flush with some idealism left over from the 1960s, I hoped to make the world a better place, and the tax system a better system. Thus, I was impressed with, and inspired by, the large words inscribed in stone over the entrance to the building:

*Taxes are what we pay for civilized society.*²

—Oliver Wendell Holmes

I believed that statement then and, 20 years later, I tenuously continue to hold on to that belief.

I am now an aging tax professor. I am teaching students who were toddlers when I was at Georgetown in 1978. When I recently read the Holmes quote to one of my classes, the students laughed. I was startled by their response, but mostly I was troubled. What had gone wrong? Or perhaps, more accurately, was it ever right to begin with? If it was, what had changed to so damage or destroy our underlying belief in our federal tax system?

Beliefs and values are the focus of this article, since a cultural perspective on American tax policy necessitates an examination of culture itself. Culture is defined as the integrated pattern of human knowledge, belief, and behavior that depends upon man's capacity for learning and transmitting knowledge to succeeding generations.³ A college course in cultural anthropology nearly 30 years ago opened my eyes to human cultures throughout the world, and throughout the ages, with respect to social structures, language, law, politics, religion, art, and technology. For example, no matter whether sophisticated or remote, I discovered that every societal group throughout the world had developed religion as an integral part of its culture—a belief in some being or force greater than themselves. Whenever groups of people live together, they develop rules to govern behavior: to encourage certain actions and to discourage other actions. Our choices of language,

² *Compania General de Tabacos de Filipinas v. Collector of Internal Revenue*, 275 U.S. 87, 100 (1927) (Holmes, J., dissenting).

³ See WEBSTER'S NINTH NEW COLLEGIATE DICTIONARY 314 (1985).

law, politics, and religion are reflections of what our society values and believes.

Why do we choose to live in societal groups? There are simply some things that a group can provide for us that we cannot provide for ourselves. The tangible benefit of protection, for example, and the intangible benefit of social interaction immediately come to mind. The group benefits come to us at some cost; e.g., we must share physical resources and individual skills in order to provide protection for the group.

Thus, a society's choice of a system of taxation speaks volumes about what that society values and believes.⁴ In societal groups, humans share. How a particular society chooses to share its resources or revenues among villagers or throughout a nation is reflective of what that society holds dear in its culture. There is both a cost and a benefit to this sharing. The societal objective is to make the benefit outweigh the cost, as perceived by the values and beliefs of that particular society. According to Justice Holmes, in the society of the United States in 1927, the cost of taxes bought the benefit of civilization in the form of goods and services provided by the government.⁵

We tax ourselves as the price for living in a particular civilized society. If a group in a village goes off to hunt or fish and is expected to share its "catch of the day" with others in the village upon its return, then that sharing is, in effect, a tax upon their catch.⁶ If we, as a society, choose to tax income at the federal level rather than the transfer of goods and services, through, for example, a national sales tax, then that conscious choice says something about what we believe. The choices we make within the tax system, and continue to make, also reflect the evolving values of our culture.

When we examine our American tax policy from this perspective, what values and beliefs do we find? What do we hold near and dear to our hearts? Have our values changed over the years or

⁴ "Ultimately, decisions as to how a polity should finance its public spending reveal as much about the character of the regime as how it chooses to spend the revenue." Sheldon D. Pollack, *Tax Reform: The 1980s in Perspective*, 46 TAX L. REV. 489, 496 (1991). Professor Alice Abreu concludes that our choice of an income tax is not accidental: "tax systems are products of human creation. They exist because they serve human objectives, reflecting the values of their designers. A tax system's design can reveal much about those values." Alice G. Abreu, *Taxes, Power, and Personal Autonomy*, 33 SAN DIEGO L. REV. 1, 16 (1996).

⁵ See *Compania General de Tabacos de Filipinas*, 275 U.S. at 100.

⁶ A society in which members are expected to share the proceeds of a hunt with others is, in effect, imposing a tax on that hunt. . . . In the most basic of senses, then, I heartily agree with Justice Holmes that taxes are the price we pay for civilization [citation omitted]. Indeed, I might go even further and say that taxation, that is, the means by which we share resources, is an essential part of civilization.

Abreu, *supra* note 4, at 16 n.34.

are some fundamental, unshakable values still reflected in the tax code today? What behavior is encouraged or discouraged? What "tax culture" are we passing on from one generation to the next? With these questions in mind, our journey begins.

What I will ultimately conclude is that imposing a tax—any tax—is both powerful and manipulative. The focus of our American tax system, from excise taxes and tariff duties in the early years of the nation to the current federal income tax, never has been upon distributive justice, or any kind of justice, for that matter. Since 1789, those with the least power have borne the heaviest burden of taxation in the United States. By 1917, Congress had discovered that very slight changes in the structure of the new federal income tax could reap great quantities of revenue. Deductions, capital gains preferences, and rate changes started early and have occurred often.

Taxes may be the price we pay for civilization, but how civilized is our tax system itself? What values and beliefs are represented in our current structure? Our historical review leads us to an appreciation that, as a society, we may not really believe that the wealthy should pay more, despite our allegedly progressive tax rate schedule. We begrudgingly tax the wealthy at a slightly higher rate mainly because it is both easy and lucrative to do so, and because it makes good political sense from the point of view of a legislator. We are not motivated, and have never been motivated, however, to do so out of some basic sense of justice.

II. OUR FEDERAL TAX SYSTEM: HISTORY, VALUES, AND BEHAVIOR

The first ingredient to be examined in our cultural tax perspective is knowledge. We must be knowledgeable about our federal system of taxation. The significance of this factor is twofold: (1) knowledge of our tax system itself; and (2) knowledge of our tax history.

With its current complexity, it is all but impossible to "know" the entire Internal Revenue Code. Even alleged tax "experts" will likely admit that they are current in their knowledge of only certain areas of the Code. So, if the experts cannot master the entire Code, what chance do average taxpayers have? The complexity of the Internal Revenue Code has been the topic of discussion of tax reform for many years. No matter how much discussion takes place, however, the Code just keeps growing. In the 1997 revenue act, for example, 825 Code sections were revised and 285 new sections were added to the Code.⁷ Taxpayers are overwhelmed and fearful that, without assistance, they will miss tax deductions and

⁷ See *Early Spring Anxiety*, PROVIDENCE J.-BULL., Apr. 25, 1998, at A12. There were also 271 new IRS regulations in 1997. See *id.*

credits otherwise available to them. Thus, in 1996, more than 60 million taxpayers, representing one-half of all those filing, paid preparers to fill out their tax returns.⁸

An important fact not to be overlooked here is that whatever knowledge Americans possess about the federal income tax is passed on to succeeding generations. Even if the information we possess is not correct, our perceptions get passed on to our family members. My students come to my federal income tax class, for example, as relative novices to the federal tax system. In fact, it is ironic to teach tax to a group of people who have only liabilities (from their student loans) and no income! Yet, invariably, they already have very definite attitudes toward the federal tax system. Fully 90% of them are fearful of a tax system that impacts their lives and the lives of their soon-to-be clients. The knowledge obtained in the course, however, empowers even the most fearful, even though it barely scratches the surface of the Internal Revenue Code.

The fundamental problem regarding knowledge and the Internal Revenue Code is the amazingly steep tax learning curve. Our students might even call it a slippery slope. As taxpayers, we feel driven to "know what the rich people know." If Code sections are available to us that we do not know about, we feel stupid and taken. We have defaulted money to the federal government that is rightfully ours to keep. Thus, tax planning, tax preparation, and the computer technology associated with self-preparation have become driving forces in our current tax culture.

A final observation regarding knowledge is the difficult task of appreciating the hidden aspects of taxation. We are aware, of course, of the taxes we pay outright, but what about the so-called hidden taxes: the excise taxes on gasoline, cigarettes, and alcohol built into the cost of the goods; the corporate income tax passed along into the economy to be paid by others; and the employer's portion of the Social Security tax?⁹ No matter what the tax, whether it is a sales tax, an income tax, a corporate tax, an employment tax, or a tax upon trusts, people, not entities, pay taxes.¹⁰ An in-depth analysis of the issues surrounding the size

⁸ In 1996, 60,858,000 individual income tax returns were filed with paid preparer signatures. See INTERNAL REVENUE SERVICE, *INDIVIDUAL INCOME TAX RETURNS, STATISTICS OF INCOME BULLETIN*, Summer 1998, at 177 tbl.22 [hereinafter *STATISTICS OF INCOME*]. A total of 120,351,208 returns were filed. See *id.* at 150 tbl.3.

⁹ See Edward J. McCaffery, *Cognitive Theory and Tax*, 41 *UCLA L. REV.* 1861, 1874-86 (1994).

¹⁰ Keep in mind that taxes are borne by *people*. . . . All taxes ultimately translate into changes in individuals' purchasing power. . . . We speak of the 'nominal incidence' of a tax as the measured payments of tax by individuals or institutions. The 'real incidence,' or economic incidence, is the true burden, which can fall only on people.

and complexity of our tax law is beyond the scope of this article, but these issues impact every aspect of our analysis as we examine knowledge, beliefs, and behavior in our cultural perspective on the Internal Revenue Code.

The second primary aspect of knowledge is historical perspective. It is, in my estimation, critical to an understanding of the federal system of individual income taxation that we adequately reflect upon its evolution over the years. How did we originally fund the activities of our early, central federal government? Who in the population bore the primary burden of federal taxation? It was not until 1913, fully 124 years after the Constitutional Convention of 1789, that Congress enacted a relatively straightforward tax upon "income from whatever source derived,"¹¹ after struggling with the concept in previous decades. The enactment of this federal system of income taxation was made possible only by the passage of the 16th Amendment in February 1913. Thus, the questions become: how and why did we arrive upon "income" as our tax base, what values were reflected in a federal system that taxed income, and what was considered "income" in 1913?

My initial goal is to briefly bring to light the amazing history of the federal system of taxation. This article attempts to illuminate not just the facts, but also the values and beliefs reflected in our tax history, the choices Congress made along the way, and who historically bore the major burden of the federal taxes. Our discovery will be that the road to the federal taxation of income was one of "War and Panic."

A. Knowledge: The Evolution of the Federal Tax System

History, of course, can influence us only if we actually know, understand, and appreciate what happened. Otherwise, our perceptions about history, right or wrong, will dictate our future. What we believe to be true about the evolution of the federal tax system and what actually occurred may be accurate—or not. Noted scholars and historians previously have detailed the history of the federal income tax.¹² My intention in this section is to emphasize cultural perspectives and observations throughout the factual, historical summary.

¹¹ Section 22 of the Internal Revenue Code of 1913 (now I.R.C. § 61 (1994)).

¹² See, most notably, RANDOLPH E. PAUL, *TAXATION IN THE UNITED STATES* (1954); JOHN F. WITTE, *THE POLITICS AND DEVELOPMENT OF THE FEDERAL INCOME TAX* (1985); and ROBERT STANLEY, *DIMENSIONS OF LAW IN THE SERVICE OF ORDER: ORIGINS OF THE FEDERAL INCOME TAX 1861-1913* (1993). These authors are extensively cited throughout this section of the article.

1. The Early Federal System: Excise Taxes and Tariffs

When our Republic was formed, the primary societal concern was the preservation of the states. The states were reluctant to relinquish any taxing power to the national government. The colonies had no national system of taxation, and none was established for the national government under the Articles of Confederation.¹³ No national tariff could be levied without an amendment to the Articles of Confederation, which required unanimous consent of the states.¹⁴ The new federal government had to rely upon a process of requisitioning the states for revenue in proportion to the value of their lands and improvements.¹⁵ The states viewed these requests as voluntary contributions, which were not paid, and the new government, thoroughly bankrupt, ultimately defaulted on its considerable debt.¹⁶

The new Constitution adopted in 1789 addressed these financial concerns. In Article I, the Constitution gave Congress the "Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States" and specified that "all Duties, Imposts and Excises shall be uniform throughout the United States."¹⁷ In addition, Article I prohibited a direct tax "unless in Proportion to the Census or Enumeration"¹⁸ and prohibited the federal government from imposing a tax or duty "on Articles exported from any State."¹⁹

Thus was born a federal tariff²⁰ and an elaborate and unpopular federal system of excise taxes. Between 1789 and 1800, the initial tax-of-choice of the new centralized federal government was the excise tax. Taxes were imposed on carriages, the sale of certain liquor, the manufacture of snuff, the refining of sugar, auction sales, legal investments and bonds.²¹ Congress adopted a stamp tax upon legal instruments as well as "a direct tax upon dwelling houses, land, and slaves, which was apportioned among the states on the basis of population."²² Open rebellion against the excise tax on whiskey ensued in western Pennsylvania in 1794; federal excise officials were attacked, and President Washington was com-

¹³ See PAUL, *supra* note 12, at 4.

¹⁴ ARTS. OF CONFED. arts. VIII, XIII.

¹⁵ *Id.* art. VIII.

¹⁶ See PAUL, *supra* note 12, at 5.

¹⁷ U.S. Const., art. I, § 8, cl. 1.

¹⁸ *Id.* § 9, cl. 4.

¹⁹ *Id.* § 9, cl. 5.

²⁰ The Madison bill, the first American tariff act, became law in 1789. See PAUL, *supra* note 12, at 7.

²¹ See PAUL, *supra* note 12, at 5-6.

²² *Id.* at 6.

pelled to send 15,000 federal troops to restore the authority of the federal government.²³

The Whiskey Rebellion was not an auspicious beginning for the federal taxing power. What cultural observations are we entitled to at this point? Colonial Americans did not react well to a new system of federal taxation. The idea of a centralized government itself was a hard-fought issue among the states, and funding its operation was to be another. It appears that hostilities erupted because the change was simply too much too soon. Resentment arose as a consequence of rapid imposition of excise taxes upon so many items and at rates that were exceedingly high.²⁴ Early resistance to providing the federal government with any source of revenue at all already existed. A heavy federal tax hand was not reflective of this new collective society of colonies. It seems plausible that there were few believers among the general public in the benefits to be derived from this new, abstract, and remote federal government.²⁵

The Jefferson administration (1801-1809) relied upon the tariff as the federal government's primary source of revenue and abolished most of the early system of excise taxes.²⁶ The need for revenue during the War of 1812, however, brought back both excise taxes and direct but apportioned taxes upon dwelling houses, lands, and slaves.²⁷ After the war, when heavy trade with England threatened to ruin American manufacturers, the emphasis in tariff planning turned, for the first time, from revenue production to the protection of American industry.²⁸

By the 1850s, the federal tax system drew 92% of its total revenue from import duties.²⁹ Tariff schedules included manufactures, from machine tools to luxury items, raw materials such as mining and agricultural products, and a free list of varying size.³⁰ Importers initially paid the taxes but passed the cost along to the ultimate consumers by raising the prices on these imported goods. This system was thought to provide a competitive price edge to

23 See STEPHEN B. PRESSER & JAMIL S. ZAINALDIN, *LAW AND JURISPRUDENCE IN AMERICAN HISTORY: CASES AND MATERIALS* 151 (3d ed. 1995).

24 See PAUL, *supra* note 12, at 6. A gallon of whiskey in the early 1790s cost 50 cents; while the maximum whiskey excise tax was 30 cents per gallon. *Id.*

25 It is always dangerous to make generalizations about a society as diverse as the original 13 colonies, just as it is difficult to make generalizations about our current population of more than 270 million Americans. However, throughout this cultural perspective, it will be the questions that we ask and the observations that we make that will inform our discussion.

26 The tariff was a consumption tax initially imposed upon imported luxury items, but ultimately imposed upon hundreds of basic items. See PAUL, *supra* note 12, at 6.

27 See *id.*

28 See *id.* at 7.

29 See STANLEY, *supra* note 12, at 25.

30 See STANLEY, *supra* note 12, at 26 n.38 (citing FRANK W. TAUSSIG, *THE TARIFF IN UNITED STATES HISTORY* (8th ed. 1967)).

similar goods produced domestically. Thus, the so-called “protective tariffs” were not just a source of federal revenue. These taxes initially reflected attitudes of making the rich pay more than the poor through tariffs on luxury items, with the added benefit that the tariff could, supposedly, stimulate domestic economic growth.³¹

To tax the rich on luxury items may have been the initial rationale for the tariff system. Its base broadened tremendously over the years, however, evolving into a regressive tax system borne heavily by the laboring masses, taxing every imported item from the food they put on the table to the clothes on their backs. It has been convincingly argued that, during this period of tremendous growth, a conscious decision was made to subsidize economic development³² through the legal system rather than the tax system.³³ Thus, a disproportionate share of the burden of economic growth fell upon the least empowered members of society.

Throughout the 1800s, state governments depended primarily upon the property tax, supplemented by excise taxes on slaves,

³¹ See *id.* at 25-26.

³² Indeed, the law of negligence became a leading means by which the dynamic and growing forces in American society were able to challenge and eventually overwhelm the weak and relatively powerless segments of the American economy. After 1840 the principle that one could not be held liable for socially useful activity exercised with due care became a commonplace of American law. In the process, the conception of property gradually changed from the eighteenth century view that dominion over land above all conferred the power to prevent others from interfering with one's quiet enjoyment of property to the nineteenth century assumption that the essential attribute of property ownership was the power to develop one's property regardless of the injurious consequences to others.

MORTON J. HORWITZ, *THE TRANSFORMATION OF AMERICAN LAW: 1780-1860*, at 99 (1977).

³³ One of the most striking aspects of legal change during the antebellum period is the extent to which common law doctrines were transformed to create immunities from legal liability and thereby to provide substantial subsidies for those who undertook schemes of economic development. . . . What factors led antebellum statesmen generally to turn to subsidization through the legal, rather than the tax, system? One explanation seems fairly clear. Change brought about through technical legal doctrine can more easily disguise underlying political choices. Subsidy through the tax system, by contrast, inevitably involves greater dangers of political conflict. . . . Nevertheless, it does seem fairly clear that the tendency of subsidy through legal change during this period was dramatically to throw the burden of economic development on the weakest and least active elements in the population. . . . There is reason to suppose, therefore, that the choice of subsidization through the legal system was not simply an abstract effort to avoid political contention but that it entailed more conscious decisions about who would bear the burdens of economic growth. It does seem likely, moreover, that regardless of the actual distributional effects of resorting to the existing tax system, a more general fear of the redistributive potential of taxation played an important role in determining the view that encouragement of economic growth should occur not through the tax system, but through the legal system. . . . Thus, whether or not legal subsidies to enterprise were optimally efficient or instead encouraged overinvestment in technology, it does seem quite likely that they did contribute to an increase in inequality by throwing a disproportionate share of the burdens of economic growth on the weakest and least organized groups in American society.

Id. at 99-101.

carriages, and personal property in general.³⁴ Local governments relied primarily upon the property tax as well. In 1890, the property tax produced 72% of state revenues and 92% of local revenues.³⁵ In the early 1800s, more than 80% of the populace lived in rural areas; thus a tax levied on the value of land impacted most of the population and had the effect of taxing the holders of the most valuable land most heavily, effectuating an ability-to-pay philosophy.³⁶

What does the developing system of taxation in the states tell us about our cultural values and beliefs? First, hard money was scarce, and the voting public was not accustomed to the idea that it should pay any appreciable chunk of their income or wealth to the state.³⁷ Second, early in the 1800s, wealth was defined in terms of property. As the century progressed, however, dramatic societal changes occurred. New kinds of wealth, in the form of commercial paper, stocks, and other evidences of debt, were expanding but were not being reached by the property tax system.³⁸ The property tax system also was not reaching salaries. The increase in both mercantile and manufacturing activity brought large new populations to the cities, and these populations depended on salaries for their livelihood.³⁹ It was more than just coincidence that when the federal government needed more revenue to fund the cost of the Civil War, it turned to the new rising source of wealth: income.

2. The Civil War and the First Federal Income Tax

Robert Stanley provides the following perspective on wealth in the United States just before the Civil War:

[o]f the adult males living in the ten largest urban counties in 1860, over half owned no property whatsoever, and nearly 60 percent had under \$100 worth. Moreover, wealth was more unequally held in the cities than in rural areas. Nevertheless, across the rural/urban dimension the corpus of wealth remained in astonishingly few hands. Nationwide, the top 10 percent of the families owned approximately 72 percent of the gross national wealth in 1860, and the trend was toward greater inequality by 1900.⁴⁰

³⁴ See LAWRENCE M. FRIEDMAN, *A HISTORY OF AMERICAN LAW* 185 (2d ed. 1985).

³⁵ See *id.* at 567.

³⁶ See STANLEY, *supra* note 12, at 25.

³⁷ See FRIEDMAN, *supra* note 34, at 567.

³⁸ See STANLEY, *supra* note 12, at 25.

³⁹ See *id.*

⁴⁰ *Id.* at 23 n.32. General observations concerning the Civil War and wealth in 1860 would not be complete without reference to slavery. Any cultural perspective of America, whether tax policy or otherwise, must address our 200-year history of slavery and its lingering societal aftermath.

Congress was desperately in need of revenue to fund the Civil War. In 1861 and 1862, Congress enacted the first income tax legislation. The federal government, however, was still primarily funded through the tariff system on imports, although the sale of federal war bonds provided a substantial surge in federal revenue. Professor Stanley observes that:

[t]he result of the fiscal decisions made during the early war years was a war effort almost completely dependent upon the investments of private financiers, and the creation of a revenue structure designed to establish credit, to fund ordinary operations including debt maintenance, and to draw taxes through a system acknowledged to be thoroughly regressive and consumption-oriented. Only income taxation seemed to promise that the burdens of the war would not ultimately fall, in the words of John Sherman, "entirely" on the shoulders of "the poorer class."⁴¹

The basic structure of exemptions, graduated tax rates, and deductions introduced in the income tax law of 1862 still persists in the Internal Revenue Code as we know it today. The \$600 exemption level reflected the intention to reach only a tiny, wealthy fraction of the population.⁴² The very low and slightly graduated rates—from 3 to 5% on incomes over \$600 and \$10,000, respectively—reflected the concerns of a leadership reluctant to use the power of the law to affect the wealthiest portions of the population substantially, while at the same time affirming the principle of "ability to pay."⁴³ Deductions of federal, state and local taxes were

The American style of black-white relations can be traced far back into the colonial past. . . . The exact legal origins of slavery are obscure; but clearly it was developing custom that guided the lawmaker's hand. Slavery did not exist in the mother country. Early references to slaves and slavery have a certain vagueness and ambiguity. Yet before the end of the 17th century, slavery had become a definite legal status in both the North and the South; it is peculiarly associated with blacks; it had become a terrible, timeless condition, inherited by children from their mothers. The legal status of the slave, as it took shape in statute books, reflected and ratified social discrimination and race. [citation omitted] . . . Once the fundamental lines of the law were set, the colonies, particularly in the South, carried the logic of slavery to its grim outer limits. The slave was property, a capital asset of his master. He passed by will, was bought and sold, could be seized for his master's debts, and was taxed like other property. . . . Slavery was a coiled spring. In the end, it was a trap for whites as well. The whites, of course, had the upper hand; but even they paid the price in the long run. Slavery was one of the irritants that brought on a great civil war. Hundreds of thousands died, victims in a sense of the South's "peculiar institution."

FRIEDMAN, *supra* note 34, at 85-86, 229. An in-depth analysis of slavery is beyond the scope of this article. For an enlightening collection of works and cases on the subject, see PRESSER & ZAINALDIN, *supra* note 23, at 376-442.

⁴¹ Stanley, *supra* note 12, at 32.

⁴² See PAUL, *supra* note 12, at 10. A cashier on the Commissioner of Internal Revenue's staff earned an annual salary of only \$1600, for example, while collecting \$37 million of taxes in six months. See *id.*

⁴³ See STANLEY, *supra* note 12, at 30.

allowed under the 1862 Act.⁴⁴ The 1862 Act also imposed an inheritance tax of .75% to 5% on personalty in excess of \$1000, depending on the relationship of the heirs.⁴⁵

The income tax was increased in 1864, doubling the top rate to 10%⁴⁶ and authorizing deductions of mortgage interest, repairs, and losses from the sale of lands.⁴⁷ Income taxes were reduced in 1867, and again in 1870 when the inheritance tax was repealed.⁴⁸ By 1869, the yield from the federal inheritance tax had reached more than \$3 million, with the greater part of the taxes being collected at the lowest rates.⁴⁹ About 55% of the inheritance taxes collected came from New York, Massachusetts, and Pennsylvania.⁵⁰

From 1862 to 1866, no more than 1.3% of the American people ever paid federal income tax.⁵¹ The use of income as the basis of taxation, coupled with high exemption levels, "had the effect of targeting a group drawn primarily from the most heavily urban states and regions of the country, just as opponents of the tax would charge, and gave to the protectionists the 'victims' they sought to hold up before the eyes of the poor, rural, and Western constituents."⁵² In 1864, 61.3% of the revenue from the income tax came from taxpayers in just three states (New York, Massachusetts, and Pennsylvania), and together the Northeast yielded about 76% of all income tax revenue.⁵³ The Civil War income taxes made no attempt to levy a tax upon capital gains, other than capital gains arising from real estate held for a short period.⁵⁴

The federal income tax was allowed to expire in 1872 when the federal government was enjoying large budget surpluses.⁵⁵ At the same time, Congress sent additional good news to constituents in the form of the Tariff Act of 1872.⁵⁶ The Tariff Act placed popular items such as coffee and tea on the free list, adopted a 10% reduction on major protected items, and expanded the free list slightly with some minor items used by manufacturers.⁵⁷

44 See PAUL, *supra* note 12, at 13.

45 See *id.* at 10.

46 See MICHAEL J. GRAETZ AND DEBORAH H. SCHENK, *FEDERAL INCOME TAXATION: PRINCIPLES AND POLICIES* 6 (3d ed. 1995).

47 See PAUL, *supra* note 12, at 13.

48 See GRAETZ & SCHENK, *supra* note 46, at 6.

49 See PAUL, *supra* note 12, at 17.

50 See *id.*

51 See STANLEY, *supra* note 12, at 39-40.

52 *Id.* at 40.

53 See *id.* at 40-41.

54 See PAUL, *supra* note 12, at 13.

55 See GRAETZ & SCHENK, *supra* note 46, at 6-7.

56 See STANLEY, *supra* note 12, at 55.

57 See *id.*

Thus Congress abandoned income and returned to consumption as its major source of tax revenue. The year 1872 was not the first time, and certainly would not be the last, that Congress acted to reduce taxes when faced with a strong economy and fiscal surplus.

3. A Tumultuous Time: 1873-1900

Just one year later, the Panic of 1873 caused 5,000 businesses to fail, and 10,478 closed before the country turned a corner in 1879.⁵⁸ The Panic of 1873 was "essentially the result of years of over-trading, over-production, over-speculation, over-issues of paper money and inflated prices."⁵⁹ Thirty-seven banks and brokerage houses closed on September 18, 1873.⁶⁰ Two days later, the Stock Exchange closed for an unprecedented 10 days.⁶¹ Railroads and additional banks were soon forced to shut down, which affected the fortunes of thousands of merchants and farmers.⁶²

After the Panic of 1873, the country witnessed a very long struggle against the tariff system of taxation. Between 1873 and 1879, congressmen from the Middle West and the South introduced 14 different income tax bills.⁶³ In the meantime, the high tariff piled up huge and embarrassing Treasury surpluses. In 1875, a Republican Congress repealed the 10% reduction made in 1872 as a concession to tariff reformers.⁶⁴ A Tariff Commission was authorized by Congress in 1882; tariffs, however, remained a protective device to help American business, much to the disappointment of the rest of the world and in spite of the enormous costs to farmers and laborers.⁶⁵

An 1883 act raised duties even higher on protected articles imported in large volume. Grover Cleveland, the Democratic President elected in 1884,⁶⁶ called the tariff "ruthless extortion," and unsuccessfully urged tariff reduction.⁶⁷ In 1888 Harrison defeated Cleveland, and, with the Republicans back in power elected on a protectionist platform, Congress passed the McKinley Tariff

⁵⁸ See THE ALMANAC OF AMERICAN HISTORY 325 (Arthur M. Schlesinger, Jr. et al. eds., 1993) [hereinafter ALMANAC].

⁵⁹ *Id.*

⁶⁰ See *id.* at 324-25.

⁶¹ See *id.* at 325.

⁶² See *id.*

⁶³ See PAUL, *supra* note 12, at 30.

⁶⁴ See *id.* at 31.

⁶⁵ See ALMANAC, *supra* note 58, at 349. President Arthur appointed nine members to the Tariff Commission. John L. Hayes, the Secretary of the National Association of Wool Manufacturers and not exactly a disinterested party, was named chairman. See *id.*

⁶⁶ See *id.* at 356. Cleveland was the first Democratic President to be elected since James Buchanan, who served from 1857-1861. See *id.*

⁶⁷ See PAUL, *supra* note 12, at 31. The Democratic House was united in support of Cleveland. The Republicans in control of the Senate, however, prevented any action. See *id.*

Act of October 1, 1890, increasing the average rate imposed upon dutiable imports to 48%.⁶⁸ According to tax historian Randolph Paul, "[t]his legislation as much as any one fact led to a rout of the Republicans in the 1890 election."⁶⁹

What cultural observations are we entitled to at this point? The political process we choose to govern ourselves is, of course, an integral component of our culture. We are not the world's only democratic society, but our three-part system of executive, legislative, and judicial branches, with its intricate interrelationships, is unique to our American system of government. So how did governmental process respond to the dire poverty, labor unrest, and general economic crisis of this tumultuous period? The historical party system of Democrats and Republicans apparently did not respond well in the eyes of the American people. Farmers⁷⁰ and laborers⁷¹ were pitted against merchants and bankers. The Midwest, South, and the West battled with wealthy Eastern capitalists. Noted historian Arthur M. Schlesinger, Jr. offers this sad observation for the year 1880:

[l]aborer, farmer, city dweller, politician flounder in paradoxes presented to them by new needs. Cherished values and protections of free men are being lost just when a promised better world seems within grasp. Now, when the nation could have profited from vigorous public debate, Congress is dominated by rascally, small-minded men.⁷²

Interestingly, the people responded with a number of novel ideas such as new political parties and labor unions. The Greenback Labor Party and the Antimonopoly Party, which supported a graduated income tax, merged to become the relatively influential Populist Party.⁷³ The Prohibitionist Party held its fourth national convention that same year and nominated a candidate for president.⁷⁴ The American Federation of Labor grew out of a national gathering of unions in 1881, fought for the right to collective bargaining and, by the turn of the century, had half a million members.⁷⁵ So, although the formal national government seemed mired in a stalemate, much was transpiring at the populist level.

⁶⁸ See *id.*

⁶⁹ *Id.*

⁷⁰ See ALMANAC, *supra* note 58, at 342. As of April 1880, "[t]he farmers' plight has taken on the proportions of catastrophe in the face of high tariffs, flood and drought, unfair railroad rates and high interest on loans and mortgages." *Id.*

⁷¹ Railroad labor strikes as well as strikes in the mining industry were common in the late 1870s and severe strikes engulfed the iron and steel industries in the early 1880s. See *id.* at 336, 349.

⁷² *Id.* at 343.

⁷³ See *id.* at 353-54.

⁷⁴ See *id.* at 355.

⁷⁵ See *id.* at 359.

Democrat Grover Cleveland regained the Presidency in 1892. He faced a strong movement in both the Democratic and Populist parties favoring income taxation.⁷⁶ Once again, a panic ensued. The Panic of 1893 witnessed the crash of the New York stock market and a massive financial crisis.⁷⁷ Unemployment and labor unrest were widespread.⁷⁸

Finally, in August 1894, Congress returned to the income tax as a source of federal revenue when it enacted the Wilson-Gorman Tariff Act.⁷⁹ The 1894 federal income tax was directed at taxing only those with vast accumulations of wealth.⁸⁰ "Census statistics showed that over 90 percent of the twelve million families of the country owned less than 30 percent of the national wealth,"⁸¹ while the other 10% of the families owned more than 70% of the national wealth. The Act imposed a rate of 2% on incomes in excess of \$4000, was scheduled to expire in five years, included gifts and inheritances as well as the proceeds therefrom as income, and imposed a separate tax upon corporations, with major categories of exempt associations.⁸²

The 1894 income tax was cut short by the fascinating decision of the U.S. Supreme Court in *Pollock v. Farmers' Loan & Trust Co.*⁸³ Pollock challenged the constitutionality of the 1894 income tax by instituting a representative stockholder suit against the Farmers' Loan and Trust Company, seeking to enjoin the bank from paying the tax upon his income and the income of various trusts administered by it.⁸⁴ The Supreme Court permitted a direct appeal and heard arguments for five days.⁸⁵ Historian Lawrence Friedman notes that the eight sitting justices

held the tax unconstitutional, but only as it applied to income derived from real estate. On the big question, whether the whole law was unconstitutional as a "direct Tax," the Court was evenly divided, four against four. The ninth judge, Jackson, was sick. The case was then reargued—with Jackson present—and this time the Court declared the whole law void, by a bare majority, 5-4.⁸⁶

⁷⁶ See PAUL, *supra* note 12, at 34.

⁷⁷ See ALMANAC, *supra* note 58, at 376. The Silver Purchase Act had badly drained gold reserves. *See id.*

⁷⁸ *See id.* at 376-78.

⁷⁹ *See id.* at 379.

⁸⁰ The 1880s and 1890s witnessed massive accumulations of wealth in oil, copper, steel, tobacco, and sugar trusts. *See id.* at 350.

⁸¹ PAUL, *supra* note 12, at 39.

⁸² See STANLEY, *supra* note 12, at 132.

⁸³ *Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429 (1895); *Pollock v. Farmers' Loan & Trust Co.*, 158 U.S. 601 (1895).

⁸⁴ See PAUL, *supra* note 12, at 40. Pollock owned only 10 shares of stock. *See id.*

⁸⁵ *See id.* at 40-41.

⁸⁶ FRIEDMAN, *supra* note 34, at 566.

It is important to note that, during the 40-year period from 1860 to 1900, 14 million immigrants came to the United States.⁸⁷ The face of America was changing dramatically, and urbanization was in full swing. In addition, the antics of the Republicans and the Democrats a century ago seem painfully reminiscent of the political polarization of today. While the Republicans insisted upon the continuance of the tariff system, severely penalizing the poor for consumption of basic goods, massive wealth accumulated in a small percentage of the population. The distance between economic classes of citizens became even greater. Professor Stanley summarizes this period as follows:

[i]ncome taxation had existed as a symbol of the taxation of accumulated wealth, offering the illusion of a significant contribution toward the overall revenues, and thereby of the potential easing of the cost of living through reductions made possible in the consumption schedules of the tariff. It spoke powerfully to the ability of the Congress to reach especially the pockets of those whose income was not "earned," but existed in investments. The Fuller opinion had specifically prohibited the unapportioned taxation of the most visible, most powerful, most "unearned" income in the nation, thereby wholly compromising the claims to tapping wealth which the Congress might make and ending the law's utility as a pacifier of class animosity. Worse, the Court had happily permitted, as the dissenters pointed out, the unapportioned taxation of "earned" income, that from salaries, professions, and other employments. This was the income of precisely the groups toward whom the symbolism of income taxation was directed: the groups who most needed assurance that the system was, indeed, a fair one.⁸⁸

4. The Early 1900s

In the wake of the Panic of 1907, caused by a shortage of currency from reckless over-capitalization of new enterprises,⁸⁹ Congress was forced to make a choice. In 1909, President Taft offered a compromise solution to the congressional debate over new

When the Court is evenly divided, by custom it does not reveal who voted on which side. When the case was reargued, Jackson, the missing judge, voted to uphold the act. This should have given the law a 5-4 majority; in fact it lost by 5-4. There is a minor historical mystery here, since one of the other four judges in the majority must have changed his mind between the time of the two votes. No one is quite sure which judge is the guilty one.

Id. at n.81. See also PAUL, *supra* note 12, at 214-17.

⁸⁷ See ALMANAC, *supra* note 58, at 351.

⁸⁸ STANLEY, *supra* note 12, at 177.

⁸⁹ See ALMANAC, *supra* note 58, at 414. Professor Stanley observes about the Panic of 1907: "In terms of severity, the depression ranks sixth of fifteen depressions and recessions measured by the average percentage decrease in indexes including imports, clearings, pig-iron production, cotton consumption, railway revenue, and coal production." STANLEY, *supra* note 12, at 184 n.6.

sources of federal revenue. The President made two proposals that ultimately were accepted by Congress: first, an amendment to the Constitution regarding a federal income tax to be submitted to the States; and second, a 2% excise tax on net corporate income.⁹⁰

Between 1909 and 1913, 42 of the 48 states approved the 16th Amendment to the U.S. Constitution.⁹¹ On February 25, 1913, the 16th Amendment to the U.S. Constitution became law:⁹²

[t]he Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

As Professor Stanley points out, the states had little reason to oppose the Amendment. Most of the states already had turned to either the inheritance tax or the income tax at the state level, taxing accumulated wealth by the use of low progressive rates and high exemptions. Thus adoption of the measure addressed “class anxiety.”⁹³

In addition, the states were possibly operating under their own paradigm when it came to the income tax. Although the Amendment clearly stated that Congress would have the power to tax “income, from whatever source derived,” it is doubtful that any of the state legislators ever envisioned the imposition of the income tax upon more than 1% of the population—the “excessively wealthy”—since that is the only population that had ever been taxed in the past. As we are all painfully aware, that is not how the Amendment unfolded over time.

5. The Early Years of the Internal Revenue Code: 1913-1930s

Just one week after the adoption of the 16th Amendment, the first Democratic President since Grover Cleveland, Woodrow Wilson, was inaugurated.⁹⁴ Committed in the campaign of 1912 to tariff reform, the incoming Democratic leadership, the first with majorities in the House and the Senate as well as the presidency

⁹⁰ See PAUL, *supra* note 12, at 94. The amendment to the Constitution proposal was overwhelmingly approved by the Senate (77-0) and by the House (318-14, 55 not voting). See *id.* at 97. The Payne-Aldrich Bill, authorizing the 2% excise tax on net corporate income, was narrowly approved by both the Senate (47-31) and the House (195-183). See *id.* at 96.

⁹¹ See STANLEY, *supra* note 12, at 178. This 88% approval by the States was six states in excess of the constitutionally required minimum. Of 39 ratifying States for which complete information is available, the mean margin of support in the houses was 94.9% and in the senates was 89.4%. See *id.* at 212.

⁹² See ALMANAC, *supra* note 58, at 422.

⁹³ See STANLEY, *supra* note 12, at 178-79.

⁹⁴ See ALMANAC, *supra* note 58, at 422-23.

in 20 years,⁹⁵ moved quickly to establish its reformist credentials in the Underwood-Simmons Tariff Act of 1913.⁹⁶ President Wilson set about reforming the hitherto intractable tariff and banking systems.⁹⁷

On October 3, 1913, Congress enacted the Underwood-Simmons Tariff Act, the first tariff reform since the Civil War.⁹⁸ The Act brought down tariff duties on 958 items, including foodstuffs, clothing and raw material; rates on cotton were cut 50%; and rates on woolens were cut by more than 50%.⁹⁹ The Act also introduced the first post-Amendment federal income tax.¹⁰⁰ The tax applied to the income of individuals and corporations, removed the existing \$5000 exemption for corporate taxpayers, applied a \$3000 exemption to the incomes of individuals, and established two rate scales: a "normal" rate of 1% on taxable income, and an additional tax or surcharge ranging from 1% to 6% on amounts in excess of \$20,000.¹⁰¹

Contemporary estimates indicated that fewer than 4% of American families received as much as \$3000 in income in 1910.¹⁰² Since the tax was imposed upon "taxable income," after taking certain deductions into account,¹⁰³ only 1% of the American public was actually subject to the tax. Notwithstanding the small proportion of taxpayers, \$71 million was collected from this income tax in 1914, and the amount rose to \$80 million in 1915.¹⁰⁴ A copy of the 1913 Federal Income Tax Return is included in the Appendix to this article.

In 1916, the Supreme Court upheld the constitutionality of the new federal income tax.¹⁰⁵ A unanimous Court concluded that the Amendment granted no new taxing power since none had ever been taken away; rather, it removed the necessity of subjecting

⁹⁵ "Democrats outnumbered Republicans by 291 to 128 in the House (with 15 Progressives and an Independent), and 51 to 44 in the Senate (with one Progressive)." WITTE, *supra* note 12, at 76.

⁹⁶ See STANLEY, *supra* note 12, at 226.

⁹⁷ See ALMANAC, *supra* note 58, at 423.

⁹⁸ See *id.* at 424.

⁹⁹ See *id.*

¹⁰⁰ "At the time the tax was accepted as a natural and inevitable culmination of the constitutional amendment. It was not deemed as important as the tariff bill itself. The income tax section occupied only 8 pages of an 814-page report." WITTE, *supra* note 12, at 77.

¹⁰¹ See STANLEY, *supra* note 12, at 226-27.

¹⁰² See *id.* at 227, n.155.

¹⁰³ The 1913 Form 1040 Tax Form indicates that six general deductions were available from gross income: 1) business expenses; 2) interest paid on personal indebtedness (thus the home mortgage interest deduction was available from the start); 3) national, state, county, school, and municipal taxes; 4) uncompensated casualty losses; 5) worthless debts; and 6) depreciation deductions. See Appendix, *infra*, at 90-93.

¹⁰⁴ See STANLEY, *supra* note 12, at 227.

¹⁰⁵ *Brushaber v. Union Pacific Ry. Co.*, 240 U.S. 1 (1916).

taxes on income to a threshold inquiry into sources, as in *Pollock*, prior to application of the rule of apportionment.¹⁰⁶

Also in 1916, in yet another search for revenue in the face of a budget deficit of \$177 million,¹⁰⁷ Congress increased the maximum income surtax rate from 6% to 13% and enacted a federal estate tax.¹⁰⁸ By 1917, the estate tax rates ranged from .5% on estates above \$50,000 to 10% on estates over \$10 million.¹⁰⁹ The enactment of a federal estate tax was the culmination of a grassroots effort. The ideas of Theodore Roosevelt and a growing class-consciousness persisted in the early 20th century.¹¹⁰ Income and wealth disparity was a growing source of social and economic anxiety. The federal income tax system, as revised by Congress, offered little to counter this imbalance.

The congressional trend of increasing tax rates had an early beginning. By 1917, with U.S. involvement in World War I, the top income tax rate (normal and surcharge combined) reached 67%.¹¹¹ Just one year later, the top combined rate was increased to 77%.¹¹² The Revenue Act of 1917 "marked the shift of the finances of the United States from a base of customs and excises to one of income taxes."¹¹³ As tax historian John Witte notes:

World War I was a shock to government finances that dramatically and permanently affected the internal revenue system in the United States. What began as a modest income tax with a very large exemption, a maximum tax rate of 7 percent, and a negligible share of revenue expanded in four years to a tax accounting for close to 60 percent of all revenue and having a maximum rate of 77 percent.¹¹⁴

The decade of the 1920s brought an interesting array of tax legislation to the table. In 1920, there were only 5.5 million taxable returns for a population of 106 million and an estimated labor force of 41.7 million.¹¹⁵ The Revenue Act of 1921 limited the tax on

¹⁰⁶ See STANLEY, *supra* note 12, at 228.

¹⁰⁷ See WITTE, *supra* note 12, at 81.

¹⁰⁸ See PAUL, *supra* note 12, at 107-08. The estate tax was imposed on estates in excess of \$50,000 at rates ranging from 1% to 10% on amounts above \$5 million. See *id.* at 108.

¹⁰⁹ See WITTE, *supra* note 12, at 84-85.

¹¹⁰ See PAUL, *supra* note 12, at 108.

In 1915 Basil M. Manly, Research Director of the Commission of Industrial Relations, had given as a cause of industrial unrest the unjust distribution of wealth and income as represented by the fact that forty-four families in the country possessed income of at least \$50 million a year while the majority of adult, male workers in factories and mines received meager wages of from \$10 to \$20 a week. Manly urged an inheritance tax as a check upon the industrial feudalism created by the fortunes of the Rockefellers, Morgans, Vanderbilts, and Astors.

Id.

¹¹¹ See *id.* at 114.

¹¹² See *id.* at 118.

¹¹³ WITTE, *supra* note 12, at 84.

¹¹⁴ *Id.* at 87.

¹¹⁵ See *id.* at 86.

net capital gains (on capital assets held for more than two years) to 12.5%¹¹⁶ but did not provide for any limitation upon the deduction of capital losses.¹¹⁷ The Fordney-McCumber flexible tariff act became law in September 1922, materially increasing rates.¹¹⁸ The 1924 Revenue Act placed the first limitation upon capital losses.¹¹⁹ By 1925, with the heavy influence of then-Secretary of the Treasury Andrew Mellon, the top income tax rate was dramatically reduced to 25%, where it remained until 1932.¹²⁰

During the decade of the 1920s, it can be said generally that the country witnessed a low level of taxation and a period of peace and prosperity. However, such a statement is deceiving. The low level of taxation primarily benefited the wealthy since, under the Mellon Plan approved by Congress, the top rates dropped from 50% to 25%, while the lowest-income taxpayers saw their rates lowered from 4% to 3%.¹²¹ Historian Howard Zinn carefully notes that prosperity was not experienced equally throughout the United States:

[u]nemployment was down, from 4,270,000 in 1921 to a little over 2 million in 1927. The general level of wages for workers rose . . . But prosperity was concentrated at the top. While from 1922 to 1929 real wages in manufacturing went up per capita 1.4 percent a year, the holders of common stocks gained 16.4 percent a year. Six million families (42 percent of the total) made less than \$1,000 a year. One-tenth of 1 percent of the families at the top received as much income as 42 percent of the families at the bottom, according to a report of the Brookings Institution. Every year in the 1920s, about 25,000 workers were killed on the job and 100,000 permanently disabled. Two million people in New York City lived in tenements condemned as firetraps.¹²²

The stock market crash of 1929 is generally attributed to wild speculation. People were buying securities blindly, with little if

116 "It was believed that this provision would stimulate profit-taking transactions, and give relief from the hardship involved in a bunching of income where a gain represented an increase in value accruing over a long period of years." PAUL, *supra* note 12, at 129. Thus the preferential treatment for capital gain income has been an integral part of the Code since 1921. The preference was actually eliminated for a short while by the 1986 Tax Reform Act (when overall rates were also drastically reduced to just two brackets of 15% and 28%) but was almost immediately reintroduced in 1990 and retained in 1993 when the top rate on ordinary income increased to 31%, and again to 36% and 39.6% while the rate of capital gain income remained at 28%. In 1997, the preference became even more enhanced, generally dropping the capital gain tax rate to 20%. See *infra* Part II.A.8.

117 See J. MARTIN BURKE AND MICHAEL K. FRIEL, *TAXATION OF INDIVIDUAL INCOME* 643, 645 (5th ed. 1998).

118 See PAUL, *supra* note 12, at 130.

119 See BURKE & FRIEL, *supra* note 117, at 646.

120 See GRAETZ & SCHENK, *supra* note 46, at 8.

121 See HOWARD ZINN, *A PEOPLE'S HISTORY OF THE UNITED STATES: 1492-PRESENT* 375 (1995).

122 *Id.* at 373-74.

any disclosure. The crash marked the beginning of the Great Depression, bringing the entire economy to its knees. Unemployment reached a peak of 13 million by the end of 1932, and total wages declined by 60% from their 1929 levels.¹²³ Again, historian Howard Zinn notes:

[b]ut, as John Galbraith says in his study of that event (*The Great Crash*), behind that speculation was the fact that “the economy was fundamentally unsound.” He points to very unhealthy corporate and banking structures, an unsound foreign trade, much economic misinformation and the “bad distribution of income” (the highest 5 percent of the population received about one-third of all personal income).¹²⁴

In the 1930s, Congress increased income tax rates, exacerbating the Great Depression. In addition, with passage of the Smoot-Hawley Tariff Act of 1930, Congress reinstated high tariffs, prompted both by a nostalgic desire to return to the tariff as the principal source of federal revenue and by an isolationist reaction to the fallout from World War I.¹²⁵ By 1932, the Republican majority in Congress, so dominant in the previous decade, was gone.¹²⁶ Faced with a mounting federal deficit,¹²⁷ Congress increased corporate income tax rates to 14% and upped the surcharge on individuals to 55%.¹²⁸ By 1932, there were 2 million taxable federal income tax returns.¹²⁹ Beginning with the Revenue Act of 1934, capital losses could generally only be deducted to the extent of capital gains, although up to \$2000 of any excess capital losses over gains also could be deducted.¹³⁰ In 1935, the top individual income tax rate was increased from 59% to 75% on incomes over \$500,000, and the corporate income tax was graduated, with rates ranging from 12.5% to 15%.¹³¹ In addition, taxes on inheritances and gifts were also increased.¹³² The most significant tax legislation of this decade was the enactment of the Social Security Act of 1935 and its 1939 amendment, created to provide a federal retirement, disability, and unemployment insurance system.¹³³

123 See ALMANAC, *supra* note 58, at 460.

124 ZINN, *supra* note 121, at 377.

125 See PAUL, *supra* note 12, at 163. “The effect of the high tariffs enacted was to make it impossible for foreign countries to pay their World War I debts and almost completely to stifle foreign trade.” *Id.*

126 See WITTE, *supra* note 12, at 97.

127 The deficit was \$2.7 billion for 1932. See WITTE, *supra* note 12, at 96.

128 See *id.* at 97.

129 See PAUL, *supra* note 12, at 319.

130 See BURKE & FRIEL, *supra* note 117, at 646.

131 See WITTE, *supra* note 12, at 101.

132 See ALMANAC, *supra* note 58, at 469.

133 See GRAETZ & SCHENK, *supra* note 46, at 9.

Originally, the Social Security tax rate was set at 1 percent of wages to grow to 5 percent, split evenly between employees and their employers. Today the combined tax rate on employers and employees exceeds 15 percent and an additional tax of

Considering the depth of the Depression, it is interesting to note that neither Congress nor the Roosevelt administration turned heavily to the federal income tax for a revenue fix.¹³⁴ Meanwhile, labor continued to clamor to be heard and to be seriously addressed. A million and a half workers in different industries went on strike in 1934.¹³⁵ In 1936, there were 48 sit-down strikes; in 1937, there were 477.¹³⁶ The Fair Labor Standards Act of 1938, which established the 40-hour week and outlawed child labor, addressed some of the workers' concerns, although the minimum wage was set at a low twenty-five cents an hour the first year.¹³⁷ Given these statistics, it may not be surprising that, by 1939, only 5% of the population was subject to the federal income tax.¹³⁸

6. The "Taxing of the Masses": The Internal Revenue Code from the 1940s to the Korean War

Revenue Acts in 1941 and 1942 to finance military expenditures during World War II turned the federal income tax into a mass tax. The 1942 Act carried the total number of income tax returns to 37 million, of which almost 28 million reflected a tax liability.¹³⁹ Including a Victory Tax,¹⁴⁰ the top income tax rate increased to 90% and the number of taxpayers increased to 50 million.¹⁴¹ Tax revenues were expected to increase by \$9 billion.¹⁴² Of crucial significance, the 1942 Act provided that only 50% of long-term capital gain and loss was to be taken into account in computing net income.¹⁴³ The top corporate tax rate rose from 31% to 40%.¹⁴⁴

The Current Tax Payment Act of 1943 put wage and salary earners on a withholding basis of tax collection.¹⁴⁵ The Revenue Act of 1944 was vetoed by President Roosevelt in February

nearly 3 percent of wages is imposed to pay for hospital insurance under Medicare. The share of federal revenues supplied by these payroll taxes has grown substantially over time, and they now account for nearly 40 percent of federal revenues.

Id.

134 Several early pieces of New Deal legislation had tax implications. The Agriculture Adjustment Act, for example, included taxes on food processing, and, more important, the National Industrial Recovery Act levied a 5 percent tax on dividends and revived the wartime excess profits tax at a modest level.

WITTE, *supra* note 12, at 98.

135 See ZINN, *supra* note 121, at 386.

136 See *id.* at 391.

137 See *id.* at 393-94.

138 See TIMOTHY J. CONLAN ET AL., TAXING CHOICES: THE POLITICS OF TAX REFORM 19 (1990).

139 See PAUL, *supra* note 12, at 319.

140 The Victory Tax was a 5% tax on all income over \$624, to be levied until the war ended. See ALMANAC, *supra* note 58, at 490.

141 See PAUL, *supra* note 12, at 319.

142 See ALMANAC, *supra* note 58, at 490.

143 See BURKE & FRIEL, *supra* note 117, at 644.

144 See PAUL, *supra* note 12, at 319-20.

145 See *id.* at 348; ALMANAC, *supra* note 58, at 493.

1944,¹⁴⁶ but Congress overrode the veto later that same month.¹⁴⁷ The Act reduced the Victory Tax rate from 5% to 3%, introduced several new deductions and exclusions from gross income, provided numerous benefits for industry, and sent many excise taxes to new high levels.¹⁴⁸ The Individual Income Tax Act of 1944 simplified the income tax for persons with small or moderate incomes.¹⁴⁹ The government raised \$380 billion between June 30, 1940, and the end of 1945; of this amount, \$153 billion, or about 40%, came from income taxes.¹⁵⁰ At the conclusion of World War II, the Revenue Act of 1945 reduced the income tax burden considerably—12 million taxpayers were removed from the tax rolls, revenue from individuals dropped \$3.8 billion, and corporations received a \$5.2 billion tax reduction.¹⁵¹

The net impact of these wartime tax acts was dramatic. It may best be summarized as follows:

[t]he number of personal income tax returns filed almost doubled between 1940 and 1941, nearly doubled again by 1942, and then again by 1945. Although marginal rates were raised to as much as 94 percent in the highest brackets, people of more modest means bore most of the cost of the new "warfare state." In 1939 taxpayers with incomes under \$3,000 had paid just 10 percent of all income tax revenue. By 1948 they were paying half.¹⁵²

By 1947, the feared post-war recession had not occurred, and the federal government actually experienced a surplus.¹⁵³ The quality of life in America, both social and economic, had improved dramatically in the years between 1939 and 1948.¹⁵⁴ The Revenue

¹⁴⁶ See PAUL, *supra* note 12, at 371. "This was the first veto of a tax bill in American history." *Id.*

¹⁴⁷ See *id.* at 375.

¹⁴⁸ See *id.* at 375-79. The changed excise tax rates alone accounted for an increased revenue of more than one billion dollars. See *id.* at 378.

¹⁴⁹ See *id.* at 384-86.

¹⁵⁰ See *id.* at 394.

¹⁵¹ See *id.* at 420.

¹⁵² CONLAN ET AL., *supra* note 138, at 18.

¹⁵³ See PAUL, *supra* note 12, at 479.

Except for stock market apathy, the year had been a banner year. Industrial production, supported by a record money supply, had risen to a peacetime peak. There had been a boom in exports, a drop in strikes, record corporate profits and dividends, record farm, professional, and proprietors' income, record wage and salary income, record employment, and few business failures. Most extraordinary of all things, there had been at long last a government surplus.

Id.

¹⁵⁴ From the middle of 1939 to the middle of 1948 employment had increased 28 percent; the consumer price index for all items more than 70 percent and for food 129 percent; wholesale price indexes 112 percent with agricultural prices in the vanguard of the advance; weekly earnings in manufacturing 118 percent; the gross national product in current dollars about 173 percent; manufacturing sales 231 percent; corporate profits after taxes 272 percent.

Id. at 522.

Act of 1948, enacted over President Truman's veto, provided post-war tax reductions.¹⁵⁵ It reduced individual income tax rates at all levels,¹⁵⁶ increased exemption levels,¹⁵⁷ and instituted the joint income tax return for married couples.¹⁵⁸ In addition, the Act introduced the marital deduction into the estate and gift tax system.¹⁵⁹

Congress increased the individual income tax to finance the Korean War.¹⁶⁰ By 1950, as much as 59% of the population was subject to the individual income tax and 45% of all federal receipts were from the individual income tax.¹⁶¹ In 1951, 90 million federal income tax returns were filed.¹⁶² The Revenue Act of 1951 transformed the preference for capital gains into a deduction from gross income equal to 50% of the net capital gain for the taxable year.¹⁶³

7. The 32-Year Reign of the 1954 Code

The Eisenhower administration was effective in shepherding the passage of the Internal Revenue Code of 1954.¹⁶⁴ The new Code extended the 52% corporate income tax rate and enacted numerous revenue-losing provisions that provided benefits to a wide

¹⁵⁵ See *id.* at 493-94. According to Randolph Paul, the breakdown of federal estimated primary sources of revenue in 1948 was:

<i>Revenue</i>		
Individual income tax	\$18.4 billion	46%
Corporate taxes	\$8.2 billion	21%
Excise taxes (50)	\$6 billion	15%
Estate & gift taxes	\$730 million	1.8%
Customs	\$517 million	1.3%

Id. at 437.

¹⁵⁶ "Before its enactment the actual tax rate started at 19 percent for taxable incomes under \$2,000 and increased to 86.5 percent for incomes over \$200,000. Under the 1948 act the actual rates ranged from 16.6 percent to 82.1 percent with a maximum effective rate limitation of 77 percent." *Id.* at 494.

¹⁵⁷ See *id.*

¹⁵⁸ See *id.* at 496.

¹⁵⁹ See *id.* at 497.

¹⁶⁰ The 1950 tax legislation increased individual and corporate tax rates, closed some tax avoidance opportunities in the area of capital gains, and amended estate and gift tax provisions. See *id.* at 567-70. The 1951 tax legislation slightly increased the capital gains tax rate from 25% to 26%; allowed the gain from the sale or exchange of a personal residence to be offset by the cost of purchase or construction of a replacement residence; and raised corporate income taxes to a new high. See *id.* at 622-23. Regarding the 1951 tax legislation, John Witte observes: "Most important, however, a veritable landslide of special provisions were enacted aiding a wide range of groups." WITTE, *supra* note 12, at 142.

¹⁶¹ See CONLAN ET AL., *supra* note 138, at 19.

¹⁶² See PAUL, *supra* note 12, at 319.

¹⁶³ See BURKE & FRIEL, *supra* note 117, at 644.

¹⁶⁴ See WITTE, *supra* note 12, at 146.

[S]taff members from Treasury, the Joint Committee on Taxation, the House Office of Legislative Counsel, and the Office of the Chief Counsel of the Internal Revenue Service . . . were given the responsibility for proposing technical and policy changes and were in constant contact with executive agencies, outside groups, and the staffs of Ways and Means and Finance.

Id.

range of groups and individuals.¹⁶⁵ Eight years passed before another significant piece of tax legislation became law. Revisions enacted in the Revenue Act of 1962¹⁶⁶ and the Revenue Act of 1964¹⁶⁷ significantly reduced taxes and “both the rhetoric and the results were extremely favorable to capital formation and business. The 1969 Tax Reform Act reversed this bias.”¹⁶⁸

President Johnson’s Great Society and the Vietnam War¹⁶⁹ combined to influence the 1969 tax legislation, “the most liberal peacetime tax bill ever enacted.”¹⁷⁰ Revenue-gaining provisions exceeded revenue loss provisions for both individual income taxpayers and corporations.¹⁷¹ However, despite its “reform” label, the legislation did little to simplify or streamline the basic structure of the income tax system.¹⁷² As Professor Witte shrewdly observes:

[f]inally, even though the Tax Reform Act of 1969 was the only major postwar tax bill that increased revenue (at least in its first year), it still provides evidence for the bias of tax politics in favor of tax reduction. The country was in the middle of a war, deficits had been persistent for years, inflation was becoming a continuous concern, and the political mood favored closing loopholes and tax shelters and taxing corporations and the wealthy. And it still took three years of planning and pressure and finally a well-publicized attack on a few people able to avoid taxation completely to stimulate the enactment of reforms. Even then, the provisions were mostly patchwork rules that did nothing to alter the underlying laws that served as a foundation for abuse. At the same time, five new tax expenditure provisions were created to further politically acceptable goals of the time. In the

¹⁶⁵ *Id.*

¹⁶⁶ The Revenue Act of 1962 instituted the investment tax credit, revised depreciation schedules, and imposed restrictions upon certain business deductions. *See* WITTE, *supra* note 12, at 156-58.

¹⁶⁷ Rates were reduced, particularly for the income groups below \$5000; new provisions were added such as moving expense deductions, income averaging, minimum standard deduction, and capital gains exclusion on the sale of a residence by the elderly; and many more provisions were liberalized. *See id.* at 165. “As finally enacted, the legislation offered a 20 percent tax reduction for individuals and corporations, bringing the top personal income bracket down from 91 percent to 70 percent and lowering the bottom rate from 20 percent to 14 percent.” CONLAN ET AL., *supra* note 138, at 21-22.

¹⁶⁸ WITTE, *supra* note 12, at 172.

¹⁶⁹ President Johnson’s Great Society and War on Poverty policies were implemented through the creation of the Office of Economic Opportunity and the successful push for enactment of the Civil Rights Act, the Voting Rights Act, Medicare, and the Water Quality Act. However, the President’s continued support of U.S. involvement in Vietnam and the heavy financial demands of the war diverted funds away from these domestic goals. *See* ALMANAC, *supra* note 58, at 568.

¹⁷⁰ WITTE, *supra* note 12, at 173.

¹⁷¹ *See id.* at 171 tbl.8.2.

¹⁷² In a section entitled “Lessons of the 1969 Tax Reform Act,” John Witte observes: “Rather than decisive, definitive action to eliminate or curtail basic provisions that erode the tax base, tax reform, true to the incremental approach, often becomes a matter of adjustment and counteradjustment in a cat and mouse game played between clever government experts and tax lawyers.” *Id.* at 173.

end, only a strong threat of veto and Treasury's careful monitoring of Conference Committee actions prevented a bill that would have meant substantial tax reduction.¹⁷³

By 1970, 81% of the population was subject to the individual income tax.¹⁷⁴ Inflation was the driving force behind enactment of the Tax Reduction Act of 1971. Upon enactment, the bill was predicted to reduce revenue by \$25.9 billion over three years and its major provisions strongly favored business by reinstating the investment tax credit and initiating a more rapid system of depreciation known as Asset Depreciation Range (ADR).¹⁷⁵

The 1970s were tumultuous years. Just a smattering of events are referenced to provide a cultural perspective for this time. In just the first few years of the decade, for example, the last U.S. ground forces were withdrawn from Vietnam in 1972 but bombings continued;¹⁷⁶ busing to achieve school integration was a divisive issue,¹⁷⁷ the 1973 landmark decision of *Roe v. Wade* held all state laws that prohibit voluntary abortions before the third month unconstitutional,¹⁷⁸ and the Watergate break-in and ensuing cover-up led to the conviction of six defendants in 1973, plus, in 1974, the unprecedented resignation of a President and the conviction of many of his White House staff members.¹⁷⁹ Voters were registering general disillusionment.¹⁸⁰

By 1975, the country was in the grips of a steep recession.¹⁸¹ As historian Howard Zinn notes:

[t]he Census Bureau reported that from 1974 to 1975 the number of Americans "legally" poor (that is, below an income of \$5,500) had risen 10 percent and was now 25.9 million people. Also, the unemployment rate, which had been 5.6 percent in 1974, had risen to 8.3 percent in 1975, and the number of people who exhausted their unemployment benefits increased from 2 million in 1974 to 4.3 million in 1975.¹⁸²

¹⁷³ *Id.* at 174-75.

¹⁷⁴ See CONLAN ET AL., *supra* note 138, at 19.

¹⁷⁵ See WITTE, *supra* note 12, at 176-79.

¹⁷⁶ See ALMANAC, *supra* note 58, at 592-93.

¹⁷⁷ In 1972 George Wallace ran an impressive race for the Democratic nomination, in part, because of the stress he placed on the busing issue . . . Boston, Massachusetts (1974) and Louisville, Kentucky (1975) were the scenes of bloody confrontations when busing plans were implemented in those cities. . . . By 1976 17,216 white students had left the Boston public schools either for the suburbs or for private schools.

Id. at 588.

¹⁷⁸ *Roe v. Wade*, 410 U.S. 113 (1973).

¹⁷⁹ See ALMANAC, *supra* note 58, at 597-99.

¹⁸⁰ In 1960, 63% of those eligible to vote voted in the presidential election. By 1976, this figure had dropped to 53%. See ZINN, *supra* note 121, at 551. Some of this decline may be attributable to the passage of the 26th Amendment in 1971.

¹⁸¹ See WITTE, *supra* note 12, at 183.

¹⁸² ZINN, *supra* note 121, at 545-46.

Amazingly, the next four years, 1975 through 1978, witnessed annual enactments of tax reduction legislation. Income taxes were again reduced to stimulate a lagging economy with minor Code changes in the Tax Reduction Act of 1975¹⁸³ and massive changes in the Tax Reform Act of 1976.¹⁸⁴ Most of the 1976 revenue-gaining provisions (30 changes) affected primarily high-income groups while the revenue-losing provisions (20 changes), with the major exception of the extension of the investment credit, primarily benefited those in the lower-income category.¹⁸⁵

The 1977 Tax Reduction and Simplification Act did reduce taxes¹⁸⁶ but accomplished little to simplify the growing complexity of the Code.¹⁸⁷ The 1978 Revenue Act reduced taxes across all income levels, but the highest-income taxpayers benefited the most.¹⁸⁸ Thus the 1978 tax legislation marked the beginning of a congressional trend to shift the overall burden of the income tax from the wealthy to the poor, at a time when the skewed distribution of wealth in the country had reached startling proportions.¹⁸⁹

183 See WITTE, *supra* note 12, at 182-87. One new provision in the 1975 tax-reduction legislation that turned out to be quite significant was the earned income credit. Primarily enacted to provide low-income taxpayers with relief from the growing, regressive effect of Social Security taxes, I.R.C. § 32 has been amended over the years (in 1978, 1980, 1984, 1986, 1990, 1993, and 1996) to now serve as a substantial mechanism for assistance to the poor. See Michael J. Caballero, *The Earned Income Credit: The Poverty Program That Is Too Popular*, 48 TAX LAW. 435 (1995); George K. Yin et al., *Improving the Delivery of Benefits to the Working Poor: Proposals to Reform the Earned Income Tax Credit Program*, 11 AM. J. TAX POL'Y 225 (1994); and Sharon C. Nantell, *The Tax Paradigm of Child Care: Shifting Attitudes Toward a Private/Parental/Public Alliance*, 80 MARQ. L. REV. 879, 962-64 (1997).

184 See WITTE, *supra* note 12, at 195. "[R]eduction was estimated at \$15.7 billion for fiscal year 1977 and \$11.6 billion for 1978. Of that amount, most came from the extension of the general tax credit and the lowered standard deduction." *Id.*

185 See *id.* at 196.

186 "[T]he estimated reduction in the bill was approximately \$11 billion in fiscal year 1978." *Id.* at 202.

187 The New Jobs Tax Credit instituted in this legislation was intended to accomplish a simple purpose: to provide a wage tax credit to induce new employment. Ironically, its language was exceedingly and intentionally complicated, to prevent unfair advantages by either particular businesses or tax conscious employers in general. See *id.* at 203-04.

188 Compared with existing law, the largest cuts in terms of percentages went to those with incomes under \$10,000 (since they initially paid very low taxes). However, unlike earlier tax cuts, this one gave all income groups above that level a cut close to the same percentage (around 6.8 percent), with those above \$20,000 actually receiving higher percentage reductions than those between \$10,000 and \$20,000. In absolute dollar terms those in the higher-income groups received much more. Of the total cut, 67 percent went to the 21 percent of the taxpayers who had incomes over \$20,000.

Id. at 213.

189 The fundamental facts of maldistribution of wealth in America were clearly not going to be affected by Carter's policies, any more than by previous administrations, whether conservative or liberal. According to Andrew Zimbalist, an American economist writing in *Le Monde Diplomatique* in 1977, the top 10 percent of the American population had an income thirty times that of the bottom tenth; the top 1 percent of the nation owned 33 percent of the wealth. The richest 5 percent owned 83 percent of the personally owned corporate stock. The one hundred largest corporations (despite the graduated income tax that misled people into think-

In addition, the 50% deduction from gross income for net capital gains was increased to 60% and remained at that level until 1986.¹⁹⁰ It must be noted that, during this extended period of "tax reduction," Congress did not actually need to enact new tax legislation to increase federal revenue since steadily rising incomes moved individuals and families into higher tax brackets.¹⁹¹

No less than six major tax bills were enacted during the 1980s. Championed by President Reagan and Republican Senator Roth (Del.) and Representative Kemp (N.Y.),¹⁹² the Economic Recovery Tax Act of 1981 provided the largest tax reduction in the nation's history.¹⁹³ It reduced the top marginal tax rate for individuals from 70% to 50%, added eight new tax expenditure items, and reduced the projected share of federal revenue from corporations from approximately 13% in 1981 to less than 7% by 1986.¹⁹⁴ However, the drastic tax reduction caused the federal deficit to climb from \$79 billion in 1981 to \$128 billion in 1982, and up to nearly \$208 billion in 1983.¹⁹⁵

In addition to the deficit woes, the statistics for 1982 were alarming: Census Bureau statistics revealed the U.S. poverty rate to be at 14%, the highest rate since 1967 and a 7.4% increase over 1980; the Labor Department reported a projected 6% rise in the cost of living over a 12-month period, based upon a .5% increase in October; and Federal Reserve Board figures indicated that the nation's factories were operating at 67.8% capacity, the lowest since 1948, when the Bureau first began to compile such records.¹⁹⁶ Congress responded to this fiscal calamity in 1982 with the Tax Eq-

ing the very rich paid at least 50 percent in taxes) paid an average of 26.9 percent in taxes, and the leading oil companies paid 5.8 percent in taxes (Internal Revenue Service figures for 1974). Indeed, 244 individuals who earned over \$200,000 paid no taxes.

ZINN, *supra* note 121, at 558-59.

190 See BURKE & FRIEL, *supra* note 117, at 644.

191 In 1965 a family earning the median income was in the 17 percent marginal tax bracket. . . . By 1980 a similarly situated family found itself paying income taxes at the 24 percent rate. For better-off families, those with twice the median income, the increase was even more pronounced. Their tax rate nearly doubled, between 22 to 43 percent from 1965 to 1980.

CONLAN ET AL., *supra* note 138, at 19 (citing JOSEPH J. MINARIK, MAKING TAX CHOICES 37 tbl.4 (1985)).

192 These three espoused a new tax philosophy, believing that existing marginal tax rates had greatly depressed incentives to work, save, and invest. These "supply-siders" argued that high marginal personal income tax rates were the main cause of America's low productivity growth, economic stagnation, and high inflation. According to their theory, if tax rates were reduced, real growth would ensue which, in turn, might make the tax reduction self-financing. Although Congress pursued their theory, recession, not growth, was to be the consequence. See Marvin A. Chirelstein, *Back From the Dead: How President Reagan Saved the Income Tax*, 14 FLA. ST. U.L. REV. 207, 218-22 (1986); and CONLAN ET AL., *supra* note 138, at 30-35.

193 See CONLAN ET AL., *supra* note 138, at 33.

194 See WITTE, *supra* note 12, at 228-35.

195 See CONLAN ET AL., *supra* note 138, at 34.

196 See ALMANAC, *supra* note 58, at 614.

uity and Fiscal Responsibility Act, the largest peacetime tax increase in the nation's history (until 1993), and with another increase in the Deficit Reduction Act of 1984,¹⁹⁷ restoring annual amounts of \$27 billion and \$23 billion, respectively, to the Treasury.¹⁹⁸ By 1985, 73% of all federal receipts were from the individual income tax.¹⁹⁹

8. The Internal Revenue Code of 1986 and Its Aftermath

The 1986 overhaul of the Internal Revenue Code²⁰⁰ reflected several major and significant shifts in federal tax policy. First, Congress retreated from the age-old graduated rate structure, which had grown to 15 brackets ranging from 11% to 50%, to just two low tax brackets of 15% and 28% by 1988.²⁰¹ At the same time, numerous exemptions, credits, and deductions were eliminated, thus broadening the tax base.²⁰² With the significant reduction in tax rates, Congress decided that the long-standing preferential treatment for capital gain income could be repealed; thus net capital gains were now fully included in gross income.²⁰³ Elimination of the investment tax credit, long favorable to corporations, as well as a new corporate minimum tax, caused projected revenue from the corporate income tax to increase by \$120 billion by 1991.²⁰⁴ The irony of the Tax Reform Act of 1986, so close on the heels of the 1981 Act, was not lost upon historian John Witte:

[i]t is also important to note that the least reform-minded bill in history was the Economic Recovery Tax Act of 1981, which opened seven new tax expenditures, expanded the benefits of thirty others, and only tightened up two provisions. Thus, separated by only five years, the same president and the same institutional arrangements produced the historic extremes of tax reform and anti-reform legislation.²⁰⁵

Congress, in the new decade of the 1990s, was faced with a considerable tax legacy.²⁰⁶ In addition, in 1989, President Bush had vetoed legislation that would have increased the minimum

197 See GRAETZ & SCHENK, *supra* note 46, at 9.

198 See CONLAN ET AL., *supra* note 138, at 34.

199 See *id.* at 19.

200 "The 900-page document altered most provisions of U.S. tax law, creating what is now rightly named the Internal Revenue Code of 1986." *Id.* at 1.

201 See *id.* at 2. The top marginal rate of 28% was an astonishing drop from the top rate of 70% when President Reagan took office in 1981. See *id.* at 3.

202 See *id.* For a detailed listing of the items that were reduced, increased, repealed, limited or modified, and retained, see *id.* at 4-5 tbl.1-1.

203 See BURKE & FRIEL, *supra* note 117, at 644-45.

204 See CONLAN ET AL., *supra* note 138, at 6.

205 John F. Witte, *Congress and Tax Policy: Problems and Reforms in a Historical Context*, 10 AM. J. TAX POL'Y 107, 113 (1992).

206 "As a result of all the tax bills from 1978 to 1990, the net worth of the "Forbes 400," chosen as the richest in the country by *Forbes Magazine* (advertising itself as a "capitalist tool"), was tripled. About \$70 billion a year was lost in government revenue, so that in

wage from \$3.35 to \$4.55 per hour, but a few months later signed a compromise bill that increased the minimum wage to \$4.25 per hour by 1991.²⁰⁷ Tax increases continued in 1990, with the top rate increased to 31%, and in 1993, with a new top rate of 39.6%,²⁰⁸ to combat large federal deficits; however, net capital gains were still preferentially taxed at only 28%.²⁰⁹ In 1992, 83% of all of the federal income tax returns filed reflected adjusted gross income below \$50,000.²¹⁰

The transformation of the federal system of taxation from a tariff and excise tax based system to an income and employment tax system was startlingly complete. In 1993, the gross collection of internal revenues by source were:²¹¹

	In Billions	Percentage
Individual income taxes	\$586	49.7
Employment taxes	412	35.0
Corporate income tax	132	11.2
Excise taxes	35	3.0
Estate & gift taxes	13	1.1

Effective October 1, 1997, the minimum wage was increased 50 cents per hour, to \$4.75, and was automatically increased to \$5.15 per hour effective September 1998.²¹² The Taxpayer Relief Act of 1997 established a new preferential treatment structure for net capital gain, providing a 20% maximum rate on certain long-term capital gains,²¹³ and introduced several new provisions into the Code.²¹⁴ The IRS Restructuring and Reform Act of 1998 addressed concerns with the Internal Revenue Service enforcement

those thirteen years the wealthiest 1 percent of the country gained a trillion dollars." ZINN, *supra* note 121, at 568.

207 See ALMANAC, *supra* note 58, at 629-30. Workers 16-19 years old would be paid only \$3.35 per hour during their training period. See *id.* at 630.

208 See BURKE & FRIEL, *supra* note 117, at 645.

209 See *id.*

210 See BUREAU OF THE CENSUS, ECON. AND STATISTICS ADMIN., U.S. DEP'T OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES 346 tbl.534 (115th ed. 1995) [hereinafter STATISTICAL ABSTRACT].

211 See *id.* at 344 tbl.532.

212 See Small Business Job Protection Act of 1996, Pub. L. No. 104-188, 110 Stat. 1755 (1996). See also Paul Richter & James Gerstenzang, *Clinton Signs Minimum Wage Hike*, L.A. TIMES, Aug. 21, 1996, at A1. Prior to the increase, the minimum wage, adjusted for inflation, had been at its lowest value in 40 years. See *id.* It had not been raised since 1991. See *supra* note 207.

213 See BURKE & FRIEL, *supra* note 117, at 645.

214 Two new provisions were of notable consequence. New Section 121 provided an exclusion from gross income of up to \$500,000 for married taxpayers realizing gain upon sale of a personal residence. See *id.* at 99-106. The new Roth IRA provided for nondeductible contributions with tax-free qualifying distributions. See *id.* at 132-33.

policies and procedures.²¹⁵ Congress and President Clinton are presently grappling with a phenomenon new to politics in the last 30 years—a projected federal surplus—with Republicans and Democrats facing off with respective rhetoric of tax reduction or shoring up the Social Security system.²¹⁶

B. Values and Beliefs: Historical and Cultural Observations

Our cultural perspective of the federal income tax commenced with the first element: knowledge. Armed with a basic knowledge of our tax history, some attention must now be paid to the second fundamental aspect of culture: values and beliefs. What have we learned from our quick historical tour? Remember, the premise of this piece is that how a society chooses to tax itself says something significant about that society.

The importance of cultural beliefs, as opposed to the primary focus upon economics, in the development and acceptance of a tax by a society must be examined. What cultural perspectives do we employ when assessing the viability of our current federal income tax, or any alternative tax system? What is our “tax culture?” This analysis necessitates some reflection upon our values and beliefs, as reflected, or perhaps more significantly, as not accurately reflected, in our current tax code. What follows is a brief and sometimes unsettling assortment of cultural observations and conclusions.

1. The Federal Income Tax: Not an Overnight Event

First, and most significantly, our historical review reveals that the shift from federal reliance upon excise taxes and tariff duties to the individual income tax as the major source of revenue was not a wholesale, overnight event. It required nearly a century for the federal income tax, first imposed upon the wealthiest 1% of the population in 1913, to evolve into a system of taxation upon us all. As the need for revenue increased for a multitude of reasons over the years, Congress gradually shifted away from excise taxes and tariffs to the income-based system of today.

This observation becomes a crucial factor to consider as we evaluate proposed alternatives to the current income tax structure. Too drastic or rapid a change to an alternative federal taxation system could easily meet with fear, resistance, and distrust in the general population²¹⁷—a sense of culture shock. How funda-

²¹⁵ See generally CCH, 1998 TAX LEGISLATION: LAW, EXPLANATION AND ANALYSIS: IRS RESTRUCTURING AND REFORM ACT OF 1998 (1998).

²¹⁶ See Alissa J. Rubin, *Clinton to Propose Tax Breaks to Aid Domestic Agenda*. L.A. TIMES, Jan. 19, 1999, at A1.

²¹⁷ Remember the Whiskey Rebellion of 1794. See *supra* notes 23-25 and accompanying text.

mental a change the American public will tolerate is unknown. Our historical perspective indicates, however, that an overnight overhaul of the federal income tax system to a consumption-based system of taxation, for example, would not be a likely event.

2. The Legacy of Tax Laws by and for Wealthy White Males

Our tax system, much like the rest of our law, was created by mostly wealthy, mostly male, mostly white individuals. Just a few examples and statistics adequately support this observation.

Most of us are aware of the fact that the early Framers of the Constitution were wealthy, white male landowners.²¹⁸ More than 100 years later, wealthy white males were still a dominant force in shaping law in the United States. In 1909, for example, 23 of the 80 U.S. Senators were millionaires.²¹⁹ This was at the time when Congress could not agree upon an income tax (as then proposed, to be imposed only upon the wealthiest 1% of the population) and President Taft ultimately had to recommend that a constitutional amendment be submitted to the States.²²⁰ It was also at the time when fewer than 4% of American families received as much as \$3000 per year in income.²²¹ Another notable example of the influence of wealth upon the creation of our tax laws is the fact that, during the presidencies of Harding and Coolidge, Andrew Mellon, one of the richest men in America, served as the Secretary of the Treasury.²²² Noted historian Morton J. Horwitz contends that, as far back as 1895, poignantly illustrated by the

²¹⁸ Historian Howard Zinn notes several observations made in the early 20th century by historian Charles Beard (*in* CHARLES A. BEARD, AN ECONOMIC INTERPRETATION OF THE CONSTITUTION (1935)):

In short, Beard said, the rich must, in their own interest, either control the government directly or control the laws by which government operates. Beard applied this general idea to the Constitution, by studying the economic backgrounds and political ideas of the fifty-five men who gathered in Philadelphia in 1787 to draw up the Constitution. He found that a majority of them were lawyers by profession, that most of them were men of wealth, in land, slaves, manufacturing, or shipping, that half of them had money loaned out at interest, and that forty of the fifty-five held government bonds, according to the records of the Treasury Department. Thus, Beard found that most of the makers of the Constitution had some direct economic interest in establishing a strong federal government: the manufacturers needed protective tariffs; the moneylenders wanted to stop the use of paper money to pay off debts; the land speculators wanted protection as they invaded Indian lands; slaveowners needed federal security against slave revolts and runaways; bondholders wanted a government able to raise money by nationwide taxation, to pay off those bonds. Four groups, Beard noted, were not represented in the Constitutional Convention: slaves, indentured servants, women, men without property. And so the Constitution did not reflect the interests of those groups.

ZINN, *supra* note 121, at 89-90.

²¹⁹ See PAUL, *supra* note 12, at 94.

²²⁰ See *supra* Part II.A.4.

²²¹ See *supra* note 102 and accompanying text.

²²² See ZINN, *supra* note 120-121, at 375. For a discussion of the Mellon Plan adopted by Congress in 1925, see *supra* footnotes 121-22 and accompanying text.

Supreme Court's decision in *Pollock*,²²³ the country was committed "to a neutral, non-redistributive state."²²⁴

No woman served in the House of Representatives until Jeannette Rankin of Montana was elected in November 1916.²²⁵ In the 105th Congress (1997-1998), only nine of the 100 Senators and only 54 of the 435 Representatives (12.4%) were women.²²⁶ Of the 63 women serving in Congress in 1998, 17 (27%) were women of color.²²⁷ Seven states have never sent a woman to either the Senate or the House.²²⁸ Jennifer Dunn (R-Wash.) is only the fifth woman ever to serve on the Ways and Means Committee of the House of Representatives.²²⁹

The historical statistics for the U.S. Supreme Court and the presidency are dismal for both female and minority representation. Of the 113 Supreme Court Justices who have interpreted our laws for the past two centuries, only two have been women and two racial minorities.²³⁰ No woman or minority has ever served as either President or Vice President in our nation's history.²³¹

The data confirm that wealthy, white males have dominated the creation and interpretation of our laws, including our tax laws. The question becomes, is this bad per se? The answer is "yes," for not all of their assumptions about American values and behavior are necessarily reflective of a primarily middle- and lower-class, two-gender, multi-ethnic society. Our historical survey has revealed that we have, over the years, selected a shifting balance and mixture of tariffs, excise taxes, corporate taxes, individual income taxes, and estate and gift taxes. This mixture has reflected a general "tax the lower classes" attitude—first evident with the Federalist excise taxes, then continued with over a century of oppressive tariff duties, and finally reflected today in our income tax system. Such an observation is undoubtedly not

223 *Pollock v. Farmers' Loan & Trust Co.*, 158 U.S. 601 (1895). See *supra* Part II.A.3. for a discussion of this case.

224 MORTON J. HORWITZ, *THE TRANSFORMATION OF AMERICAN LAW: 1870-1960*, at 16 (1992). For a thoughtful discussion of the case and its legacy, see *id.* at 19-27.

225 See ALMANAC, *supra* note 58, at 431.

226 See CENTER FOR THE AMERICAN WOMAN AND POLITICS (CAWP), NATIONAL INFORMATION BANK ON WOMEN IN PUBLIC OFFICE, EAGLETON INSTITUTE OF POLITICS, RUTGERS UNIVERSITY, *WOMEN WHO WILL SERVE IN THE 106TH CONGRESS* (1998).

227 See *id.* One African American woman served in the Senate, while eleven African American women, one Asian American/Pacific Islander, and four Latinas served in the House. See *id.*

228 Alaska, Delaware, Iowa, Mississippi, New Hampshire, Vermont, and Wisconsin. See *id.*

229 See Robert A. Rosenblatt, *Securing the Future for Women*, L.A. TIMES, Jan. 27, 1999, at E1.

230 Sandra Day O'Connor was appointed to the Court in 1981, Ruth Bader Ginsburg in 1993, Thurgood Marshall in 1967, and Clarence Thomas in 1991. THE WORLD ALMANAC AND BOOK OF FACTS 1998, at 89 (1997).

231 See *id.* at 479-80.

unique to societies today, but it is a sad observation for our democratic society.

Our differentiation of income as either "earned" and "unearned" reflects our conflicting attitude toward how wealth is obtained. Income is clearly a matter of what is valued in the market—in our society. The professional athlete, for example, earns far more than the professional teacher.²³² That fact alone says something about us as a society. Labor has, historically, been undervalued in our society. We espouse to a strong work ethic, but employees are generally paid as little as the market will bear. As Professor Kornhauser observes:

American attitudes about money, spending, and wealth are complicated because money and wealth are not mere commodities. They also signify deep-seated, complex values and beliefs about morality, equality, and the American system of government. The basic traditions of the United States extol individualism and the sacred right to property while simultaneously proclaiming the equality of man and government by and for equals. The former concepts inevitably result in unequal accumulations of wealth, while the latter argue for a more equal distribution.²³³

What could be added to the debate with more representative governmental participants in the decision-making process? A feminist vision of humanity, for example, would contend that "a sense of connectedness with and obligation to others is an intrinsic part of the nature of the individual. Such a view of humanity naturally supports a redistributive progressive income tax."²³⁴ Gender bias throughout the Code has marginalized women and negatively impacted the family.²³⁵ However, commentators over the last 25 years have been largely unsuccessful in effectuating any significant change in the Code due primarily, in my opinion, to the fact

²³² "People rarely appreciate the degree to which wealth is a *psychological* phenomenon. The value of assets depends on what we believe is going to happen in the future. . . . Because wealth is a phenomenon of expectations and beliefs, it is also a function of information." Bradford, *supra* note 10, at 22.

²³³ Marjorie E. Kornhauser, *The Morality of Money: American Attitudes Toward Wealth and the Income Tax*, 70 *IND. L.J.* 119, 120 (1994).

²³⁴ Marjorie E. Kornhauser, *The Rhetoric of the Anti-Progressive Income Tax Movement: A Typical Male Reaction*, 86 *MICH. L. REV.* 465, 506 (1987).

²³⁵ See, for example, EDWARD J. McCAFFERY, *TAXING WOMEN* (1997); Alice Kessler-Harris, "A Principle of Law but not of Justice": *Men, Women and Income Taxes in the United States 1913-1948*, 6 *S. CAL. REV. L. & WOMEN'S STUD.* 331 (1997); Edward J. McCaffery, *Taxation and the Family: A Fresh Look at Behavioral Gender Biases in the Code*, 40 *UCLA L. REV.* 983 (1993); Nancy E. Dowd, *Work and Family: Restructuring the Workplace*, 32 *ARIZ. L. REV.* 431 (1990); Pamela B. Gann, *Abandoning Marital Status as a Factor in Allocating Income Tax Burdens*, 59 *TEX. L. REV.* 1 (1980); Michael J. McIntyre & Oliver Oldman, *Taxation of the Family in a Comprehensive and Simplified Income Tax*, 90 *HARV. L. REV.* 1573 (1977); Boris I. Bittker, *Federal Income Taxation and the Family*, 27 *STAN. L. REV.* 1389 (1975); and Grace Blumberg, *Sexism in the Code: A Comparative Study of Income Taxation of Working Wives and Mothers*, 21 *BUFF. L. REV.* 49 (1972).

that male legislators have little motivation to revise the laws against their interest.

The most glaring consequence of a system of tax laws created by and for wealthy, white males, however, is the exacerbation of "a growing gap in the relative economic positions between rich and poor, the latter disproportionately represented by women, children and people of color."²³⁶ Tax provisions such as the home mortgage interest deduction and the preferential tax treatment for capital gains primarily benefit taxpayers in the upper-income brackets. As Professor Shurtz notes:

[t]he disparity in property ownership between white and black people, in concert with numerous tax provisions granting favorable treatment to property owners, such as the untaxed gains on appreciated (but unrealized) assets such as stocks, or on inherited property that acquires a step up in basis but is untaxed, I.R.C. §1014 (1994), has underscored an unwritten but real class and race bias embedded in our tax laws.²³⁷

To support the contention that we are, after 200 years of struggle, very much a society of rich and poor, I offer data regarding the top 1% of the population by income class. From 1977 to 1989, the income of the top 1% increased by 80.3%, while the income of all families increased by only 15.5%; the income of the lowest 40% of American families actually decreased during this period.²³⁸ In 1992, the top 1% of federal returns included 1.1 million filers earning above \$181,713 and, although they paid 27.4% of all taxes, this small group also earned 14.2% of all income.²³⁹ Interestingly, the tax rate for these high-income earners actually declined between 1982 and 1992, from a top rate of 50% to a top rate of 31%, respectively, but their share of taxes paid increased substantially, from 19.0% to 27.4%.²⁴⁰ This seemingly incongruous result came about because high-income taxpayers still reported a disproportionate share of the total adjusted gross income. While the top 1% of taxpayers earned 8.9% of income in 1982, they earned 14.2% of all income in 1992.²⁴¹ In addition, the reported income of the top 10% of all income earners rose from 32.3% of the total in 1982 to 39.2% of the total in 1992.²⁴² Thus, in 1992, 90% of

²³⁶ Nancy E. Shurtz, *Gender Equity and Tax Policy: The Theory of "Taxing Men,"* 6 S. CAL. REV. L. & WOMEN'S STUD. 485, 528 (and accompanying footnotes) (1997).

²³⁷ *Id.* at 528 n.198.

²³⁸ See Martin J. McMahon, Jr., *Individual Tax Reform for Fairness and Simplicity: Let Economic Growth Fend for Itself,* 50 WASH. & LEE L. REV. 459, 462-63 (citing House Comm. on Ways and Means, 1992 Overview of Entitlement Programs 1454, at 1511 tbl.15, 1513 tbl.16 (Comm. Print 1992)).

²³⁹ See Chris R. Edwards, *Who Pays Federal Income Taxes?*, 66 TAX NOTES 105 (1995).

²⁴⁰ *See id.*

²⁴¹ *See id.* at 107.

²⁴² *See id.*

the taxpaying public was receiving 60% of all income, while 10% of the taxpaying public was receiving nearly 40% of the income.

Due to the sharp decline in the progressivity of the tax rates²⁴³ and the plethora of tax expenditure items available to upper-income taxpayers,²⁴⁴ the lower- and middle-classes²⁴⁵ in America still bear a substantial portion of the federal income tax burden. In 1996, nearly 22% of the total federal income tax revenue was collected from those taxpayers with adjusted gross incomes below \$50,000.²⁴⁶ Nearly 49% of the total federal income tax revenue was collected from those taxpayers reporting adjusted gross incomes below \$100,000. Add into this equation the impact of the Social Security tax, collected on gross wages up to \$62,700, and the burden of taxation upon the working class in America is again quite evident. Taxpayers reporting adjusted gross income of \$500,000 or more paid slightly more than 21% of the total federal income tax burden in 1996.²⁴⁷ These figures lead us directly to the next observation: the tax expenditure phenomenon.

3. The Tax Expenditure Phenomenon

Since 1913, within the evolving structure of the federal income tax, and beyond the obvious issues of tax rates, we have made continuous and crucial decisions regarding exemptions, exclusions, capital gains and losses, deductions, and credits. For the last 30 years, the primary tax policy focus has been upon "tax expenditures"—reductions in individual or corporate income tax liabilities that result from special tax provisions or regulations that provide tax benefits to particular taxpayers.²⁴⁸ Tax expenditures

²⁴³ See *supra* Part II.A.7. & 8.

²⁴⁴ See *infra* Part II.B.3.

²⁴⁵ How we define "middle-income" or "middle-class" is problematic. The higher our income, the greater our tendency to stretch the definition of middle-income to include our own income. See WITTE, *supra* note 12, at 340-43.

²⁴⁶ For 1996, \$142 billion of the total revenue of \$658.2 billion was collected from taxpayers reporting adjusted gross incomes (AGI) under \$50,000. Percentages of total tax collected and total number of returns, by AGI, for 1992 and 1996 are:

Adjusted Gross Income	1992	1992	1996	1996
	% of Total Tax Collected	% of Total Returns	% of Total Tax Collected	% of Total Returns
0-\$49,999	30.4%	82.80%	21.6%	78.18%
\$50,000-\$99,999	29.4%	13.89%	27.1%	16.72%
\$100,000-\$199,999	14.1%	2.47%	16.7%	3.83%
\$200,000-\$499,999	10.9%	.66%	13.3%	1.00%
\$500,000-\$999,999	5.2%	.12%	6.6%	.18%
\$1,000,000 or more	10.0%	.06%	14.7%	.09%

See STATISTICS OF INCOME, *supra* note 8, at 150 tbl.3.

²⁴⁷ See *id.*

²⁴⁸ Defined in the Congressional Budget and Impoundment Control Act of 1974. See GRAETZ & SCHENK, *supra* note 46, at 44. The "top 10 tax expenditures" of 1995 as estimated by the Staff of the Joint Committee on Taxation were:

purportedly facilitate congressional pursuit of a strong “stimulate the economy” approach to the Code and tax legislation, encouraging and discouraging specific types of behavior through its coercive and manipulative taxing power. Congress has emphasized more politically palatable tax subsidies (i.e., tax expenditures) rather than politically deadly direct subsidies (i.e., welfare).²⁴⁹

The final result is an excessively complex and brutally unfair system of taxation. As Marvin Chirelstein observes:

[t]ax preferences have grown phenomenally since World War II, and it is not possible today to regard our national tax system as anything but unfair and unequal in its application. The Internal Revenue Code contains a multitude of special interest provisions. Some are “industry specific” concessions to big businesses like extractive industries, defense contractors, and bank and insurance companies, while others benefit investors and high-salaried individuals through reduced tax rates on capital gains, and travel and entertainment expense deductions for executives and professionals. The ideal of a comprehensive tax base—a tax on “all income from whatever source derived”—now really applies only to middle- and lower-income taxpayers who have few opportunities to exploit the preferences which the Code affords to others.²⁵⁰

We, as a society, appear to value the importance of choice and, as the federal income tax became a tax upon us all, the importance of individual choice emerged as a prominent aspect of the system. However, as Professor Chirelstein indicates, the matter of choice to exploit tax preference items in the Code is mostly an illusion for individual taxpayers.²⁵¹ Not all tax systems empower; the extent to which a tax system empowers reflects and implements important values.²⁵² Our current tax system generally grants choices to

	<u>In Billions</u>
1. Pensions + IRAs/Keoghs	85.5
2. Mortgage Interest + Property Taxes (homes)	71.3
3. Medical Insurance	50.4
4. Accelerated Depreciation	31.2
5. Charitable Deduction	29.5
6. State & Local Tax Deduction	26.2
7. Social Security (the non-taxable portion of benefits)	24.1
8. Deferral of Gain & Exclusion on Homes	20.4
9. Life Insurance	17.7
10. Medicare	15.3

Id. at 46-47.

²⁴⁹ “[T]ax expenditures make it possible for Congress to give financial aid to specific groups or industries that could never obtain direct appropriations from the government because of the public outcry that would arise. Most people, however, do not recognize tax expenditures as subsidies.” THOMAS J. REESE, *THE POLITICS OF TAXATION* xi (1980).

²⁵⁰ Chirelstein, *supra* note 192, at 210, and accompanying footnotes.

²⁵¹ More than 78% of all returns filed in 1996 reflected adjusted gross income below \$50,000. See *supra* note 246.

²⁵² See Abreu, *supra* note 4, at 6.

people who possess material wealth, and it distributes those choices progressively.²⁵³ Professor Chirelstein adds the following sobering observation:

the investor class, whether by reason of the tax deferral permitted to real estate owners, or by reason of the capital gain preference allowed to security speculators, pays tax at much lower rates on investment income than do those who receive income from personal services. From the standpoint of income tax fairness, not the slightest justification can be offered.²⁵⁴

If we are to remain with income as our basic tax structure, then we must return to a broadened income tax base. This goal is, obviously, more easily stated than achieved. The primary difficulty now is that we, as a society, have been conditioned into believing that the Internal Revenue Code, through specific tax provisions, can be the cure-all for nearly every imaginable social and economic ill.²⁵⁵ Every candidate for political office, from city council to President, includes a tax agenda in his or her platform. Politicians have now maneuvered themselves into a corner. The elimination of tax preference items would be politically controversial, to say the least, and would undermine the alleged basis for their very existence: the stimulation of the economy.

4. Americans: A Source of Frustration to Economists

There is much that can be said about American irrationality. We are an amazing source of contradictory beliefs and irrational behavior—an economist's nightmare. We loan money to our relatives (with a high probability that we will never see the money again). We give money to our children with little control over how they will spend it. We buy items we don't need on the Home Shopping Network®, on credit no less. Sometimes, we even spend more than we earn.²⁵⁶ Even the renowned tax expert, Boris Bittker, observes: "I will pursue the road of rationality as far as I can trace its tracks; but for me, the final destination is not attained without wandering in the wilderness with only one's soul for guidance."²⁵⁷

Despite the core principle of raising revenue, however, viewing our federal income tax system from a purely economic point of view results in major flaws in our analysis, for the economist "only

²⁵³ See *id.* at 9.

²⁵⁴ Chirelstein, *supra* note 192, at 211.

²⁵⁵ See *infra* Part II.B.6.

²⁵⁶ "For the first time since the Great Depression, Americans spent more money in a single month than they earned, driving the personal savings rate into the negative zone." Jonathan Peterson and Stephen Gregory, *Personal Savings Rate in Red, 1st Time Since '30s*, L.A. TIMES, Nov. 3, 1998, at A1.

²⁵⁷ CHARLES O. GALVIN AND BORIS I. BITTKER, *THE INCOME TAX: HOW PROGRESSIVE SHOULD IT BE?* 28 (1969).

claims to show us how the world works apart from idiosyncrasies of time, place, and individual personality.²⁵⁸ We need to recognize and appreciate cultural as well as economic factors and influences in our tax Code.²⁵⁹ One consequence of professional economists holding the high road in tax theory is a general acceptance among them:

of a certain view of human well being, which translates into assumptions about distributive fairness. Another [consequence] is the indifference of most tax theory to the admittedly unique aspects of the political process through which each country's peculiar tax system is created. This indifference is no doubt a direct reflection of the way in which economists view their discipline as a whole. They typically aspire to produce simple, elegant, strongly explanatory, and in brief, highly general theories of the phenomenon with which they deal. But a corollary is that cultural, partisan, and irrational elements in actual tax systems seem to the economist uninteresting and irrelevant. As a result much of the best work on taxation, done by economists, seems to pay no attention to how tax policy is made in real life. People find this apparent lack of realism puzzling.²⁶⁰

Much has been done to the Internal Revenue Code in the name of economics. The rapid-fire, massive changes to the Code in the early 1980s, for example, were prompted by erroneous economic theory.²⁶¹ Our historical survey has repeatedly revealed congressional tax action to either increase revenue or to reduce inflation, the federal deficit, or both. Thus, the next observation must, by necessity, address the political process through which our country's peculiar tax system is created.

5. The Not-So-Pretty Political Process and the Congressional Tax Ritual

The political process is not a pretty picture in the context of tax legislation. Thomas J. Reese observed in 1980 (prior to the Tax Reform Act of 1986 but still applicable today) that:

²⁵⁸ STEPHEN G. UTZ, *TAX POLICY: AN INTRODUCTION AND SURVEY OF THE PRINCIPAL DEBATES* 73 (1993).

²⁵⁹ My sense is that it is probably better to recognize the legitimacy of cultural factors in tax policy than to treat them as some sort of alien invasion of the economist's territory. This admission need not lead to an academic retreat, nor to an easy acceptance of tax subsidies. Because a factor is nonquantifiable does not mean that it cannot be evaluated. If the cultural value behind a given tax provision can be identified, the importance of that value can be assessed as well as the effectiveness of the provision in advancing that value. This process should by no means replace the economist's art, but it is a vital addition.

Michael Livingston, *Risky Business: Economics, Culture and the Taxation of High-Risk Activities*, 48 *TAX L. REV.* 163, 229-30 (1993).

²⁶⁰ UTZ, *supra* note 258, at 71.

²⁶¹ See *supra* footnotes 192-95, and accompanying text.

[t]ax reformers would prefer to replace this system of high tax rates and loopholes with a system of lower rates and fewer tax expenditures. Although the reformers' position is economically logical, the current system is politically attractive. Politicians can defend the tax system to poor people by pointing to the highly progressive rates. At the same time, wealthy and powerful interests are not upset because there are loopholes to protect them.²⁶²

The dynamics of tax policy-making have changed dramatically in the last 20 years. The political reality is that congressional and presidential candidates are elected by an ever-decreasing percentage of the population willing to vote.²⁶³ Those willing to participate in the election process thus, by default, wield a significant amount of power. In addition, policy entrepreneurs, tax experts,²⁶⁴ journalists,²⁶⁵ the media, policy promoters in Washington think tanks,²⁶⁶ and public interest groups²⁶⁷ recently have been added to the traditional mix of congressional tax committees in formulating tax policy.²⁶⁸ Corporate lobbyists, long a political reality in Washington, are now more organized, and obvious.²⁶⁹ Additionally, the American two-party political system is at risk of collapse.²⁷⁰ As Professor Pollack notes:

²⁶² REESE, *supra* note 249, at xi.

²⁶³ For example, only 44.6% of the more than 190 million Americans eligible to vote in the 1994 congressional elections actually voted. See STATISTICAL ABSTRACT, *supra* note 210, at 289 tbl.459.

²⁶⁴ While a generation ago, it was judicial gloss upon the barebone statutes that added the real substance to the Code, tax laws now are given their substance by the tax experts in the Treasury Department and Service who issue the regulations and other published authority that guides the actual practice of tax law.

Sheldon D. Pollack, *A New Dynamics of Tax Policy?*, 12 AM. J. TAX POL'Y 61, 72-73 (1995).

²⁶⁵ See, e.g., DONALD L. BARTLETT & JAMES B. STEELE, AMERICA: WHAT WENT WRONG? (1992). The authors, journalists with the *Philadelphia Enquirer*, wrote this book as an expanded version of their nine-part newspaper series originally published in 1991. The book was a best seller.

²⁶⁶ See, e.g., JAMES ALLEN SMITH, THE IDEA BROKERS: THINK TANKS AND THE RISE OF THE NEW POLICY ELITE (1991). The author notes that: "there is something troubling about the relationship among experts, leaders, and citizens that tends to make American politics more polarized, short-sighted, and fragmented—and often less intelligent—than it should be." *Id.* at xxi. See also DAVID M. RICCI, THE TRANSFORMATION OF AMERICAN POLITICS: THE NEW WASHINGTON AND THE RISE OF THINK TANKS (1993).

²⁶⁷ See, e.g., JEFFREY M. BERRY, LOBBYING FOR THE PEOPLE: THE POLITICAL BEHAVIOR OF PUBLIC INTEREST GROUPS (1977).

²⁶⁸ See Pollack, *supra* note 264.

²⁶⁹ See, e.g., JEFFREY H. BIRNBAUM, THE LOBBYISTS: HOW INFLUENCE PEDDLERS GET THEIR WAY IN WASHINGTON (1992). The author, a reporter for the *Wall Street Journal*, recounts the intense activities of the more than 80,000 corporate lobbyists in Washington D.C. in the years 1989-1990.

²⁷⁰ Perhaps my prediction of "collapse" is overly influenced by the recent, disheartening, partisan activity in President Clinton's impeachment proceedings in both the House and the Senate. However, the general decline in the U.S. political party system has previously been addressed in JAMES L. SUNDQUIST, DYNAMICS OF THE PARTY SYSTEM: ALIGNMENT AND REALIGNMENT OF POLITICAL PARTIES IN THE UNITED STATES (1973). See also DAVID S. BRODER, THE PARTY'S OVER: THE FAILURE OF POLITICS IN AMERICA (1971). The *Washington Post* correspondent analyzes the polarization of the party system in the two-decade period

[t]he proliferation of tax policy entrepreneurs and public interest groups reflects the decline of the party hierarchy in Congress and the weaknesses of the American party system. . . . In other words, the erratic course of tax policy during the 1980s was a product of the continued deterioration in the political process through which tax policy is made. The unstable political framework and the lack of consensus over tax policy resulted in an unusually turbulent decade of tax politics. This unstable politics could produce tax legislation such as Reagan tax cuts in one year and a tax reform bill such as the 1986 Act only five years later. Events in the 1990s already suggest that much the same turbulence continues to haunt federal tax policy.²⁷¹

John Witte's concerns regarding the course of tax policy after the Tax Reform Act of 1986, expressed in 1992, hold true today:

[r]egardless of how one evaluates the politics of TRA [Tax Reform Act of 1986], two long-standing historical problems with income tax policy persist despite the changes enacted in 1986. The first is the continuing possibility that tax expenditures will again begin to increase, thus narrowing the tax base, increasing specialized benefits, and further complicating the tax code. Despite the landmark nature of the 1986 Act, which eliminated 14 tax expenditures and reduced benefits in 72 other provisions, a vast array of tax expenditures remain. And since 1986 the only serious tax proposals have been to restore benefits curtailed by TRA, e.g., capital gains, IRAs, earned income credit, child care. In part, the current pressure to expand tax expenditures may be a cyclical reaction to the severity of the changes enacted in 1986.²⁷²

As previously noted, Congress has, as feared, recently expanded tax expenditures by enacting a 20% tax rate preference for capital gains, creating a new Roth IRA, and adding other tax expenditure provisions to the Code.²⁷³

Although our history reveals that the congressional ritual of considering new tax legislation is not a recent phenomenon, it has accelerated in the past three decades to a nearly annual event. Thus, the public has grown to expect a tax policy position from every candidate running for public office. Our cultural expectations now include an annual dose of tax "reform," "reduction," "relief," "recovery," "simplification," "technical correction," or "restructuring" from an ever more remote, frustrating, and blatantly political process. This reality leads us to a final observation.

from Eisenhower to Nixon. However, see LARRY J. SABATO, *THE PARTY'S JUST BEGUN: SHAPING POLITICAL PARTIES FOR AMERICA'S FUTURE* (1988), which provides historical background and then presents a hopeful agenda for party renewal.

271 Pollack, *supra* note 264, at 62.

272 Witte, *supra* note 205, at 113.

273 See *supra* Part II.A.8. and, in particular, footnote 214 and accompanying text.

6. The Allegedly All-Purpose, Cure-All Tax Code

History has established that it is often exceedingly difficult for the political animal that is Congress to accept a major new concept such as the federal income tax or the Social Security tax. However, once the idea morphs through the political process and is finally "put into play" as enacted law, constant congressional tinkering is the norm. As previously discussed,²⁷⁴ Congress has modified tax rates, exemption levels, and deductions, and added or revised a plethora of tax preference provisions to address both good times and bad, to stimulate the economy or to slow it down, and to encourage business, investment, home ownership and savings. The frightening reality of this "reform," "reduction," "relief," and "recovery" cycle is that no one really *knows* whether any of the tax legislative proposals are capable of remedying the perceived economic or social crisis of the day. Identifying the parameters of the current economic or social dilemma, agreeing upon a politically palatable solution, and predicting the future behavior of 270 million Americans are tasks likely beyond the capabilities of *any* group of individuals. The drive to "fix it," however, whatever "it" might be, through the tax Code is now an innate political instinct comparable to "survival of the fittest."

The result is that the accelerated rate of recent tax legislation is nothing short of mind-boggling. For example, the Tax Reform Act of 1969, which was the first major overhaul of the 1954 Code, affected only 271 Internal Revenue Code subsections.²⁷⁵ In comparison, the six major tax bills enacted between 1976 and 1984 affected 5815 subsections.²⁷⁶ And, as previously noted, the recent Taxpayer Relief Act of 1997 alone revised 825 code sections and added 285 new sections to the Code.²⁷⁷

I remain unconvinced that the solution to all social and economic ills lies in the Internal Revenue Code. Professor Martin J. McMahon, Jr. observes that:

[t]raditional tax policy analysis focuses on whether the system (1) raises adequate revenue, (2) in an equitable manner, (3) without undue complexity, and (4) without undue interference with the economic system. Since 1981, however, the dominant characteristic of tax policy debate in the political arena has been the effect of the current rules and proposed changes on economic behavior. When tax reform is considered, the focus rarely is on the tax system as a source of revenues the effectiveness and fair-

²⁷⁴ See *supra* Part II.A.

²⁷⁵ See Richard L. Doernberg & Fred S. McChesney, *On the Accelerating Rate and Decreasing Durability of Tax Reform*, 71 MINN. L. REV. 913, 922 (1987) (citing Harold Apolinsky, *The Changes Just Cost Money*, WASH. POST, Apr. 6, 1986, at C8).

²⁷⁶ See *id.*

²⁷⁷ See *supra* note 7, and accompanying text.

ness of which should be measured against the full range of traditional criteria of tax policy. Nor is the redistributive function of taxation considered in a balanced manner. Use of the tax system to redistribute the social product has been decried. Instead, tax policy analysis has been dominated by demands for either investment neutrality or investment incentives, with pseudo-economists somewhat amazingly demanding both simultaneously. Advocates of changing the tax system to encourage economic growth do not seem to view the tax system as a vehicle to collect adequate revenues fairly or to soften the harsh distributional results that capitalism sometimes produces. They evaluate the tax system solely as a tool for managing economic activity, both on a macroeconomic and microeconomic scale. In other words, much of what passes for "tax policy" in the political arena today is in reality "tax expenditure policy."²⁷⁸

Is the tax Code tail wagging the economic dog, or vice-versa? It is exceedingly difficult to tell whether Congress believes that the economy wags the Internal Revenue Code or the Internal Revenue Code wags the economy. Those on the lower end of the income spectrum are shaking, nonetheless.

C. The Behavior Factor

The third cultural factor to examine in our income tax perspective is behavior: how the tax system in obvious as well as hidden ways attempts to modify our economic, as well as our personal, behavior. Volumes could be written about this cultural and psychological phenomenon, but my discussion shall be restricted to just a few observations.

The first observation of critical significance is that our tax payments are removed from the behavior that generates the tax liability and "[t]his behavioral, or functional, separation leads us to perceive tax payments as punishment for having succeeded financially."²⁷⁹ We engage in productive activity that is rewarding and apparently valued by society and yet, at the same time, we are "punished," through taxes, the more successful we become. Thus, observes Professor Rosenberg:

[u]nfortunately, the imposition of occasional punishment in response to behavior that is generally positively reinforced has been shown not only to generate hostility, but also to literally to [sic] drive subjects crazy. Those who feel they are being punished tend to retaliate by punishing back, and the one at whom they tend to direct their punishment is the one they perceive to

²⁷⁸ McMahon, *supra* note 238, at 461 (and accompanying footnotes).

²⁷⁹ Joshua D. Rosenberg, *The Psychology of Taxes: Why They Drive Us Crazy, and How We Can Make Them Sane*, 16 VA. TAX REV. 155, 183 (1996).

be punishing them; in this case, the perceived punisher[s] are the Service and taxes in general.²⁸⁰

Congress fed into this general hostility toward the Internal Revenue Service with substantial taxpayer testimony relating instances of IRS taxpayer abuse prior to passage of the 1998 IRS Restructuring and Reform Act. The irony of this scenario is that much of the taxpayer hostility was misplaced. Congress creates the tax laws that punish us and drive us crazy; the IRS is merely the visible enforcer. How convenient for Congress that a "fall-guy" was available to receive the taxpayers' wrath.

The second observation is that congressional efforts to alter, encourage or discourage our behavior through the tax code have enjoyed varying degrees of success and failure. As Sheldon D. Pollack observes: "[t]he tax laws have a peculiar impact upon private behavior insofar as they do not strictly prohibit particular private action or conduct, but rather establish a broad framework of incentives and disincentives through which private activity is subtly altered."²⁸¹ The following four examples illustrate this point.

The first example is savings. Economists generally are in agreement that Americans need to save more. Changing our income tax system to a consumption tax system, it is argued, would encourage savings behavior because the funds saved during the year would not be subject to tax. However, this argument assumes that Americans are at present not saving because the current income tax system does not strongly encourage it. Other than tax-deferred contributions to pension plans, income from savings is taxed at normal tax rates. However, it might just as easily be plausible that Americans are not saving because they can't afford to save—most need their annual incomes just to make ends meet.²⁸² As previously noted, 78% of all tax returns filed in 1996 reflected AGI of \$50,000 or below.²⁸³ Taking into account the federal as well as state income taxes plus the Social Security tax, this statistic indicates that the majority of Americans are not generating sufficient income to accommodate savings. The issue is not so much the income tax as the ability to generate income.

²⁸⁰ *Id.* at 185-86 and accompanying footnotes.

²⁸¹ Sheldon D. Pollack, *Tax Complexity, Reform, and the Illusions of Tax Simplification*, 2 GEO. MASON INDEPENDENT L. REV. 319, 357 (1994).

²⁸² [M]ost Americans would have difficulty recognizing the consumption tax as superior in fairness and equity to a broad-based income tax. The reason for this is that people do not regard saving as an act of self-denial where high-income taxpayers are concerned, or as mere postponed consumption. In our day at least, saving generally appears to take place only after all reasonable consumption preferences have been fully satisfied, and hence sometimes appears to be the ultimate luxury.

Chirelstein, *supra* note 192, 217-18.

²⁸³ See *supra* note 246.

The second example is the filing of returns. Filing individual income tax returns gives us a sense of control, although most of us need some assistance in completing our returns.²⁸⁴ There is a sense of accountability and control that seems important to us. The cultural phenomenon of filing our returns at midnight on April 15th is, in my opinion, more than a media event; rather, it represents a demonstration of individual control over a perceived tax system gone awry. A negative behavioral consequence of our self-reporting process, however, is its inherent unreliability.²⁸⁵

A third example is the deadweight loss factor. We spend an inordinate amount of time, energy, and money attempting to avoid the imposition of the tax burden. As David Bradford observes:

tax rules impose two sorts of burden. One is the transfer of purchasing power from the individual to the government; the other is the effective waste of purchasing power owing to the distorting effects arising from the effort to avoid tax. The latter burden, called by economists the "deadweight loss" due to the tax, represents a gain to no one—neither to other individuals nor to the government.²⁸⁶

For illustration purposes, let's examine the situation of a spouse (the wife, for purposes of this example) who would like to go to work to supplement the family's income. Due primarily to the Social Security tax and the fact that the wife's income will be added on top of her husband's income, her additional work income could actually result in less overall income for the family.²⁸⁷ Numerous devastating social consequences flow from the spouse's decision not to work in order to avoid the cascading impact of the taxes:

- (1) the loss to the workplace and the community of the skills of the woman who intelligently decides not to enter the workforce;
- (2) the loss to the woman of her opportunity to pursue her career;
- (3) the loss to the father of time with his family since he must increase his workplace hours rather than have his wife work outside the home;
- (4) the loss to the children of the father who has less time to share in their growing up;
- (5) the loss to the children of the mother (whether married or single) who would rather work only part-time but is economically compelled to work full-time; and

²⁸⁴ See *supra* note 8.

²⁸⁵ See Rosenberg, *supra* note 279, at 191. "Self-reporting suffers from an unconscious, and therefore almost inescapable bias, even in the absence of any deliberate effort by the taxpayer to cheat or under-report." *Id.*

²⁸⁶ BRADFORD, *supra* note 10, at 135.

²⁸⁷ See Nantell, *supra* note 183, at 894-97.

- (6) the stigma placed upon a poor single parent who intelligently decides to accept welfare rather than a minimum wage job which cannot provide her and her children with sufficient resources to cover the necessities of life, including medical and child care costs.²⁸⁸

Thus, prudent tax avoidance behavior on the part of a taxpayer results in a multitude of wasted purchasing power—a deadweight loss.

The final example is home purchases and sales. Nowhere is the behavioral impact of the tax code more evident than in the purchase and sale of homes. We often buy homes because we are motivated to take advantage of the home mortgage interest and real estate taxes deductions.²⁸⁹ Prior to the 1997 tax Code changes, most taxpayers felt compelled under the Code to buy a home more expensive than the one they sold in order to avoid recognition of realized gain upon the sale.²⁹⁰

An inherent flaw in the behavior modification aspect of this Code section was magnified by experiences in the early 1990s. As the economy in California declined, many Californians sold their homes at high prices and moved to states with traditionally lower home prices such as Colorado²⁹¹ and Utah.²⁹² The Californians, not wanting to recognize the gain upon the sale of their California residences, built and bought expensive homes in their new states, thus rapidly, and falsely, inflating the value of homes in those states. By 1995 in Colorado, for example, heavy in-migration to the state spurred luxury home construction out of a five-year slump.²⁹³ In Utah, the average home sold for \$77,788 in the first quarter of 1991, the second year that the state began seeing heavy

²⁸⁸ *Id.* at 896.

²⁸⁹ See I.R.C. §§ 163 and 164 (1994), respectively. These two benefits combined to a total of \$71.3 billion in 1995, thus ranking as the #2 tax expenditure on the "top ten list" for the year. See *supra* note 248.

²⁹⁰ See former I.R.C. § 1034 (repealed by the 1997 Taxpayers Relief Act). The impact of § 1034 was to defer the reporting of realized gain on the sale of a residence by reducing the basis of the newly purchased residence. However, in order to qualify for this deferral, the section mandated that the taxpayer "buy-up"—that is, buy a home more expensive than the home he or she sold. The deferral of gain upon sale of a personal residence totaled \$20.4 billion in 1995, thus ranking it the #8 tax expenditure on the "top ten list" for the year. See *supra* note 248.

²⁹¹ See Guy Kelly, *State's Explosive Growth Tapering Off*, ROCKY MOUNTAIN NEWS, Jan. 29, 1996, at 4A.

²⁹² "At least 37,000 Californians parked their moving vans at Utah's curbs in the first three years of this decade, according to the best estimates, and they brought more than their belongings." Colleen Diskin, *California Influx Changing the Pace in Laid-Back Utah*, DENVER POST, Jun. 18, 1995, at C7.

²⁹³ See Michelle Mahoney, *Invasion of the Monster Mansions*, DENVER POST, Aug. 2, 1995, at F1. The managing broker for Devonshire Co. stated: "the home you could buy two years ago for \$500,000 is now \$750,000." *Id.*

migration from California; but in the first quarter of 1995, the average house statewide sold for \$119,653, a nearly 54% increase.²⁹⁴

Old section 1034 influenced more than just the inflation of home prices in many states. It also encouraged individuals to invest the gain from the sale of their residences in ever-more-expensive residences, rather than in more productive investments such as retirement savings, insurance, securities, or bonds.²⁹⁵ The personal, psychological, social, and economic consequences of these "misplaced" funds over five decades can hardly be estimated.

Now, the new exclusion from gross income of gain from the sale of a personal residence, \$250,000 for single taxpayers and \$500,000 for married taxpayers,²⁹⁶ is beginning to change property owners' behavior. It has been estimated that the new tax exclusion could have influenced anywhere from 100,000 to 500,000 of 1998's record 4.8 million resales.²⁹⁷

The end result of a tax policy comprised of motivation-oriented, behavior-altering provisions is an exceedingly complex set of statutes. Political scientist John Witte observes that "[w]hen it comes to fitting the incentive to a precise type of behavior and population, while at the same time trying to anticipate and thwart the legal maneuvers of those attempting to exploit the provision, what may be simple conceptually becomes unmercifully complex in practice."²⁹⁸ Drafting tax statutes for 270 million Americans, with the intent of encouraging very specific behavior, is thus doomed to a fate of intricacies and exceptions—our present, unpleasant predicament. Given the fact that no one is actually capable of predicting the exact behavioral consequences of any one, specific tax statute, the existence of our current melange of tax Code provisions is truly frightening.

III. SHIFTING THE INCOME TAX PARADIGM

When the 16th Amendment to the Constitution was approved by Delaware, the 32nd state, on February 25, 1913, my father was 13 *days* old. We tend to think that the adoption of the federal income tax is "ancient history" but, in my family, it is only two generations old.

²⁹⁴ See Diskin, *supra* note 292.

²⁹⁵ See Lee A. Sheppard, *Should Sales of Personal Residences Be Exempt From Tax?*, 50 TAX NOTES 1433 (1991).

²⁹⁶ See I.R.C. § 121 (West 1988 & Supp. 1999).

²⁹⁷ See Kenneth R. Harney, *Tax Law Change Gives Boost to Home Sales*, L.A. TIMES, Jan. 24, 1999, at K1 (Orange County ed.). "The actual cost, at least as measured in new estimates by the congressional Joint Tax Committee, turns out to be substantial: About \$31 billion over the next five years. For home sellers, at least, that's a bipartisan \$6 billion a year they'd never be able to pocket if they paid capital gains taxes on their profits." *Id.*

²⁹⁸ WITTE, *supra* note 12, at 204.

I believe this observation is important for several reasons. First, my parents' generation, and every person born after 1913, has primarily known an income tax system at the federal level. One would need to talk to centenarians in order to record personal reflections regarding the prior, longstanding federal tariff structure.

Second, I believe this observation is important in looking back on the development of the federal income tax system. Those men²⁹⁹ who created and changed the federal tax Code in the subsequent decades of the '20s, '30s, and '40s, in particular, were certainly influenced by the economies and events of their times. However, they also possessed a personal frame of reference, a personal historical perspective, of a very different tax structure and system.

Third, this observation becomes important because our own personal experiences, our individual historical perspectives, instruct, shape, dictate, and, often, constrain our future decisions to amend or not to amend a system of laws, any laws, whether they be tax or otherwise.

Nearly every individual living in the United States today has only known a system of income taxation at the federal level.³⁰⁰ It is an accepted part of our lives and an integral aspect of our culture. When I ask my Federal Income Tax students why we have an income tax system as opposed to a national sales tax system, for example, they look at me as if I am from Mars (or is it Venus?).³⁰¹ In their personal historical experiences, sales taxes are the domain of state and local governments, as are property taxes. The income tax system is the only federal tax system they have ever known. It is their paradigm, and too drastic a change is simply not trusted as legitimate.

Yet, "Why a federal income tax system?" is the threshold, fundamental question to answer if we are to engage in a meaningful discussion of tax policy. As I have stated, all of our legal rules are reflections of our values and beliefs,³⁰² and this statement is certainly true in our choice of a tax system.³⁰³ As Professor Pollack observes:

299 The term "men" is used intentionally. *See supra* Part II.B.2.

300 Certainly immigrants bring their own cultural perspectives regarding taxation with them. However, once here in the United States, the income and employment tax systems are the primary federal tax systems they will encounter, and they will encounter them immediately, with their first paychecks.

301 My apologies to JOHN GRAY, *MEN ARE FROM MARS, WOMEN ARE FROM VENUS* (1992).

302 *See generally* STEVEN J. BURTON, *AN INTRODUCTION TO LAW AND LEGAL REASONING* (2d ed. 1995).

303 "[T]ax systems are products of human creation. They exist because they serve human objectives, reflecting the values of their designers. A tax system's design can reveal

[t]he abandonment of the tariff and the political battle culminating in the adoption of the federal income tax in 1913 as the new (and soon-to-be primary) source of revenue proved to be a watershed event in the development of public finance, as well as a milestone in the development of the national political party system.³⁰⁴

This observation leads us to the problem of paradigms. If things have always been done a certain way—if income has always been taxed in our personal experiences—then it is so. The questioning and rationality are often lost in the inevitability of the answer.³⁰⁵ This paradigm phenomenon occurs within tax policy analysis as well. For example, one of the longstanding tenets of American tax policy is the supposed necessity of a tax system to achieve both horizontal and vertical equity.³⁰⁶ Under the premise of horizontal equity, taxpayers with equal incomes should pay an equal amount of taxes. Lack of horizontal equity is a major criticism of our current tax system. For example, if Taxpayer A has \$50,000 of adjusted gross income and owns a home, then she will receive the benefits of the home mortgage interest deduction and the real estate tax deduction in computing her federal income tax liability. If Taxpayer B has \$50,000 of adjusted gross income and pays rent, however, then she will pay more income tax, since she will only be able to utilize the lower standard deduction to shelter her income.

Horizontal equity as an objective of a tax system may have some fundamental flaws.³⁰⁷ For example, in our previous example, is all \$50,000 of adjusted gross income created equal? Assume that Taxpayer A's income came solely from interest and dividends on investments gifted to her by her grandparents, and then assume that Taxpayer B's income came from working 60-hour workweeks at two different jobs. Should the objective of the tax system be to tax them the same?

Vertical equity necessitates that those taxpayers with more income should pay a greater share of the tax burden. The theory is that every added dollar of income means less to a rich person than to a poor person. These concepts of equity have come to be an accepted tax policy paradigm of a supposedly neutral system of

much about those values. In other words, our choice of an income tax over a head tax as a mechanism for raising revenue is not accidental." Abreu, *supra* note 4, at 16.

³⁰⁴ Pollack, *supra* note 4, at 496 and accompanying footnotes.

³⁰⁵ The phenomenon reminds me of the old (somewhat sexist) joke about the young woman who always cut off the end of the roast before putting it in the oven. When her husband asked her why she did this, she responded, "That is what my mother always did." The young woman then asked her mother why she always cut off the end of the roast before cooking. Her answer: "Because my pan was too small."

³⁰⁶ See generally GRAETZ & SCHENK, *supra* note 46; see also CONLAN ET AL., *supra* note 138, at 26 n.21.

³⁰⁷ See BRADFORD, *supra* note 10, at 151.

taxation. However, at their core, such concepts presuppose that all Americans agree that horizontal and vertical equity in a tax system epitomize “fairness” and that all of us are in agreement as to what constitutes “fairness.”³⁰⁸ Furthermore, why must horizontal and vertical equity be fundamental goals of fairness of the federal income tax, but not other tax systems such as the sales tax or Social Security tax?

David F. Bradford concludes that “there is no single measure of fairness. At bottom, an individual value judgment is involved, and it is not realistic to hope for complete consensus on a particular standard. But there is room for reasoned argument on the subject.”³⁰⁹ What specific criteria should we employ to determine when two individuals have equal circumstances? What judgments should we make as to which circumstances are better and which worse, and, further, the degree to which burdens should differ in the different circumstances?³¹⁰ Bradford again concludes that “tax burdens should be related to the quality of individuals’ opportunities. Those with better opportunities than others should be expected to bear relatively more of the tax burden.”³¹¹

We sometimes are successful in making significant changes in our cultural paradigms. For example, a fundamental tenet of our society is outright ownership of property. The condominium concept, however, has gradually taken root and gained acceptance, where individuals do not actually own the structure itself—a community or association of individual homeowners owns the structure. The trade-off for nonownership is that the “community” pays for outside improvements, landscaping, and general maintenance. There is, apparently, enough of a trade-off to make condominium ownership an acceptable American choice, and choice becomes the key ingredient here. For some, the benefit of condominium living will outweigh the benefit of outright ownership, but, in the end, it is a matter of choice.

An example of a cultural shift that is not working well, in my estimation, due to lack of choice, is the health care HMOs. Operating on the premise of efficient cost management, we are offered only HMOs as our health care choice. Within the HMO, there is little choice, and sometimes, limited benefit. Our personal, historical perspectives tell us that freedom of choice of our physicians and hospitals is of primary importance. Our HMO experience is to

308 For a critical analysis of horizontal and vertical equity, see WITTE, *supra* note 12, at 56-58. See also Pollack, *supra* note 4, at 500-02. For a thoughtful discussion of equity in general in the context of our federal income tax system, see Joseph T. Sneed, *The Criteria of Federal Income Tax Policy*, 17 STAN. L. REV. 567, 574-80 (1965).

309 BRADFORD, *supra* note 10, at 148.

310 See *id.* at 151-52.

311 *Id.* at 148.

the contrary. Thus, resistance and friction are the norm in the managed health care field.³¹²

Choice is a matter of "weighing and balancing." What we are willing to adjust to that deviates from our personal, historical perspectives is largely a matter of weighing and balancing the benefits: what will we gain in exchange for what we have to give up?

Is not this weighing and balancing really the basis of all law? Are we not willing to drive the speed limit and stop at stop signs because we believe that the benefits of these rules outweigh the restrictions upon our individual freedom? Are we not willing to line up at airports to have our luggage, as well as our bodies, searched because we believe that the benefit of deterring terrorism is worth this amazing amount of infringement upon our privacy? Our laws reflect our beliefs, and our beliefs are an integral part of our culture.

One of the problems with weighing and balancing the costs and benefits of the federal income tax is that the benefits, at least on a day-to-day basis, are largely invisible to us. In the area of traffic regulations and airport security, we see and experience the benefits obtained when we agree to the personal freedom restrictions. The income tax system, however, is unique, for its benefits are removed, both physically and temporally, from its burdens.³¹³ Who or what is benefiting when, for example, an individual has to pay up to 40% of his or her gross income every month just to fulfill the obligations of federal and state income tax withholding and the Social Security and Medicare taxes? Where is all of that money going?

The larger the community, the more difficult it is to answer that question. Our community now consists of over 270 million people.³¹⁴ Amazingly, 54% of the entire population resides in only 20% of the states.³¹⁵ How do we see or experience the benefits of

³¹² My own personal, historical perspectives may be coming out here. After all, I remember when our family doctor, James P. Corrigan, M.D., came to the house on a regular basis to care for my two sisters and me.

³¹³ See Rosenberg, *supra* note 279, at 179-83.

Unlike the costs of other laws, the costs of tax payments are neither physically nor temporally contiguous with any benefit, service or product. While our taxes may bring us goods and services throughout the year, no one good or service is either large enough or close enough in time or place to the moment we fill out our tax returns (or become frustrated with the size of our withholding payments) to hold our attention. . . . When we make our tax payments, there is simply no contemporaneous or physically proximate governmental benefit with which to associate those payments.

Id. at 181-82

³¹⁴ The U.S. population on November 12, 1998 at 4:13:15 A.M. Eastern Time was 270,993,467. U.S. CENSUS BUREAU, THE OFFICIAL STATISTICS (1998).

³¹⁵ In 1994, the top 10 states in terms of population were: 1) California—31,431,000; 2) Texas—18,378,000; 3) New York—18,169,000; 4) Florida—13,953,000; 5) Pennsylvania—12,052,000; 6) Illinois—11,752,000; 7) Ohio—11,102,000; 8) Michigan—9,496,000; 9) New Jersey—7,904,000; and 10) North Carolina—7,070,000. These states totaled 141,307,000

defense expenditures, Social Security and Medicare costs, and interest payments on the national debt? Yet, 83% of our annual federal budget outlay is for these three benefits alone.³¹⁶ Other benefits such as highway costs over 50 states, agriculture and energy regulation, the cost of the federal executive, legislative, and judiciary structures, social welfare costs, and the regulation of the insurance, food and drug, and security industries are only slightly more visible.

These are just the tangible benefits; the benefits that an economist would conclude to be benefits of a tax system. There are, however, numerous cultural, intangible benefits as well: the sense of sharing,³¹⁷ the sense that the community is protecting itself against possible harm, the sense that we are providing for our elderly and disabled, and the sense that we are making good on our debts throughout the world. In addition, we have cultural benefits of choice. We are free to make choices of our sources of income—to work or to invest—and to pay the consequences of taxation. We are free to make choices regarding how we spend our money, and whether the cost will be deductible or not. These are also benefits that should not be underestimated in evaluating a tax system.³¹⁸

Is the perception of who or what is benefiting the same as the reality? The reason that the answer to this question is so important is due to the fact that, even if the perception is wrong, the perception becomes part of our cultural paradigm. The perceptions that tax loopholes keep many rich taxpayers from paying any taxes at all, or that welfare payments are only to individual poor people, are part of our belief system. Stating the fact that very few of the wealthy actually pay no federal income tax, or that corporate welfare far exceeds individual welfare, does little to al-

of the total population of 260,341,000. See STATISTICAL ABSTRACT, *supra* note 210, at 28 tbl.27.

³¹⁶ "Out of the total budget dollar about forty-seven percent is expended for social security, twenty-two percent is for national defense, and fourteen percent is for interest." Charles O. Galvin, *Past, Present, and Future*, 49 SMU L. REV. 83, 93 (1995) (citing the Economic Report of the President, H.R. Doc. No. 103-178, at 361 (1994)).

³¹⁷ The creation of a tax system is an imperative of group (i.e., societal) living. Although tax systems as we now know them did not exist in aboriginal societies, systems of communal sharing did. Members of numerically small societies share food, protection from the elements, and defense against predators. The existence of an organized society implies, by its very definition, the existence of different roles for different members of it, and the existence of different roles necessitates sharing. A society in which members are expected to share the proceeds of a hunt with others is, in effect, imposing a tax upon that hunt. . . . In the most basic of senses, then, I heartily agree with Justice Holmes that taxes are the price we pay for civilization. [citation omitted] Indeed, I might go even further and say that taxation, that is, the means by which we share resources, is an essential part of civilization.

Abreu, *supra* note 4, at 14-16 n.34.

³¹⁸ "The decision to adopt a tax system that provides opportunities for taxpayers to exercise choice, and thus allows them to determine their own tax liability, reflects deference to the value of personal autonomy." *Id.* at 16.

ter or erode the paradigm. What we believe to be true influences our reality.

In America, what are our benefit expectations from our government? What do we expect to pay for our civilized society? The answer to these questions may, in fact, vary depending upon our individual historical perspectives.³¹⁹

Anyone 70 years old or older in America today, for example, will have a very different personal, historical and cultural perspective than members of younger generations. These individuals lived through the depths of the Great Depression as youngsters and experienced first hand the implementation of the New Deal. Sacrifice, hunger, and hard work were nothing new to them. They witnessed the horrors of no federal unemployment insurance protection and no federal regulation of pensions, as well as destitution among injured family members who had no access to state or federal disability assistance. In addition, these individuals were witnesses to and participants in a world war fought from both shores. They suffered the loss of nearly 300,000 lives at sea and on foreign soil, and nearly 700,000 of them came home wounded.³²⁰ They endured the mania of Hitler and the decimation of six million Jews. And all of this became a part of their individual, historical perspectives before they were out of their 20s! Obviously, these experiences shaped their attitudes toward government, benefit expectations, and the price that needed to be paid for public welfare and protection.

The next generation, the so-called Baby Boom generation, generally had a better life thanks to the sacrifice and hard work of those who had gone before. Economic depression and world war did not shape the beliefs of the Baby Boomers. They generally experienced less hardship and sacrifice, were the beneficiaries of more government benefits and protections, enjoyed the idealism of the Kennedy era, and suffered through the disillusion of the Vietnam War, assassinations, and Watergate. Now they are heading toward retirement, expecting that the generation immediately behind them will provide for them as they have provided for their parents.

What is the strength of belief of those in their 20s and 30s toward their responsibility for the welfare of the Baby Boomers through the tax system? For the small percentage of the popula-

319 It is always dangerous to attempt to summarize attributes of entire generations of people. For example, the media term "Generation X" has been used to describe an entire generation of people roughly between the ages of 18 and 38, and yet 28-year old author Michele Mitchell detests this term. See MICHELE MITCHELL, *A NEW KIND OF PARTY ANIMAL: HOW THE YOUNG ARE TEARING UP THE AMERICAN POLITICAL LANDSCAPE* (1998); Dennis McLellan, *New Kids in the Bloc*, L.A. TIMES, Sept. 30, 1998, at E1 (Orange County ed.). I will attempt to avoid overly broad statements in my generational observations.

320 See STATISTICAL ABSTRACT, *supra* note 210, at 366 tbl.569.

tion today who falls into this age bracket, the responsibility must seem daunting.³²¹ This generation was bussed to school in order to effectuate integration, or their families moved to the suburbs to avoid the issue. Before they were 20, they experienced America putting a man on the moon, the end of the Vietnam War with neither victory nor defeat, and the only resignation of a President that America has ever known. In their 30s, they witnessed tax reform which, when coupled with the continuation of major federal expenditures, resulted in the ballooning of the federal deficit to its peak of \$290.4 billion in 1992.³²² Governmental expectations became entrenched institutions of education and welfare.

What about those under the age of 20 today? They have known only three Presidents—Reagan, Bush, and Clinton. In many respects, this generation is a study in contrasts. For example, a recent survey of our teens indicates that they are dramatically lacking in knowledge of their government and their legal system. Only 41% could name the three branches of government; only 21% knew how many members were in the Senate; and only 2% knew the name of the Chief Justice of the U.S. Supreme Court.³²³ These are the same children who have never known a typewriter, and who receive vast amounts of information daily through computers and the Internet.³²⁴ These children have experienced dramatic changes in the stock market and the general resurgence of a vital economy; yet 20% of all children living in America today live in poverty.³²⁵ Nowhere is the line between the “haves” and “have nots” greater than in this age group.³²⁶ The changing concept of family is also dramatically in evidence in this age group. Three out of every 10 children under the age of 18 in America today are being raised in a single-parent household; this figure was just 1.3 out of 10 in 1970.³²⁷

321 There are approximately 76 million Baby Boomers. See Carolyn Lochhead, *Clash of the Titans: Collision Between Baby Boom Generation and the New Deal*, REASON, Mar. 1997, at 42. See also Robert A. Rosenblatt, *Securing the Future for Women*, L.A. TIMES, Jan. 27, 1999, at E1 (Orange County ed.). “The big debate deals with keeping Social Security solvent so baby boomers can get their checks. The crisis year is 2032, when Social Security will have consumed its surplus, and payroll taxes will be sufficient to pay only 75% of benefits promised under current law.” *Id.*

322 See ECONOMIC REPORT OF THE PRESIDENT 373 tbl.B-78 (1998).

323 See *Teens Know of DiCaprio but Not Rehnquist*, L. A. TIMES, Sept. 3, 1998, at A17.

324 “[T]hree-quarters of young people aged between 15 and 24 are familiar with computers.” *Spotlight: Personal Computers*, MKT. WEEK, Feb. 19, 1998, at 38.

325 Poverty rates for all children in 1997 were at 19.9%. See JOSEPH DALAKER & MARY NAIFEH, *POVERTY IN THE UNITED STATES 1997*, at vi (Bureau of the Census Current Population Reports No. P60-201, 1998).

326 “[C]hildren continued to represent a large share of the poor population (40 percent) even though they were only about one-fourth of the total population.” *Id.*

327 Only 69% of these children are being raised in two-parent households; 31% are being raised in single-parent households. See STATISTICAL ABSTRACT, *supra* note 210, at 61 tbl.71. These figures contrast with 1970 figures of 87% of children living in two-parent households and 13% in single-parent households. *Id.*

What does all of this mean for the issue at hand—that of federal tax policy? I believe it means that we cannot and should not make sweeping generalizations about what Americans want or need when it comes to a federal tax system. We, as tax commentators, need to “keep perspective.” We must remain ever vigilant that economics does not so dominate our analysis that we forget we are talking about people and not economic charts and models. We must be ever sensitive to our cultural perspectives—our individual histories, beliefs, and values and our perceptions about those beliefs—when proposing and discussing federal tax policy for the new millennium.

Most importantly, we must be ever vigilant to the fact that wealth, no matter how defined—whether in terms of property or income—equates into opportunity. We tax the wealthy at a greater rate not necessarily because the wealthy derive more governmental benefits, but rather because their wealth affords them so much cultural opportunity.³²⁸ Professors Blum and Kalven observe that:

the gravest source of inequality of opportunity in our society is not economic but rather what is called cultural inheritance for lack of a better term. Under modern conditions the opportunities for formal education, healthful diet and medical attention to some extent can be equalized by economic means without too greatly disrupting the family. However, it still remains true that even today much of the transmission of culture, in the narrow sense, occurs through the family, and no system of public education and training can completely neutralize this form of inheritance. Here it is the economic investment in the parents

328 We also must maintain a minimal, less burdensome connectedness to the non-proximate stranger. At this minimal level of care, I need make no great sacrifices to help the unmet others. Moreover, I need respond only to those others' most urgent and basic demands. The basic needs of any person go beyond those of bare survival to include attainment of the preconditions of liberty that allow us to be free, voluntary agents working towards self-fulfillment. These conditions include education and some level of personal safety and comfort. Only when a person has these basics is she able to work towards her potential and self-fulfillment. The minimal level of care, then, requires that I help others attain these basics so that they have an opportunity to achieve self-fulfillment just as I do. Because it involves a minimal level of responsibility, my obligation to help others attain this state of opportunity does not require that I give up my own opportunity, nor even that I constrain it very much. It does require that as my discretionary income grows, I contribute money at a greater rate than previously to help others. This is not an unduly burdensome obligation. It denies me no freedom of action. I can still choose when, where, and how much to work. I am still rewarded for my efforts. The income contribution required of me will not be so large as to unduly handicap my own attempts at self-fulfillment. As my income grows, it is easier for me to contribute more without impinging on my ability to reach my own goals. My minimal obligation to others requires that I contribute that nonintrusive amount. Thus, a progressive income tax rate satisfies my obligation to myself and others. It is not a redistribution of wealth, merely a paying off of my “just debts” to others.

Kornhauser, *supra* note 234, at 510-11.

and the grandparents, irrevocably in the past, which produces differential opportunities for the children.³²⁹

IV. CONCLUSION

Our initial inquiry may be wrong. We should not be analyzing the tax side of the federal income tax as much as the income side of the equation. For me, the problem is not so much with the federal income tax and its distributional effects, but rather with the issue of income—who has it and who does not, as well as who has an *opportunity* to have it and who does not. The issue is not so much a matter that Americans need less taxes; rather, they need more income.

This conclusion brings us back to our historical and cultural perspective. Historically, Americans were taxed through a consumption-based system of excise taxes and tariffs imposed upon the purchase of goods. These taxes were perceived to be unfair because very few Americans had any income of which to speak. Before the days of government regulation and unions, men, women, and children of all ages slaved in jobs for exceedingly long hours, and under gruesome conditions, and for very little pay. The burden of excise taxes and tariffs fell disproportionately upon the working class. These hardworking Americans were not empowered; they often lacked education, suffered from racial and ethnic discrimination, and initially lacked organization. Most importantly, the burdens of economic development were intentionally thrust upon the unempowered poor.

Thus the problem is, historically, what it has always been: the gross disparity in the distribution of income throughout the U.S. population. This article has repeatedly highlighted the ever-present income disparity throughout our history. Depressingly, the income disparities of today are painfully reminiscent of the statistics of 1860, 1890, and 1920. Our “evolved” Internal Revenue Code does little to remedy this income disparity, but rather exacerbates it with a plethora of tax preference items favoring wealthy owners of capital. At a minimum, Congress needs to return the Code to its original constitutional mandate of taxing “income from whatever source derived,” broadening the tax base by eliminating many of the tax preference items that disproportionately favor the wealthy in the name of “stimulating the economy.”

Our cultural perspective reveals that we will likely not embrace a wholesale substitution for our current income tax system, that the wealthy, predominantly male politicians will continue to perpetuate their self-preservationist agenda through the tax sys-

³²⁹ Walter J. Blum & Harry Kalven, Jr., *The Uneasy Case for Progressive Taxation*, 19 U. CHI. L. REV. 417, 504 (1952).

tem, that tax expenditure items have severely enhanced the disproportionality of income distribution throughout the United States, that a rational, economic solution may not address our basically irrational economic nature, that fundamental reform is not likely to survive the harsh reality of the American political process, and that we have been cajoled into believing that the Internal Revenue Code can cure all social and economic ills. Not an optimistic, uplifting summation, I realize, but a culturally and historically accurate one nonetheless.

Perhaps our system of taxation is not as civilized as we would like because our society is not as civilized as it could be. After all, our system of taxation can only be as civilized as our society. If taxes are, in fact, the price we pay for a civilized society, we are not getting our money's worth under the current federal income tax system.

(TO BE FILLED IN BY COLLECTOR.)

Form 1040.

TO BE FILLED IN BY INTERNAL REVENUE BUREAU.

List No. _____

INCOME TAX.

File No. _____

District of _____

THE PENALTY FOR FAILURE TO HAVE THIS RETURN IN THE HANDS OF THE COLLECTOR OF INTERNAL REVENUE ON OR BEFORE MARCH 1 IS \$30 TO \$4,000.
(SEE INSTRUCTIONS ON PAGE 4.)

Assessment List _____

Date received _____

Page _____ Line _____

UNITED STATES INTERNAL REVENUE.

RETURN OF ANNUAL NET INCOME OF INDIVIDUALS.

(As provided by Act of Congress, approved October 3, 1913.)

RETURN OF NET INCOME RECEIVED OR ACCRUED DURING THE YEAR ENDED DECEMBER 31, 191____
(FOR THE YEAR 1913, FROM MARCH 1, TO DECEMBER 31.)

Filed by (or for) _____ of _____
(Full name of individual.) (Street and No.)

in the City, Town, or Post Office of _____ State of _____
(Fill in pages 2 and 3 before making entries below.)

1. GROSS INCOME (see page 2, line 12)	\$				
2. GENERAL DEDUCTIONS (see page 3, line 7)	\$				
3. NET INCOME	\$				
Deductions and exemptions allowed in computing income subject to the normal tax of 1 per cent.					
4. Dividends and net earnings received or accrued, of corporations, etc., subject to like tax. (See page 2, line 11)	\$				
5. Amount of income on which the normal tax has been deducted and withheld at the source. (See page 2, line 9, column A)					
6. Specific exemption of \$3,000 or \$4,000, as the case may be. (See Instructions 3 and 19)					
Total deductions and exemptions. (Items 4, 5, and 6)	\$				
7. TAXABLE INCOME on which the normal tax of 1 per cent is to be calculated. (See Instruction 3)	\$				

8. When the net income shown above on line 3 exceeds \$20,000, the additional tax thereon must be calculated as per schedule below:

	INCOME				TAX			
1 per cent on amount over \$20,000 and not exceeding \$50,000	\$				\$			
2 " " 50,000 " " 75,000								
3 " " 75,000 " " 100,000								
4 " " 100,000 " " 250,000								
5 " " 250,000 " " 500,000								
6 " " 500,000								
Total additional or super tax	\$				\$			
Total normal tax (1 per cent of amount entered on line 7)	\$				\$			
Total tax liability	\$				\$			

GROSS INCOME.

This statement must show in the proper spaces the entire amount of gains, profits, and income received by or accrued to the individual from all sources during the year specified on page 1.

DESCRIPTION OF INCOME.	A.				B.			
	Amount of income on which tax has been deducted and withheld at the source.				Amount of income on which tax has not been deducted and withheld at the source.			
1. Total amount derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid.	\$				\$			
2. Total amount derived from professions, vocations, businesses, trade, commerce, or sales or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, including bonds, stocks, etc.....								
3. Total amount derived from rents and from interest on notes, mortgages, and securities (other than reported on lines 6 and 6).....								
4. Total amount of gains and profits derived from partnership business, whether the same be divided and distributed or not.....								
5. Total amount of fixed and determinable annual gains, profits, and income derived from interest upon bonds and mortgages or deeds of trust, or other similar obligations of corporations, joint-stock companies or associations, and insurance companies, whether payable annually or at shorter or longer periods.....								
6. Total amount of income derived from coupons, checks, or bills of exchange for or in payment of interest upon bonds issued in foreign countries and upon foreign mortgages or like obligations (not payable in the United States), and also from coupons, checks, or bills of exchange for or in payment of any dividends upon the stock or interest upon the obligations of foreign corporations, associations, and insurance companies engaged in business in foreign countries.....								
7. Total amount of income received from fiduciaries.....								
8. Total amount of income derived from any source whatever, not specified or entered elsewhere on this page.....								
9. TOTALS	\$				\$			
NOTE.—Enter total of Column A on line 5 of first page.								
10. AGGREGATE TOTALS OF COLUMNS A AND B	\$				\$			
11. Total amount of income derived from dividends on the stock or from the net earnings of corporations, joint-stock companies, associations, or insurance companies subject to like tax (To be entered on line 5 of first page.).....	\$				\$			
12. TOTAL "Gross Income" (to be entered on line 1 of first page).....	\$				\$			

GENERAL DEDUCTIONS.

1. The amount of necessary expenses actually paid in carrying on business, but not including business expenses of partnerships, and not including personal, living, or family expenses.....	\$			
2. All interest paid within the year on personal indebtedness of taxpayer.....				
3. All national, State, county, school, and municipal taxes paid within the year (not including those assessed against local benefits).....				
4. Losses actually sustained during the year incurred in trade or arising from fires, storms, or shipwreck, and not compensated for by insurance or otherwise.....				
5. Debts due which have been actually ascertained to be worthless and which have been charged off within the year.....				
6. Amount representing a reasonable allowance for the exhaustion, wear, and tear of property arising out of its use or employment in the business, not to exceed, in the case of mines, 5 per cent of the gross value at the mine of the output for the year for which the computation is made, but no deduction shall be made for any amount of expense of restoring property or making good the exhaustion thereof, for which an allowance is or has been made.....				
7. Total "GENERAL DEDUCTIONS" (to be entered on line 2 of first page).....				

AFFIDAVIT TO BE EXECUTED BY INDIVIDUAL MAKING HIS OWN RETURN.

I solemnly swear (or affirm) that the foregoing return, to the best of my knowledge and belief, contains a true and complete statement of all gains, profits, and income received by or accrued to me during the year for which the return is made, and that I am entitled to all the deductions and exemptions entered or claimed therein, under the Federal Income-tax Law of October 3, 1913.

Sworn to and subscribed before me this.....

day of, 191

(Signature of individual.)



(Official capacity.)

AFFIDAVIT TO BE EXECUTED BY DULY AUTHORIZED AGENT MAKING RETURN FOR INDIVIDUAL.

I solemnly swear (or affirm) that I have sufficient knowledge of the affairs and property of to enable me to make a full and complete return thereof, and that the foregoing return, to the best of my knowledge and belief, contains a true and complete statement of all gains, profits, and income received by or accrued to said individual during the year for which the return is made, and that the said individual is entitled, under the Federal Income-tax Law of October 3, 1913, to all the deductions and exemptions entered or claimed therein.

Sworn to and subscribed before me this.....

day of, 191

(Signature of agent.)

ADDRESS IN FULL



(Official capacity.)

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INSTRUCTIONS.

1. This return shall be made by every citizen of the United States, whether residing at home or abroad, and by every person residing in the United States, though not a citizen thereof, having a net income of \$3,000 or over for the taxable year, and also by every nonresident alien deriving income from property owned and business, trade, or profession carried on in the United States by him.
2. When an individual by reason of minority, sickness or other disability, or absence from the United States, is unable to make his own return, it may be made for him by his duly authorized representative.
3. The normal tax of 1 per cent shall be assessed on the total net income less the specific exemption of \$3,000 or \$4,000 as the case may be. (For the year 1913, the specific exemption allowable is \$2,500 or \$3,333.33, as the case may be.) If, however, the normal tax has been deducted and withheld on any part of the income at the source, or if any part of the income is received as dividends upon the stock or from the net earnings of any corporation, etc., which is taxable upon its net income, such income shall be deducted from the individual's total net income for the purpose of calculating the amount of income on which the individual is liable for the normal tax of 1 per cent by virtue of this return. (See page 1, line 7.)
4. The additional or *super tax* shall be calculated as stated on page 1.
5. This return shall be filed with the Collector of Internal Revenue for the district in which the individual resides if he has no other place of business, otherwise in the district in which he has his principal place of business; or in case the person resides in a foreign country, then with the collector for the district in which his principal business is carried on in the United States.
6. This return must be filed on or before the first day of March succeeding the close of the calendar year for which return is made.
7. The penalty for failure to file the return within the time specified by law is \$20 to \$1,000. In case of refusal or neglect to render the return within the required time (except in cases of sickness or absence), 50 per cent shall be added to amount of tax assessed. In case of false or fraudulent return, 100 per cent shall be added to such tax, and any person required by law to make, render, sign, or verify any return who makes any false or fraudulent return or statement with intent to defraud or evade the assessment required by this section to be made shall be guilty of a misdemeanor, and shall be fined not exceeding \$2,000 or be imprisoned not exceeding one year, or both, at the discretion of the court, with the costs of prosecution.
8. When the return is not filed within the required time by reason of sickness or absence of the individual, an extension of time, not exceeding 30 days from March 1, within which to file such return, may be granted by the collector, provided an application therefor is made by the individual within the period for which such extension is desired.
9. This return properly filled out must be made under oath or affirmation. Affidavits may be made before any officer authorized by law to administer oaths. If before a justice of the peace or magistrate, not using a seal, a certificate of the clerk of the court as to the authority of such officer to administer oaths should be attached to the return.
10. Expense for medical attendance, store accounts, family supplies, wages of domestic servants, cost of board, room, or house rent for family or personal use, are not expenses that can be deducted from gross income. In case an individual owns his own residence he can not deduct the estimated value of his rent, neither shall he be required to include such estimated rental of his home as income.
11. The farmer, in computing the net income from his farm for his annual return, shall include all moneys received for produce and animals sold, and for the wool and hides of animals slaughtered, provided such wool and hides are sold, and he shall deduct therefrom the sums actually paid as purchase money for the animals sold or slaughtered during the year.
- When animals were raised by the owner and are sold or slaughtered he shall not deduct their value as expenses or loss. He may deduct the amount of money actually paid as expense for producing any farm products, live stock, etc. In deducting expenses for repairs on farm property the amount deducted must not exceed the amount actually expended for such repairs during the year for which the return is made. (See page 3, item 6.) The cost of replacing tools or machinery is a deductible expense to the extent that the cost of the new articles does not exceed the value of the old.
12. In calculating losses, only such losses as shall have been actually sustained and the amount of which has been definitely ascertained during the year covered by the return can be deducted.
13. Persons receiving fees or emoluments for professional or other services, as in the case of physicians or lawyers, should include all actual receipts for services rendered in the year for which return is made, together with all unpaid accounts, charges for services, or contingent income due for that year, if good and collectible.
14. Debts which were contracted during the year for which return is made, but found in said year to be worthless, may be deducted from gross income for said year, but such debts can not be regarded as worthless until after legal proceedings to recover the same have proved fruitless, or it clearly appears that the debtor is insolvent. If debts contracted prior to the year for which return is made were included as income in return for year in which said debts were contracted, and such debts shall subsequently prove to be worthless, they may be deducted under the head of losses in the return for the year in which such debts were charged off as worthless.
15. Amounts due or accrued to the individual members of a partnership from the net earnings of the partnership, whether apportioned and distributed or not, shall be included in the annual return of the individual.
16. United States pensions shall be included as income.
17. Estimated advance in value of real estate is not required to be reported as income, unless the increased value is taken up on the books of the individual as an increase of assets.
18. Costs of suits and other legal proceedings arising from ordinary business may be treated as an expense of such business, and may be deducted from gross income for the year in which such costs were paid.
19. An unmarried individual or a married individual not living with wife or husband shall be allowed an exemption of \$3,000. When husband and wife live together they shall be allowed jointly a total exemption of only \$4,000 on their aggregate income. They may make a joint return, both subscribing thereto, or if they have separate incomes, they may make separate returns; but in no case shall they jointly claim more than \$4,000 exemption on their aggregate income.
20. In computing net income there shall be excluded the compensation of all officers and employees of a State or any political subdivision thereof, except when such compensation is paid by the United States Government.