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## The Unhappy, Big-Government Feeding 100th Birthday Of America's Income Tax

By: Doug Bandow – February 4, 2013

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A century ago Americans ratified the 16<sup>th</sup> Amendment to the U.S. Constitution. The result was the income tax. February 2, 1913, when New Mexico and Wyoming put the amendment over the top, is another day which should live in infamy.

Yesteryear's income tax advocates would not recognize their handiwork today. The tax code is mind-numbingly complex, as dedicated to manipulating individual behavior as to raising government funds. By raising nearly a trillion dollars annually it has become the chief fiscal engine of government growth. Today policymakers assume there is no program, no matter how ill-considered or ineffective, for which money is not available. Even the latest budget contretemps has had only a minor impact on Congress' spending behavior.

Proving John Madison's warning that from war "proceed debts and taxes," an income tax was first proposed in 1814 to fund combat with Great Britain during the War of 1812. The plan died the following year after the two countries agreed to peace.

Americans were not so lucky 46 years later during the Civil War. Congress first voted to tax income in 1861 as the Lincoln administration desperately sought to find the money necessary to invade the seceding southern states. The measure was replaced with another income levy the following year, which survived until 1872. The thought of Washington similarly reducing both outlays and taxes seems quaint today.

The income tax came back in 1894 amid populist currents which swept much of the country as Congress sought to replace revenue lost after tariffs were cut. But the Supreme Court declared the exaction to be unconstitutional, though only when applied to rental income and other revenues derived from property use (such as dividends). Congress could have cured the legislation by only taxing normal compensation, but waited until 1909 to propose an amendment fully constitutionalizing the income tax.

Atlanta CPA Jay Starkman contended that congressional leaders believed the amendment would fail. But they did not expect the imminent triumph of the Progressive movement, which adopted the measure as its own. The first income tax ran from 1% to 7%, though few Americans earned enough to owe anything.

Still, those who were most enthusiastic about approving the measure seemed least interested in complying with it. Observed Starkman: "After the tax law was passed, judges embraced it—for everyone else, just not themselves. Judges across the land proclaimed that the Constitution prohibited diminishing their salaries (and those of the president and state employees) through taxation. They emphasized the point by issuing

court rulings in their own favor, excusing themselves from the tax.” This shameful behavior ended only with the Great Depression.

Proving yet again that war is the health of the state, Congress raised the top rate to 77 percent during World War I. That was cut back to 25 percent during the 1920s. But the top rate more than trebled during the Great Depression, rising to 79 percent, and hit an extraordinary 94 percent in 1944 during World War II. (The bottom rate hit an equally extraordinary 23 percent.) Those rates fell to 70 percent and 14 percent, respectively, in 1965 as a result of the Kennedy tax cuts (passed after President John F. Kennedy’s assassination), and were taken to 28 percent and 15 percent by the Reagan administration. The latter’s tax reform also effectively dropped many of the lowest earners from the rolls entirely. Since then top rates have climbed back up to 39.6 percent, first under the Clinton administration and then in January as the Obama administration similarly played to the politics of envy.

During World War II half of the population was subject to the tax. Today 70 percent of the population nominally is liable, though about 60 million (out of 144 million) returns result in no tax due.

According to the Tax Policy Center 46 percent of American households paid no income tax in 2011. Roughly half of them were exempt “for subsistence level income and for dependents,” that is, the filers earned too little and had large families. The other half paid no income taxes “because tax expenditures—special provisions of the tax code that benefit selected taxpayers or activities—wipe out tax liabilities and, in the case of refundable credits, result in net payments from the government.” Almost half, 44 percent, of tax expenditures go to the elderly; 30.4 percent were credits for work (“earned income”) and children.

This phenomenon has made the income tax steadily more progressive. According to the Congressional Budget Office, the total share of income tax liabilities paid by the top one percent of households has risen from 17.4 percent in 1980 to 39.5 percent in 2007 (the CBO’s latest figures). The corresponding increase for all federal taxes, including payroll levies, is 14.2 percent to 28.1 percent.

The top five percent of the population paid 61.0 percent of all income taxes, up from 34.9 percent in 1980. The same group paid 44.3 percent of all taxes, an increase from 28.7 percent. The highest earning ten percent has gone from 47.6 percent to 72.7 percent of income tax collections. The share of all taxes paid by the latter has risen from 40.0 percent to 55.0 percent.

Particularly striking is the fact that the same phenomenon, though less dramatic, is evident for corporate tax and social insurance collections. Only the respective shares of excise tax receipts have remained largely unchanged. Today the top one, five, and ten percent of households pay 4.7, 12.7, and 20.7 percent, respectively, of excise taxes.

The American tax system actually is more progressive than that of many European nations which rely on the Value Added Tax. Politicians favor the latter since it acts like a hidden sales tax. The geese hiss less if they don’t realize they are being plucked.

Income tax withholding plays a similar role in the U.S. Created in World War II, withholding means wage earners never receive their full income, and thus never knowingly pay their taxes to the government. Many people celebrate their tax refund as

if it was a gift, rather than the return of a forced interest-free loan. In contrast, those filing quarterly on Schedule C business income know that they are being plucked.

Governments need revenue. But the income tax makes it far too easy for politicians to spend more. Moreover, the levy creates a direct disincentive to work and investment. Perhaps even worse, the system invites legislators to manipulate people's behavior by creating a bizarrely complex system of special interest deductions and credits, which act as the equivalent of cash subsidies, only carefully disguised as obscure provisions in the impenetrable tax code.

A century of the income tax has undermined individual liberty and promoted unlimited government. Americans should insist on lower and simpler taxes. That will require curbing politicians' lust to spend and engage in social engineering. And, more important, that will require the rest of us to stop asking government to tax others for our benefit.