The American Income Tax
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THE AMERICAN INCOME TAX.

THE United States seem to have come to the parting of the ways. Not only has the break been made with the traditional tariff policy of the last thirty years, but a decided change of principle has taken place in the general revenue system. So many interests have been directly affected by the alteration of the tariff that there is danger of under estimating the significance of the other changes. For the first time in American history a national income tax has been introduced during a period of profound peace. It may be of interest to pass in review the provisions of the new law, to explain the reasons of its enactment, and to forecast its consequences and probable fortunes.

I.

Let us first say a few words about the origin of the tax and the reason that it has assumed its present form.

At the very outset it must be borne in mind that the income tax ought not be considered simply by itself, but rather as a part of a larger system of taxation, federal, state and local. The condition of American taxation in general is far from satisfactory, even though the situation is in some respects less discouraging than that which exists in Europe. While the European systems of taxation vary in degree of badness, it may nevertheless be said that, on the Continent especially, the chief burden is borne by the poor. Almost everywhere indirect taxes in some shape or other yield a large proportion of the public revenues. And the indirect taxes themselves are so calculated as to fall with crushing severity on the poorer classes of the community. Even where direct taxes exist, the poor are often compelled to bear more than their share. England forms no exception. For even in England, where so many reforms have been made in the national revenue, the whole system of local taxation, with its

absence of special assessments, its exemption of non-productive realty or land held for speculative purposes, and its imposition in the first instance on the occupier, means the relative overburdening of the poorer classes.

In the United States the rich man probably does not pay more than he would abroad. But the main burden rests not so much on the poorest classes as on the lower middle classes. The almost exclusive source of state and local revenues in the United States is the general property tax. This manifestly exempts those who have no property, and who live only on their income. But it also puts a relatively slight burden on the very small proprietor; for a certain amount of property is almost everywhere exempted. On the other hand the general property tax has become almost exclusively a real property tax, except in the rural districts, where the tangible, visible personalty is to be found. The rich urban investor in securities, the wealthy business man and the well-to-do professional classes almost entirely escape taxation. The weight of the tax falls primarily on the small farmer, who, under existing conditions of international competition, is unable to shift his burdens to the community.

Again, while it might be contended that the burden of the national indirect taxes rests on the poor, in reality it is the lower middle classes that suffer. As to the artisan this is not the place to enter upon the question whether any possible increase in expenses of living, due to the tariff, may not in his case be compensated by increased wages or by greater prosperity in the community at large. But there is no doubt that the farmer is becoming restless under a system which does not seem to afford him any protection on the articles he produces and exports, but whose burden he feels in the increased prices of his tools and his articles of consumption. The farmers, and more especially the farmers of the West and South, who constitute the great bulk of the middle classes, as well as the preponderant factor in the voting population—feel that they have been bearing most of the burden. Especially in recent years, with the fall in the price of silver and with the fall in the price of wheat, have the complaints of the agricultural class become loud and deep. For some years a progressive income tax has been one of the chief planks in the platforms not only of the Populists and the anti-monopolists, but of the farmers' conventions throughout the length and breadth of the land.

When, therefore, the opportunity presented itself, the Western and Southern representatives in Congress were not slow to seize

it. The self-imposed mission of the Democratic party was to reduce and equalise taxation. Although the Democrats at first proposed simply to lower the tariff to a revenue basis, it was soon recognised that the reductions would be more radical. Looked at simply from the standpoint of convenience and ease of collection, the simple method of making good a deficit in the tariff revenue would have been to modify the internal revenue or excise system. This plan, indeed, was advanced by Mr. David A. Wells, and at one time seemed to enjoy a reasonable prospect of meeting with legislative approval. Mr. Wells showed that by leaving the whisky tax at the original figure, and by slightly raising the tobacco tax and modifying the beer tax a very considerable increase of revenue might be secured. But the project soon raised a storm of opposition. On the one hand were the immense brewery interests, which objected strenuously to the imposition of any additional burdens on them. On the other hand were the whisky interests, which desired a nominal increase of the whisky tax in order to realise temporary profits and perhaps also to take advantage of the rate in other ways. And finally there was the temperance party, which worked hand in hand with the whisky interests, although for precisely the opposite reason, in demanding a tax so high that in all probability it would have produced less revenue than a lower tax. As a matter of fact the present law has slightly increased the whisky tax, raising it from 90 cents to $1.10 a gallon, and has furthermore imposed a duty of two cents a pack on playing cards. But neither of these changes will materially affect the revenue.

Since therefore the proposed tariff schedules would have meant a considerable deficit, and since no relief was to be expected from the internal revenue system, the proposition to make good the difference by introducing the income tax received a hearty welcome. But while the anticipated deficit gave the Western and Southern representatives their opportunity, it was not so much the idea of increasing the revenue as of correcting inequalities in the tax system that was really in their mind. The truth of this assertion is evident when we reflect on the fortunes of the Wilson bill in the senate. The Gorman bill put sugar back on the dutiable list and made many other changes which so weakened the radical nature of the House bill that all danger of a deficit seemed to be at an end. The income tax was no longer a fiscal necessity. Yet all efforts to expunge it from the bill were utterly unavailing. The farmers' influence was too strong.

Opposition to the tax came, as was natural, from the great cities of the East. Its foremost adversary was the leading senator from New York, whose democracy did not lead him to the length of advocating the interests of the West and South, even though attention to these interests had become a cardinal feature of Democratic principles. The commercial and financial centres professed to fear that their prosperity might be jeopardised. The large dailies were filled with indignant protests, and the chambers of commerce in New York and other cities voiced their anger in long and vehement resolutions. Even the leading Democratic journals in the North and East did everything in their power to have the income-tax sections struck out of the tariff bill. One of them continued its opposition to the whole measure to the very end on that account, and the senator from New York finally voted against the bill.

The contest was very analogous to that over the income tax in England. For in England also the opposition was from the very beginning sectional rather than political. In reading the protests of the American Chambers of Commerce we seem to be reading the manifestoes issued in the first years of this century by the corporation of the City of London and the resolutions adopted by the Anti-income Tax League many decades later in London, Manchester and Birmingham. For there also the same extreme statements were made; there also the classes that had hitherto escaped taxation feared that they might henceforth be made to bear their share of the public burdens; there also the line was drawn not by party affiliation, but by class interests, which had found expression in party dogmas.

So it was that while the Republican journals in the East opposed the tax, the opposition was due not to the fact that they were Republican, but to the fact that they represented the great industrial centres. And even in the East the recent Republican platforms treat the tax very tenderly, and say nothing about its speedy abolition. In the West there was by no means the same opposition, even among Republicans. The sentiment in favour of some form of income taxation was so overwhelming among the mass of the voters that the Republican leaders preferred to preserve silence and not run the risk of opposing a popular measure. Thus the Eastern opposition, vehement as it was, instituted by the Republicans and more or less openly sympathised with by the Democrats, was wholly ineffectual. No feature of the tariff bill was ever in smaller danger of being successfully opposed than were the income tax sections. The

bill as it came from the House was in many respects a crude measure. But many of the glaring defects were removed by the amendment in the Senate.

The origin of the income tax is thus in line with its recent history in other countries. Altogether a product of the last hundred years, the taxation of incomes was due at first to revenue considerations. In England, both under Pitt and under Peel, in Italy, in the United States during the civil war, and in a modified form in France after the Prussian victories, the income tax was introduced almost solely in order to prevent a deficit. But of recent years the democratic trend, and the dissatisfaction with existing revenue systems have led other countries like Germany, Switzerland, Australia, and even some of the American commonwealths to adopt the income tax as a means of improving the general tax system. In England itself, the later function of the income tax has assumed even more importance than the earlier one. So also with the new American income tax. Revenue considerations were the pretext, not the cause.

II.

Let us take up next the chief provisions of the new law.[1] The tax is to begin on January 1, 1895, and is to continue for five years. The rate is 2 per cent. on the excess over $4,000. It is levied upon all 'gains, profits or incomes derived from any kind of property, rents, interests, dividend or salaries, and from any profession, trade, employment or vocation.' The period on which the tax is computed is the preceding calendar year. The tax applies to the entire income of all citizens of the United States, whether resident or non-resident, and to all persons residing within the United States; and it also applies to so much of the income of persons residing abroad as is earned from property or business within the United States.[2]

A long section is devoted to explaining what is to be considered income. The only points that need mention here are the following:

Income is deemed to include interest on all securities except the federal bonds which were expressly exempted from taxation by the law of their issue. Profits realised from the sale of real

[1] "An Act to reduce taxation, to provide revenue for the Government, and for other purposes." Act of August 24, 1894. The sections affecting the income tax are sections 27—36.

[2] Section 27.

estate are defined to be income only when the real estate has been purchased within two years previous. The amount of sales of all vegetable and animal produce grown or produced by the taxpayer himself is considered income; but the expenses of production are deducted, and the amount consumed directly by the family is not included. All personal property acquired by gift or inheritance is declared to be income. In computing income, the necessary expenses actually incurred in carrying on the occupation are deducted. A similar deduction is made for interest on indebtedness, for losses actually sustained, and for worthless debts. But no deduction is permitted for permanent improvements or betterments to real estate. Although taxes may be deducted, the term is held not to include the amount paid for special assessments. In cases where the tax has already been paid by other parties, the individual is not compelled to include that income in his return. This would apply to the salaries of all officials of the United States Government where the Government itself is directed to withhold the tax; to the income received in the shape of dividends on corporate stock where the stock company or association is required to pay the tax in the first instance; and to 'any salary upon which the employer is required by law to withhold or pay the tax.'[1] It is also provided that salaries due to state, council, or municipal officers, shall be exempt.[2]

In addition to this tax on individuals we find a tax on corporations, companies or associations doing business for profit in the United States, but not including partnerships. This tax is assessed at the same rate, but without any abatements. It is levied on the net profits or income above operating and business expenses, which are so defined as to comprise not only ordinary expenses and losses, but also interest on bonded or other indebtedness. The income is deemed to include all amounts carried to the account of any fund, or used for construction, enlargement of plant, or any other expenditure or investment paid from the net annual profits.[3]

The corporate income tax does not apply to states, counties, or municipalities; nor to charitable, religious or educational associations; nor to fraternal beneficiary orders; nor to building or loan associations; nor to mutual insurance companies; nor to savings banks or societies under certain conditions.[4]

[1] Section 28. But see below, p. 665 *ad init.* [2] Section 33. [3] Section 32.

[4] The savings bank to which the privilege of exemption is accorded must have no stockholders except depositors, and no capital except deposits; second, must not receive deposits of more than $1,000 in any one year from the same person; third, must not permit the total deposits of any one person to exceed $10,000; fourth,

We come now to the administrative features. All persons of lawful age with an income over $3,500, are required to make to the collector or deputy collector a return in such form and manner as may be directed by the commissioner of internal revenue, and with the approval of the secretary of the treasury. The collector or deputy collector shall require the return to be verified by oath or affirmation. If he has reason to believe that the return has been understated he may increase the amount. In case no return or a wilfully fraudulent return, is made, he shall make the list to the best of his information, adding 50 per cent. in the one case and 100 per cent. in the other.[1] Appeal may be taken from the deputy collector to the collector of the district. If still dissatisfied, a taxpayer may submit the case with all of the papers to the commissioner of internal revenue, after serving notice on him to that effect. His decision is final. No penalty is to be inflicted upon anyone for making a false return, or for refusing to make a return, except after reasonable notice of the time and place where the charge may be heard. A further section provides that in case a person refuses to return his list or makes a fraudulent return, the collector may inspect his books, and compel the individual, or anyone else in charge of the books, to give testimony or answer interrogatories.[2]

Every corporation or business association or company must make a full return of its gross profits, expenses, net profits, amounts paid for interest, annuities and dividends, amounts paid in salaries of less than $4,000, and amounts, with name and address of each official, paid in salaries of more than $4,000.[3] Whenever the collector or deputy collector thinks that a correct return has not been made, he may file an affidavit of such belief with the commissioner of internal revenue, who may then, after notice and hearing, issue a request to have the books inspected. If the corporation refuse such request, the collector is to make his own estimate of income and add 50 per cent. thereto.[4] The Government is required to withhold the tax from the amount of all salaries over $4,000.[5]

The tax is due on July 1st of each year, and is levied on the

must distribute the earnings, not carried to surplus, among its depositors; fifth, must not possess a surplus fund exceeding 10 per cent. of its deposits. But the exemption applies also to mutual savings banks which pay interest or dividends only to their depositors and to such part of the business of any other savings bank as is conducted on the mutual plan.

[1] Section 29.

[2] Section 34, amending section 3173 of the Revised Statutes.

[3] Section 35. [4] Section 36. [5] Section 33.

income for the year ending on the preceding December 31st. The penalty for delay in payment is 5 per cent. on the amount unpaid, together with interest at the rate of 12 per cent. This does not apply to the estates of deceased, deranged or insolvent persons.[1]

In order to insure the greatest possible secrecy it is provided that no official of the Government is to divulge any fact contained in the income return, or to allow any detail to be seen or examined by any person not authorised by law. It is further declared to be unlawful for anyone to print or publish in any manner not provided by law any income return or part thereof. The penalty is a fine not exceeding $1,000, or imprisonment not exceeding one year. But in the case of any public official, the offence entails dismissal from office, with the incapacity thereafter of occupying any position under the Government.[2]

III.

Let us now proceed to analyse the provisions which have been recounted in all their baldness.

The first point that arrests our attention is that the tax is really an income tax, *i.e.* a tax on net gains or profits, and not, as in some other countries, on gross income with or without certain deductions. For instance, all necessary expenses are to be deducted from the gross returns. In England, in the case of real estate under schedule A, it was not until the amendments adopted only a few months ago, that allowance was permitted for repairs. The new American law, indeed, does not attempt to go into all the perplexing details of what may or may not be considered income, in the purely scientific sense. Yet a few questions arise.

The law differs from those of the civil war period, in that it does not expressly exclude from income the rental value of the residence occupied by the owner. From the strictly economic standpoint, income would comprise more than purely money income. The legislator of the civil war period assumed that income would include the rental value of the homestead occupied. A special provision was therefore inserted in the law, excluding this in terms. This was done for the reason that, since a deduction was permitted from income for the amount of rent paid for a dwelling by

[1] Section 30. [2] Section 34.

a tenant, there would otherwise be a gross injustice.[1] But, as was pointed out repeatedly at the time, the deduction of rent paid was unnecessary. The same equality might have been preserved by including in income the rental value of the property occupied by the owner, and in other cases allowing no reduction for rent paid. In the present law no one is permitted to deduct from income the amount of rent actually paid—which in itself is correct enough. But as nothing is said about including in income the rental value of the dwelling occupied, it is very doubtful whether it will be so included. This is manifestly an injustice, the gravity of which is not lessened by the fact that it is found in the income tax laws of almost all countries. The matter is left to the decision of the administrative authorities.

On other points, the explanation of what is to be considered income is simply copied from the earlier laws. Some of the provisions are quite arbitrary. Such is the requirement that the profits from the sale of real estate shall be considered income only when the real estate has been purchased within two years before. Under the law of 1862, which contained no reference to this point, it was held that profits from the sale of real estate were to be considered income, irrespective of the time when the property had been purchased. The law of 1864 specifically provided that they were to be considered income only if the property had been bought in the same year. Later on, in 1867, the limit was fixed at two years. And it is this clause which has been followed in the present law. Why the precise period of two years should have been chosen is not clear.

A similar criticism may be urged against the provision that income includes the sale of all vegetable and animal products excluding any part consumed by the family. It was frequently pointed out during the earlier period that this deduction was illogical; since an artisan who had to spend his money for provisions was allowed no deduction. If the farmer sold all his produce, and then bought food, he could deduct nothing; but if he reserved from his sales an equivalent amount of food, the deduction was permitted. However, since very few farmers will be taxed by the law at all, this provision makes very little difference.

A far more important point is the definition of corporate

[1] The deduction for amount of rent paid is not found in the first law of 1862, but in an amendment of 1863. The exclusion of the rental value from income is first found in the law of 1864. Both of these provisions lasted until the expiration of the tax.

income. From the economic point of view there is an important distinction between individual income and corporate income. In the case of individuals, true taxable property consists in the surplus above indebtedness. Net income could therefore be arrived at only by deducting interest on debts. But in the case of corporations the matter is somewhat different. Capital stock represents in many cases only a portion of the property. The remainder is represented by the bonded indebtedness. In the United States railroads, for instance, are built mainly on the proceeds of the mortgage bonds, roughly equivalent to the English debenture stock. The bonded indebtedness of the railroads to day exceeds even their nominal capital stock, swollen as the latter is by the process of 'watering.' It is the stock and bonds together that represent the property and the earning capacity of the corporations. And for this reason the most advanced tax laws in America, as well as in Europe, permit an individual to deduct his indebtedness or the interest on his debts, while the corporation is assessed on both bond and stock in the case of a property tax, or on both dividends and interest in the case of an income tax. The bill as it came from the House contained a similar provision; but in the Senate the section was so amended as to permit corporations to include interest on debt among their expenses. It is evident, then, that the income tax on corporations is really not a corporate income tax, but only a tax on corporate profits over and above fixed charges. Thus at one stroke the proceeds from this source are cut down over one half.

It may indeed be alleged in extenuation that the corporations, especially the railways, are already taxed so heavily in some states, and that their financial position is in the main so precarious, that the imposition of a tax on both stock and bonds would have involved a great many companies in ruin. It may be said further that the provision is not so serious as it seems, because the individual recipients of the income from bonded interest are supposed to include those sums in their own returns. But on the other hand it must be remembered that the definition of income is certainly an uneconomic one; and that whatever arguments apply to the advisability of having corporations pay directly on their dividends, apply with equal force to the interest on indebtedness.

The third point of importance is that the law provides not only for an income tax, but for something over and above an income tax, namely, a tax on successions. If there is any mean-

ing at all to the word income that has been well settled by economic science, it is that income denotes a regular and periodic return. It is for this reason that almost all income tax laws estimate income at an average of a certain number of years; for instance, the last three or five or seven years. In that way the fat years are balanced by the lean, and a far greater degree of justice is attained. It is to be regretted that the new law takes the profits of the last year only. But still even there we find the idea of annual, recurring profits. It is very surprising to find a provision which imposes a tax upon the value of all 'personal property acquired by gift or inheritance' during the year. If anything is irregular and unperiodic, it is an inheritance. The income from the inheritance is indeed regular; but the law taxes not only the income from the inheritance, but the inheritance itself. From the standpoint of an income tax, this is not only illogical, but in so far constitutes double taxation. In all the other income taxes of the world inheritances are either expressly or impliedly excluded.

It may indeed have been desirable to impose an inheritance tax in addition to the income tax; but in that case it should have been discussed on its own merits, and not smuggled into an odd corner of the bill. England indeed has its death duties in addition to the income tax. On the other hand, when the recent income tax law was passed in Prussia, the attempt to create an inheritance tax failed. It may be noticed in passing that the new tax is really not an inheritance tax. 'Inheritance,' strictly construed, applies only to real estate passing by descent. The term inheritance tax is popularly applied in America to a tax on the devolution of realty, whether by will or by intestacy; and it is sometimes applied also to a tax on the devolution of personalty as well.[1] But the new law uses the term in a very restricted sense. The tax does not apply to real estate at all, and the law speaks of 'personal property acquired by inheritance.' This is very confusing. It ought to be called a succession tax, not an inheritance tax. But passing over this misnomer, the exemption of real estate is due to the feeling, already alluded to, on the part of the mass of the small real estate owners, that they already bear more than their share of taxation. Whether or not the passage of this succession tax law is wise, we shall consider later. The point which I desire to emphasise here, is that the new law provides not only for an income tax, but also for a

[1] Cf. West, 'The Inheritance Tax,' introduction. *Columbia College Studies in History, Economics and Public Law;* Vol. iv, No. 2, 1893.

succession tax, and that the inclusion of 'gifts and inheritances' in income is utterly unscientific.

The fourth consideration which arrests our attention is that from the American point of view the law provides for a corporation tax as well as an income tax. I say from the American point of view, because the Americans are accustomed to make a distinction between a corporation tax and other taxes. Strictly speaking, the antithesis is not between a corporation tax and an income tax or a property tax, but between a tax on corporations and a tax on individuals, or, as it is sometimes called, a personal income tax.[1]

In England it would make no difference whether the income is assessed to the individual security-holder or to the corporation; but in the United States the new law combines what during the early years of the civil war period was contained in two separate measures. There existed at that time in addition to the tax on individual incomes, not only a tax on all corporate dividends and interests, but also a tax on certain corporate gross receipts. The corporations were permitted to add the latter tax to the charges made by them, so that the tax was virtually shifted to the public. In the case of the corporate income tax, however, the corporations were not compelled to deduct the tax from the dividends or interest of each security holder; and as a matter of fact they generally assumed the tax themselves without withholding it from the bondholder. It became to that extent a tax on the corporation, not on the bondholder. Under the present law also the tax is assessed directly on the corporation; but, as we have seen above, it is not assessed on corporate bonds, so that the question of withholding the tax from the interest due will not arise. Yet in so far as it goes it is a corporation tax in addition to the individual income tax.

The fifth point of importance is the $4,000 exemption. The merit or demerit of this provision will be discussed below. But there are several considerations to which attention must be called here. In one respect the system is more logical than the English system of exemptions. In England, even since the recent changes, a certain amount is absolutely exempted, while incomes up to the higher sum are permitted certain abatements; but on all incomes above that figure the full amount is assessed. In the American income tax there is only a single exemption; but the abatement

[1] The latter term does not represent the distinction with perfect accuracy, because under the American law corporations are also considered persons.

applies to all incomes of whatever amount. The tax is assessed only on the excess of incomes over $4,000. This is a provision the principle of which was already found in the income tax acts of the civil war, and which has recently been adopted in the New Zealand income tax, where a deduction of £300 is permitted for all incomes. It is manifestly unjust to permit the man with $4,000 income to go entirely free, and to impose on his neighbour, who has perhaps $4,010 income, a tax of over $80; the jump is too sudden. It will be perceived, however, that the American system virtually provides for a slightly graduated tax, running up from zero to almost 2 per cent. on the entire income; for a proportional tax on the excess over a certain sum necessarily means a graduated tax on the entire sum.

Again, while the exemption is nominally accorded to all incomes, the introduction of the corporate income tax practically nullifies the provision in one respect. Since corporations are to pay upon their entire net profits as defined by the law, it is manifest that persons who have invested their whole property in corporate stock from which they receive less than $4,000 income, will nevertheless have the tax withheld from their dividends by the corporation. To the class of small investors the exemption accorded by the law is therefore of no use; for no machinery is provided for granting rebates to such taxpayers, as is the case in some other countries. The same inconsistency occurred in the income tax acts during the civil war, and was noted at various times; but it was deemed impracticable to remedy the injustice. In the case of official salaries, however, where the tax is advanced by the Government, provision is made for the exemption. The Government withholds the tax only in case the salary exceeds $4,000.

It must be also noticed that only one deduction of $4,000 is permitted from the aggregate income of all members of any family. This may in some cases render the exemption nugatory. Under the recent development of American law the property interests of a married woman are often entirely independent of those of the husband. Where her income is less than $4,000, she will nevertheless still be taxable if her husband's income exceeds that figure. The force of the objection is somewhat weakened, first by the fact that, after all, it is the family income as a whole which serves as the best test of ability to pay; and, secondly, by the fact that it is very unlikely that married women will be assessed at all, even though the letter of the law calls for the taxation of 'all persons of lawful age.'

The sixth and final point to which it is well to call attention is what is commonly called double taxation. The law, it will be remembered, applies not only to all citizens resident, but to the entire income, no matter where received, of citizens residing abroad and of aliens residing in the United States; and it also applies to so much of the income of non-resident aliens as is derived from property or business within the United States. Here some interesting questions arise. Even assuming that the first and fourth classes will be reached, it is difficult to believe that the second and third classes can be touched. It may indeed be possible to assess the income of a non-resident in so far as it is derived from tangible property situate in the country. But in most cases it will be virtually impossible to reach the non-resident. Still more difficult will be the task of hitting the entire income of foreigners resident in this country, in so far as their income is derived from foreign sources; for the usual means of control will naturally be lacking.

Even assuming, however, that the practical difficulties were not insuperable, there would be grave objections in principle. If a resident foreigner is taxed on his entire income here, and is again taxed on his income at home, we have manifestly double taxation. Or if a non-resident citizen is taxed by us on his entire income, and is then again taxed abroad in the country in which he happens to reside, we have a not less glaring case of double taxation. Some states, like Prussia, tax foreigners only after they have lived more than a year in the country, except when their income is derived from Prussian property or business. The American law contains no such provision. Again, while England does indeed assess resident aliens, it does not attempt to reach the entire income of any non-resident. The American civil war taxes did not at first even tax the income of aliens, although they afterwards proposed to reach the entire income of non-resident citizens. The new tax, therefore, follows the error of the later laws of the civil war period. But the practical effect of the provision will be slight; for this part of the law, it may be conjectured, will almost inevitably remain a dead letter.

IV.

What, then, are we to think of this measure? Is it a wise innovation, or is it essentially vicious in principle and ineffective in practice? Will it be a permanent feature of the revenue system, or is it a mere temporary phase? We can, perhaps, best

approach the problem by discussing some of the objections that have been raised against the law.

One of the arguments most commonly advanced by the opponents of the measure was the alleged socialistic character of the tax. To assess people upon their income was said to savour of socialism. The more violent enemies of the measure went so far as to maintain that the state has no right to confiscate any part of a man's earnings at all. This objection, indeed, scarcely deserves a refutation, for it entirely misconceives the relation of the individual to the state. The cry of socialism has always been the last refuge of those who wish to clog the wheels of social progress, or to prevent the abolition of long-continued abuses. The factory laws were in their time dubbed socialistic. Compulsory education and the post office were called socialistic. And there is scarcely a single direct tax which has ever been introduced which has not somewhere or other met with the same objection. Only a short time ago the new inheritance tax was vehemently opposed in some of the American commonwealths, as was the new estate duty in England, on the ground of socialism. The same fate befell the property tax before its recent introduction in Holland and Germany. As a matter of fact, if there is any socialism to be recognised at all in these measures, it would be far more true of the property tax, which entirely exempts all earnings of the lower classes in so far as they are again expended, than of the income tax which reaches earnings from other sources than mere property. The property tax hits only the property owner. The income tax, as such, hits the income receiver whether the income be derived from property or not. Yet the Americans have become so accustomed to the property tax that they would laugh at the idea of its being called socialistic. We do not here speak of the exemption feature to be discussed below. For the cry of socialism was raised against the income tax *per se*, while the high exemption served as an additional count against the tax.

Had the principle of progressive taxation been introduced, some colour might have been lent to the accusation. The populists, indeed, introduced several amendments with this end in view; but they were all defeated in order to allay possible opposition. As a matter of fact, however, recent investigations have shown that progressive taxation, which to some seems the very quintessence of socialism, and which has undoubtedly often been urged for socialistic reasons, is perfectly defensible in theory on purely economic and fiscal grounds, although for other reasons its application to the income tax in its present form is practically

inexpedient.[1] It must be remembered that the income taxes of the civil war period were levied on the progressive principle, and were defended on purely economic grounds, both by the administration and by the legislators. England has not hesitated to introduce within the last few months a progressive direct inheritance tax ranging from one to eight per cent. And the great extension given to the progressive principle in recent years in other countries shows that the legislators are not blinded by mere words. As it was, Congress did not attempt any graduation of the tax, except in so far as the $4,000 exemption provides for a sort of restricted progression. The cry of socialism had no weight.

A still weaker objection was the alleged un-American nature of the tax. A prominent senator loved to expatiate upon the evils of monarchic government and the tyranny of the effete civilisations of the old world. Had he been better acquainted with the science of finance he would not have ventured the startling assertion that the income tax is unknown in democratic communities. We may perhaps assume that he regards England as a hide-bound, mediæval country. But it would be interesting to ascertain what epithets he applies to the cantons of Switzerland or to the colonies of Australasia. Of course it is a well-established fact that the income tax has been most fully developed precisely in the most democratic communities; and that the whole tendency toward democracy; even in non-republican states, has gone hand in hand with the extension of direct taxation, and more especially of the income tax. Had this absurd objection not been so widely quoted and copied, it would not deserve mention here.

The third objection was that of unconstitutionality. The American constitution provides that direct taxes must be laid in proportion to the representative population in each state. This would manifestly render it impossible to levy a tax on incomes. For the number of people in the state does not, of course, bear any necessary relation to its wealth. An income tax assessed according to the principle of the constitution would give a decided relief to the industrial states at the expense of the agricultural states. It would have to be levied in a lump sum upon each state according to population, and then be ratably distributed among the tax-payers. The rate in one state would thus greatly vary from that in other states. If the income tax is a direct tax, the objection seems to be a formidable one.

[1] Compare my recent book on Progressive Taxation.

As a matter of fact, however, it is not quite so serious. Even among economists there is no absolute agreement as to the exact distinction between direct and indirect taxes. And there is no doubt that in discussing the constitutionality of such a measure we must consider what the framers of the constitution meant when they used the term. Now, at the time the constitution was discussed there were no direct income taxes in existence, if we except the 'faculty' tax in Massachusetts, and the disastrous French experiment of the *Vingtièmes*, both of which were regarded rather as adjuncts of the property tax than as distinct forms of taxation. For the income tax, as we know, is a product of the last hundred years. The Supreme Court of the United States is thus undoubtedly correct in assuming that the only direct taxes contemplated by the constitution were the poll tax and the general property tax, chiefly the land tax.[1] The question arose soon after the formation of the Government. In a leading case the federal tax on carriages was upheld as not being a direct tax within the purview of the constitution.[2] Later on, during the civil war, the same question arose in regard to the income tax. And here again the Supreme Court held in a number of cases that the income tax was not a direct tax within the meaning of the constitution.[3] There is no reason to suppose

[1] It may further be taken as established that the words 'direct taxes' as used in the constitution, comprehended only capitation taxes and taxes on land, and perhaps taxes on personal property by general valuation and assessment of the various descriptions possessed within the several States. Chief Justice Chase, in Veazie Bank *v.* Fenno, 8 Wall., 546.

[2] Hylton *v.* United States, 3 Dallas, 171. The case was argued under the Act of June 5, 1794, imposing specific duties on carriages. Hamilton, who as Secretary of the Treasury, had been responsible for the law, argued the case for the Government. His brief is very important. In Hamilton's own draft of a constitution the words used were: 'Taxes on lands, houses, and other real estate and capitation taxes shall be proportioned in each state by the population.' This would have left no possible room for dispute. But there is no doubt that the convention believed that their own wording was virtually equivalent. In his brief Hamilton makes, among other points, the following: '3. That to apply the rule of apportionment to any but capitation taxes, taxes on lands and buildings, and general assessments on the whole real or personal estate, would produce preposterous consequences, and would greatly embarrass the operations of the Government.' (Hamilton's Works, Lodge's ed., vol. vii , 328).

The Court accepted Hamilton's arguments, and declared the law constitutional. And the decision was universally acquiesced in. As Professor Burdick points out, even Madison, who had written to Jefferson on the day the case was argued, that there never was a question on which his mind was better satisfied than of the unconstitutionality of the law, did not hesitate, when President, to sign Acts of Congress laying duties on carriages and harness as indirect taxes. For an account of the origin of the clause, the debates in the Convention and the later history of the provision, see Burdick, 'Direct Taxes,' *Columbia Law Times*, vol. ii. (1889), 255.

[3] In Pacific Insurance Co. *v.* Soule. 7 Wall., 433, it was held that a tax on the

that the decision of the Supreme Court will be reversed. It would be deplorable if an important measure of this kind were to be defeated on what is in great part a mere verbal quibble.

While the above objections are not of a very serious character, there is perhaps a deeper foundation for the charge that the income tax is an expression of sectional animosity. The exemption of $4,000 income practically means that the Western and Southern states gain at the expense of the industrial centres in the East and North. In many of those states individual incomes above the exemption point are comparatively few. And it is undoubtedly a fact that the enthusiasm for the tax came chiefly from those who are thus assured freedom from its burdens. But it must not be forgotten that there was much provocation. The Southern states have for years been compelled to bear the burdens of the tariff, the proceeds of which went in great part to the pensioners of the North. It was but natural that when an opportunity came the tables should be turned. Again, as we have already seen, the Western states have felt that they were unjustly treated by a national revenue system, of which they felt the incubus, but whose advantages were not so plain. To them also the income tax seemed a piece of retributive justice. So that the sectional animus, which was no doubt present to some degree, may be explained and even partly excused. The sectional feeling itself, however, has been considerably exaggerated; for the chief explanation of the income tax is not so much geographical as economic in its character. It was not so much a movement of the South and West against the North and East, as of the agricultural class against the industrial and moneyed class. It is simply an accident that the East is the home of the moneyed interest, while the West and South are the home of the landed interest. If any class antagonisms are discernible, they are primarily economic and only incidentally sectional.

The fifth and final objection that has been urged is the old but ever new contention that the income tax, however wise in theory, works badly in practice. That there is considerable truth in this is not to be denied. But it is usually forgotten that in dealing with problems of this character the real inquiry is not what is absolutely good, but what is relatively best. In so far as

profits of insurance companies was not a direct tax. In Springer *v.* United States, 102 U.S., 586, the income tax was held not to be a direct tax. Similar decisions were made in the case of a tax on bank circulation and a tax on successions. See Veazie Bank *v.* Fenno, 8 Wall., 533, and Scholey *v.* Rew, 23 Wall., 331.

the objection is true, it will be found to be due in great part to certain provisions of the law which, as we shall see, might have been avoided. But the objection itself has been made too much of. It is undoubtedly true that the income taxes in the separate states of the Union, like Massachusetts, Virginia, and North Carolina, are almost entirely farcical. But this is owing solely to the fact that no earnest effort is made to execute the law. Where, however, there is a serious administration, as was the case with the federal income taxes during the civil war, the result is very different. It is commonly assumed that the civil war income tax was in many respects a great failure and was provocative of great frauds. But it has never occurred to any one to compare the federal income tax with the local property taxes. I have undertaken to make some comparison, and venture to say that the history of the federal income tax shows that, notwithstanding all its imperfections, crudities and ensuing frauds, it was nevertheless more successful than the general property tax.

Let us test this by taking its fortunes in a typical state, utilising the returns of the state comptroller as well as of the federal officials.

The special income tax of 1865 was levied at the rate of 5 per cent. on all incomes. Its yield in New York state was $8,765,913, which corresponds to an income of $175,318,260. The state assessment for the general property tax in that year disclosed property to the amount of $1,550,879,685. That is, the self-assessed incomes in New York amounted to over 11 per cent. of the property—a preposterously high figure. If we assume that the average rate of profit at that time was 7 per cent , the income on New York property should have been $108,561,578. Yet this was not two-thirds of the income actually assessed. The income tax yielded one-third as much again as a corresponding property tax. Of course some allowance should be made for incomes from other sources than property. But the exemption of $600 included almost all the working classes; and the profits from business are practically the income from property invested in the business. So that the only class for which an allowance must be made is that of receivers of professional incomes. The total income of this class is not large enough to make any material difference in the figures given. The great success of the income tax as compared with the local property tax was due in part to the fact of the low valuation of real estate. But its main cause was the failure of the state tax to reach personalty. In other words the federal income tax was able to reach

many of those who contrived to escape the personal property tax.

The other years disclose a similar state of affairs. In 1866—67 the income tax in New York yielded $18,448,664. It was levied at the rate of 5 per cent. and 10 per cent. Taking this as approximately equivalent to a uniform tax of about 7½ per cent., the result would be a real income of $245,982,187. But let us grant, in order to weaken the contention still further, that it was tantamount to a uniform tax of as much as 9 per cent. on all incomes. That would mean an income of only 205 millions. The property assessed in New York by the state officials is returned at $1,531,229,636. Even assuming that the rate of income on capital was as high as 7 per cent., we would have an income of $107,186,074. Yet the income actually returned exceeded this by nearly 100 millions. Even under the least favourable showing incomes appeared as more than 13 per cent. of property—a figure manifestly extravagant. The income tax, therefore, produced almost twice as much as the general property tax. And even if we make the same allowance as before for incomes derived from other sources than property, the disproportion would still be very considerable.

Even in 1870, when the limit of exemption had been increased so much as materially to reduce the returns, New York paid $10,420,035, as a 5 per cent. income tax. This corresponds to a taxable income of $208,400,700. The assessment of property for the state tax was $1,967,001,185. This would mean that incomes were 11 per cent. of property, which for that period is palpably far too high.

In short, the history of the income tax clearly shows that it was more lucrative than a corresponding property tax, and that it succeeded in many cases where the personal property tax failed. The income tax was indeed productive of great frauds, but the personal property tax created far more. It was precisely because the income tax reached so many of the mercantile and capitalistic classes who have both previously and since escaped taxation that it became unpopular and was abolished.

In other parts of the country, indeed, the results may not be quite so favourable because of the more primitive economic conditions. Where the value of tangible realty exceeds that of personalty, as in some of the more purely agricultural states, the weakness of the general property tax is less noticeable. And it is possible that in such cases an income tax would yield less than a property tax. But wherever the economic conditions to-day

begin to approach those of New York a quarter of a century ago—and there are many such states at the present time—it is probable that the results worked out above will find their counterpart under the present law.

It appears from the above review that most of the objections usually urged against the income tax either entirely lack foundation, or are the results of considerable exaggeration. To those acquainted with the history of the English income tax the objections will seem quite familiar. Very much the same points were made year after year, and often in almost the same language. But the tax nevertheless commended itself to the people as a whole, and it has persisted and developed. So also it is possible that the new tax, especially in the great industrial centres, may succeed far better than the present tax on intangible personalty. Imperfect as it undoubtedly is, the income tax may prove to be a relative good, and to constitute a considerable improvement over the existing system.

V.

After all has been said, however, it remains true that too much must not be hoped from the practical working of the income tax. A system which rests on a method of self-assessment manifestly opens wide the door to fraud and evasion. The provisions for supplementary revision of the returns in certain cases by official assessments are far from adequate. The methods of checking the returns by utilising the probate courts and the inventories of property after death, which are customary in Germany and even in democratic Switzerland, would not be possible as yet in America. And although much of the inquisitorial character of the former income tax has been removed by the stringent provisions in the new law calculated to insure the utmost secrecy, there can be very little doubt that the effort to secure correct returns of individual incomes will be far from successful. Above all, there are certain defects in the new law which do indeed constitute grave counts, and which must greatly temper any enthusiasm that might otherwise be aroused in its favour. As over against the more or less imaginary or highly exaggerated objections adverted to above, the following points are deserving of serious consideration.

In the first place, all incomes are treated alike. There is, technically speaking, no differentiation. It has been generally

conceded by economists that a distinction must be made between what are variously known as funded and unfunded incomes or permanent and precarious incomes, or property and industrial incomes. The income derived from personal exertions is usually attained with a far greater degree of effort than the income derived from property. The property is indeed the result of labour, but it is the result of past labour, and frequently of some one else's labour. The individual who enjoys the present income of the property is clearly in a different position from the taxpayer who is dependent solely on the temporary result of his own personal labour. His faculty, or ability to pay, is smaller. The tendency of modern income taxation is to charge these precarious or industrial incomes at a lower rate than the permanent incomes from property. Italy, some of the Swiss cantons, New Zealand, and still more recently North Carolina, now pursue this policy, and the movement is spreading in other countries. The new American income tax makes no such distinction.

It may be said in reply that the distinction, although not in express terms, is nevertheless virtually provided for. In the first place, the very existence of the property tax in the United States implies the non-taxation of labour. If all men are taxed alike on their income, and if an additional tax is imposed on property, then the income from property is naturally taxed more severely than income from labour. This was indeed one of the arguments for the recent introduction of the property tax in Prussia and Holland. But the force of the argument is weakened in America by the fact that under existing conditions the greater the property, or at all events the personal property, the less does it pay.

It might furthermore be contended that the $4,000 exemption frees labour incomes from taxation. This argument is good as far as it goes. But under modern conditions there are many labour incomes which exceed that figure, such as the incomes of numerous members of the professional classes and of officials of large corporations. The injustice of assessing them at the same rate as the recipients of permanent incomes is not removed by making the $4,000 exemption applicable to both. The modern theory as well as the modern practice is to pay attention not only to the income itself, but to the source from which the income is derived. The failure of the new law to observe this distinction constitutes an undeniable defect.

The second objection is one to which attention has already been called in another connection, viz. the $4,000 exemption. It is true that what is known as the exemption of the minimum of

subsistence has become a cardinal demand in the theory of taxation. Some writers have indeed attempted to prove that this is dangerous in a democracy. It is wrong, so it is said, in a country of universal suffrage to have the burdens imposed on one class and the expenditures voted by another class, thus virtually putting the control of the public moneys in the hands of those, the majority of whom have nothing at stake. Without entering into the general argument in this place, it may be said that as a matter of fact the property tax, hitherto almost the sole reliance of the United States in state and local taxation, in itself necessarily includes this exemption of the minimum of subsistence. Yet the particular evil spoken of has never made itself apparent. But even were this not so, the obvious answer is that unless the state exempts this minimum of subsistence it must make good the difference through its poor laws. If it trenches on the minimum with one hand, it must build it up again with the other.

It is one thing however, to recognise the justice of the principle in the abstract, and quite another thing to defend the particular shape given to it by the new law. He would be bold indeed who would say that a $4,000 income constitutes a minimum of subsistence. When capitalised at the current rate of interest it is equivalent to a property of from $80,000 to over $100,000. This is not a minimum, but a very comfortable subsistence. Under the former income tax laws, when the exemption was $600, the total number of taxpayers in 1866 was 460,170. With an exemption raised to $1,000 the number of taxpayers in 1867 was reduced to 240,134. When the exemption was finally reduced to 2,000 the total number of taxpayers in 1872 was only 72,949. Even making allowance for the increase of wealth and population during the last quarter of a century, it is manifest that the number of individual taxpayers under the new law will be exceedingly small. Regarded from the standpoint of revenue, Congress has therefore voluntarily abandoned a rich source.

It must, indeed, not be forgotten that we should look at the income tax, not by itself, but as a branch of the whole revenue system. Much may accordingly be said in mitigation of this seeming injustice. As we pointed out above, the burden of taxation, that is of the tariff and the local property tax, is borne primarily by the lower middle class, more especially by the farmers. Even though $4,000 be not a minimum of subsistence, it nevertheless represents in large part the income of a class which is on the whole unfairly treated at present. Moreover it must be remembered that in England the limit of abatement

has recently been raised to five hundred pounds, which, in view of the different purchasing power of money, is not much inferior to the new American limit. Nevertheless, it is probably true that the limit has been fixed too high; for already under the property tax people who earn and spend their own incomes are entirely exempt. In addition, a definite amount of property over and above the annual earnings is also exempt; so that the present law grants still another exemption. An effort was in fact made to reduce the limit of exemption to $3,000. It would without much doubt have succeeded but for an unfortunate difference, partly political, partly personal, between an individual senator and the remaining members of the dominant party. While therefore something may be said in explanation, and even in palliation, of the provision, we are forced to the conclusion that the $4,000 exemption is too high, and that it will seriously interfere not only with the fiscal success of the measure, but also with the popularity of the tax among those who think that they are being unduly burdened in order to free an entire class that is well able to contribute something.

The third objection is one to which I have already alluded—the inclusion of the inheritance tax with the income tax. I discussed it above rather from the point of view of the theory of income, and showed that the inclusion of inheritances was unscientific. But this, of course, does not settle the question whether it was correct to tax inheritances as such. It is, after all, immaterial whether the law provides for a separate inheritance tax, or whether it is made a part of a nominal income tax. Was it wise to impose a federal inheritance tax?

To answer this query it is necessary to consider the relations between federal and state taxes. From the very origin of the American government it has been the practice to make a difference between the two, and to apportion to each sphere of government certain sources of revenue upon which the other should not encroach. The country is only just waking up to the fact that the same salutary principle can and ought to be applied to the state and local governments. The whole tendency of recent tax reform in the United States, as abroad, is to observe the distinction between the sources of state and local revenue. As between the state and federal governments, the principle has been violated only in some periods of extraordinary emergency, or at other times in some minor legislation, as for instance in the case of the whisky taxes in Delaware and Kentucky, which conflict to that extent with the national internal revenue

system. But in the main it may be said that the principle of differentiation or segregation of source has been carefully observed.

The introduction of the inheritance tax, even in the modified form of a tax on successions to personal property only, is a serious break with this principle. One of the chief steps in the reform of American finance has been the growth of the inheritance tax as a commonwealth tax, and its development, together with the corporation tax, as a main, or in some cases well-nigh the exclusive, source of commonwealth revenue, thus permitting the other sources of revenue to be relegated to the local divisions. It is true that while a large number of states have recently instituted the collateral inheritance tax, a direct succession tax is found only in the state of New York. But there is very little doubt that the movement, which had received so great an impetus during the past few years would have spread until before long the inheritance tax would have become an important factor in commonwealth finance. The imposition of a federal inheritance tax, while perfectly justifiable in itself, will tend to check this salutary development. It will supply commonwealths with a reason for not adopting the inheritance tax as a source of state revenue. If the inheritance tax is to be a permanent feature of the national law, it will render far more difficult a rounding out and logical arrangement of the entire tax system. It may be said that just as an income tax is far better as a national than as a state tax, because so many complicated questions of domicile and double taxation are avoided, so in the same way, and largely for the same reasons, a federal inheritance tax is preferable to a state inheritance tax. But even if this be true, the advantage is dearly purchased at the cost of an entire reversal in the march of progress towards a consistent and logical revenue system for the entire country. It may be possible to find some method of filling the gap created in the commonwealth tax system. But it seems a pity, to say the least, to check a promising movement when the difficulty of making any changes at all are so great as in the local tax systems of the United States at present.

But all these objections to the income tax sink into insignificance when compared with the fourth and final defect. This is the failure to introduce the principle of stoppage-at-source. To all those acquainted with the history of income taxation it is well known that there are two chief methods of arrangement. The one method, as exemplified in the English income tax, is to split

the income into schedules according to the source from which it is derived, each schedule or set of schedules being assessed separately by different officials. This might be termed the scheduled or stoppage-at-source income tax. The other method is to assess the income as a whole in a lump sum, and to levy the tax directly upon the income receiver, and not, in the first instance, at the source or upon the income payer. This I have elsewhere called the lump-sum tax. England experimented for some time with the latter, only to abandon it as relatively impracticable. In England, as a result of the separation of the tax into schedules, there is no declaration of the entire income in a lump sum. There is no assessment of the whole income by the same official. There is no general attempt to ascertain details from the income receiver. On the contrary, no one has to declare his entire income; no official knows anything of the income of the taxpayer, except in respect to the special schedule with whose administration he is charged. It is the income payer rather than the income receiver who is primarily responsible for the tax. The money is collected, not from the land owner, who may be a non-resident, but from the occupier who pays the rent; not from the mortgagee, whom it might be impracticable to ascertain, but from the mortgagor; not from the clerk who receives the salary, but from the corporation which pays it; not from officers of the government, or annuitants, or investors in government bonds, but from the funds out of which the salaries, annuities, and interest are paid. The profits on the ownership of real estate are assessed locally and primarily on the land, not the land owner. The profits of farming are estimated in a fixed ratio to rent. Municipal and private corporations withhold the tax from the sum payable to secure holders and employees. The agents of foreign and colonial securities, and the bankers through whom profits are received from abroad, are compelled to advance the tax, and deduct it from the sums payable to their clients. In short, instead of being a general income tax, it is in great part a tax or system of taxes on first produce. Instead of being a tax on personal revenue, it has become a tax on net product. It is only in schedule D, which serves as a drag net for the profits which are not reached under the other schedules, that any uncertainty can arise, and here alone is there any room for the inevitable defects of an income tax. But the risk, it will be seen, is reduced to a minimum.

In the new American income tax we find none of these

features, with two exceptions. Corporations deduct the tax from the dividends, and the government deducts the tax from the salaries of public officials. It is true that in two places we find reference made to 'that portion of any salary upon which the employer is required by law to withhold the tax.'[1] Such a requirement in certain cases was originally embodied in the bill, but was struck out. The retention of the two references to the omitted clauses testifies to the careless preparation of the measure.[2]

The new tax therefore substantially follows the lump-sum idea. It would have been comparatively simple to divide the tax into schedules with the stoppage-at-source principle. For instance, the tax on income from real estate might have been levied locally by separate officials, just as the local tax on real property is levied to-day. The tax on the income from mortgages might have been levied by treating the income of the mortgage as part of a real estate, and assessing it primarily on the mortgagor, with provisions for withholding the interest by the mortgagor; and the prohibiting contracts to the contrary by the mortgagee, as is the practice in some of the American commonwealths to-day. The tax on all salaries might have been reported and withheld by the employer. The interest on all corporate bonds might have been withheld by the corporation. And in many other ways the principle of stoppage-at-source might have been introduced.

Instead of this, the American legislators chose to follow the more primitive and discredited methods. The result must inevitably be an immense increase of evasion and under-valuation. With no machinery for checking the returns, and with no trustworthy estimates for gauging the value of the self-assessments, it is unfortunately only too probable that many of the doleful predictions made by the opponents will be verified. It may not indeed be true of the new tax on individual incomes, as it has been said of the state tax on personal property, that it is looked on even by honourable citizens very much in the light of a Sunday-school donation; but it can safely be predicted that the tax on individual incomes will yield exceedingly little as compared with those two features of the law in which the stoppage-at-source idea has been introduced, namely, the tax on

[1] Section 21, parts 1 and 3.

[2] Section 28. Section 33 indeed provides that every corporation which pays to an employee a salary over $4,000 shall report the same. But the law goes on to state that 'said employee' (and not employer) 'shall pay thereon the tax, etc.

public salaries and that on corporate dividends. It is very much to be regretted that Congress should have deliberately refrained from adopting those measures which alone would have made the tax both lucrative and comparatively efficient. The difficulties have been needlessly multiplied; the lessons of experience have gone unheeded; and the income tax itself will be held responsible for what is really not the use but the abuse of the principle.

VI.

From the above review it is evident that the law falls considerably short of being a perfect measure. The enthusiastic hopes of its admirers will fail of realisation. The fraud, which is more or less inseparable from any income tax, will have fuller opportunities because of the defective provisions of the present measure. But it cannot be too often repeated that the Act must be regarded, not by itself, but simply as a part of the entire American revenue system. Even were it to be a permanent measure, it would not by any means suffice as a complete reform of the system of taxation; for the state and local revenues exceed in amount those of the federal government. Even conceding that the income tax is to be regarded as a kind of compensation for the national indirect taxes, the injustice in the actual working of the state and local system would not yet be remedied. No direct income tax can be so administered under present American conditions as to strike the wealthy and unscrupulous in the same proportion as the honest and less well-to-do. And experience has sadly shown that the attempts at tax-dodging increase in a given ratio to the amount of wealth. A direct state income tax has frequently been proposed as a remedy for the present abuses. But a local income tax would have all the disadvantages of a national income tax and none of its advantages. This is, indeed, not the place to outline a practical plan for the reform of American local taxation. But it may confidently be affirmed that the general line of development will lie in the abolition of the tax on personal property, and the substitution in its stead of indirect income taxes, such as those on rentals and on business. In no other way can the opposition of the farmer be overcome. With a state tax on corporations and inheritances, a local tax on real estate, and business licenses and rentals, a comparatively good system will have been found.

Upon the rapidity with which this programme is realised depends entirely the answer to the query whether or not the present income tax is to be permanent. As yet, every one is at sea as to its probable yield. The very loose estimates vary from twelve to forty millions of dollars, and it may, probably will, yield even more. Of course it will take several years before the tax is in full working order. But it must be conceded that the revenue will be a substantial one. Since therefore the new tariff, with the inclusion of the sugar duty and together with the indirect taxes, will about cover expenses, a considerable surplus is to be looked for. Whether the income tax will then be dropped at the expiration of the five years, or whether some change will be made in the tariff, depends so much upon purely political conditions that it is plainly impossible to forecast the future. But even if the income tax should be dropped, the prediction may be hazarded that it will reappear before long. The democratic trend toward justice in taxation cannot be prevented here, as it has been impossible to prevent it in other countries. And while many of us would prefer to see the ideal approached rather by a reform of state and local taxation, than by any change in the principles that govern the federal revenue, the difficulties in the path and the growing interstate jealousies will perhaps make it easier to alter the national than the local systems. In proportion as this is true, the ultimate permanence of the federal income tax, although not perhaps in its actual form, and with its crudities removed, seems to be assured. This is the real importance of the present measure; and this, notwithstanding its inevitable shortcomings, constitutes its undoubted strength. The mass of the people are becoming restless and dissatisfied with the tax system. The reform must be either local or national. In proportion as the former is delayed the latter will be accelerated. But national reform is well nigh impossible without a permanent income tax.

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