Written by Jack Kenny on February 4, 2013

100 Years Ago: Instituting the Income Tax

February: Americans think of Black History Month, Valentine's Day, Lincoln's and Washington's Birthday, and Groundhog Day. But February of 2013 is especially significant, as this month is the 100th anniversary of the ratification of the 16th Amendment empowering Congress to impose the federal income tax. For Americans in 2013, the federal income tax, automatic withholding, the IRS, and filing tax forms by April 15 are just a way of life. In fact, it is likely that most Americans are unaware that prior to 100 years ago, there was no federal income tax, with the exception of a short period when an income tax was used to help finance the Civil War.

Where We Began

Prior to 1913, the U.S. government was much smaller than today, and the taxes it collected through means other than an income tax were sufficient to finance federal government operations. For example, tariffs were placed on imports and excise taxes (similar to our modern sales tax) were placed on the sale of certain items such as horses and carriages, etc. "Indirect" taxes such as these were taxes on consumption rather than income, offering the citizen the option of controlling his tax burden by limiting his purchases. According to Article I, Section 2 of the Constitution, any type of "direct" tax, i.e., on a person directly, which could arguably include a person's income, had to be apportioned among the states on a per-capita basis:

> Representatives and direct taxes shall be apportioned among the several states which may be included in this union, according to their respective number, which shall be determined by adding to the whole Number of free Persons, including those bound to servitude of a Term of Years, and excluding Indians not taxed, three-fifths of all other persons.

So clearly any federal taxes on income would have to be applied uniformly, with each state contributing an amount proportionate to its population. That was the limitation the Constitution placed on direct taxes collected by the federal government. This limitation prevented the U.S. government from making first claim to the wealth of the people, effectively deciding how much income the people would be allowed to keep. On the other hand, as noted above, with the indirect taxes — particularly tariffs — that were the principal means for financing the federal government prior to the advent of the income tax, the people could to a large extent escape or limit the tax via their buying habits, and a government dependent upon tariffs and other indirect taxes for revenue could only raise the taxes so high without defeating the revenue purpose of the tax. Alexander Hamilton in 1787 expressed this eloquently in *The Federalist*, No. 21:

> It is a signal advantage of taxes on articles of consumption, that they contain in their own nature a security against excess. They prescribe their own limit; which cannot be exceeded without

> defeating the end proposed, that is, an extension of the revenue. When applied to this object, the saying is as just as it is witty, that, "in political arithmetic, two and two do not always make four." If duties are too high, they lessen the consumption; the collection is eluded; and the product to the treasury is not so great as when they are confined within proper and moderate bounds. This forms a complete barrier against any material oppression of the citizens by taxes of this class, and is itself a natural limitation of the power of imposing them.

America's early leaders understood the devastating effect taxes could have upon the liberty of a country's citizens. As Supreme Court Chief Justice John Marshall wrote in the 1819 case *McCulloch v. Maryland*, "The power to tax is the power to destroy."

Enter Karl Marx

In 1848, Karl Marx declared in his *Communist Manifesto* that a progressive tax on personal income was one of the 10 essential measures to ensure a communist revolution in an advanced country in order to bring about his fabled "classless society." Socialist and communist ideas gained momentum in many parts of Europe, and it wasn't long before they reached America. Various attempts to impose a progressive federal income tax — making the rich pay a higher percentage than the poor — soon appeared in this country. The Revenue Act of 1861 was a federal income tax used to raise revenue to fund the Civil War. It was a flat tax of three percent on annual income above $800. The following year, this was replaced with a graduated (progressive) tax from three to five percent on income above $600 in the Revenue Act of 1862, which ended in 1866.

Even these temporary income taxes were unconstitutional, as they were a percentage of income rather than being apportioned. But the movement to impose a progressive federal income tax didn't stop. The Socialist Labor Party advocated a graduated income tax in 1887, and the Populist Party demanded the same in its 1892 platform. The Populist Party, led by central-bank proponent William Jennings Bryan, advocated the income-tax law passed by a Democratic-led Congress in 1894. This was the first peacetime income tax, with a rate of two percent on income over $4,000, an amount that few people made in those days. The following year (1895) the Supreme Court ruled this tax unconstitutional in *Pollock v. Farmers' Loan and Trust Company.*

In order to enact a progressive federal income tax in America — a socialist idea — the citizens and the legislature had to be convinced that it was in the best interest of the people. This was not overly difficult considering the prevailing political ideas of the time. The year 1913 was part of the Progressive era in our nation's history. Populists and Progressives (essentially socialists) feared the concentration of wealth and power into a few private hands, a concern that eclipsed the earlier fear of the Founders of too much wealth and power concentrated in the hands of a central government. Even before Teddy Roosevelt's "Progressive Party" of the 1912 election, there were progressives in both the Republican and Democratic Party who ostensibly wanted to put more power into the hands of the people, acting through their representative government, by taking it away from the "robber barons" and other "malefactors of great wealth." For by this point in time, vast fortunes had been amassed by the titans of industry, such as the Rockefellers, Carnegies, and Vanderbilts. Wealth and power were being concentrated into the hands of fewer and fewer people at the top. This offered a perfect excuse to institute a progressive tax with the idea that it would "soak the rich."

Interestingly, the progressive income tax was originally backed strongly *by the rich themselves*. Senator Nelson Aldrich of Rhode Island, for example, a man widely known to be John D. Rockefeller's "inside man" in the Senate, was a principal proponent of a federal progressive income tax made legal by an amendment to the constitution. This is not surprising, for although the “progressives” who championed the income tax claimed that it would be a tax on the rich and that it would help the little guy, in reality it was largely a tax on the middle class. This is mainly because the wealthy, through the use of trusts and tax-exempt foundations, are able to escape much of their tax burden yet still have great influence and power over business, banking, and government. There was a significant difference between the propaganda and the reality; the populism championed by the progressives and populists was not the “share the wealth” program they portrayed it to be, but a control-the-wealth program. Under the guise of helping the little guy, the elites worked hard to implement an income tax. In keeping with the ideology of its primary backers, the new income tax was to be a “progressive” tax — one in which the tax rate increases as the taxable base income increases.

Omniscient Observers?

Senator Norris Brown of Nebraska first proposed an income-tax amendment to the Constitution with Senate Resolutions 25 and 39. The amendment proposal finally accepted was Senate Joint Resolution 40, introduced by Senator Nelson Aldrich, the Senate majority leader and Finance Committee chairman:

> ARTICLE XVI: The Congress shall have power to lay and collect taxes on income, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

On July 12, 1909, the resolution proposing the 16th Amendment was passed by the 61st Congress and was submitted to the state legislatures. Not all states were initially in favor of an amendment, however. Many knew the imposition of the income tax would mean the rise of a federal revenue bureaucracy that extended from Washington, D.C., throughout the country and into the personal and business transactions of every American and every business. Private transactions would no longer be private; government would be able to monitor what everyone was doing. Richard E. Byrd, speaker of the Virginia House of Delegates, voiced his concerns on March 3, 1910, during the debate on whether to ratify the 16th Amendment:

> It means that the state must give up a legitimate and long established source of revenue and yield it to the Federal government.

It means that the state actually invited the Federal government to invade its territory, to oust its jurisdiction and to establish Federal dominion within the innermost citadel of reserved rights of the Commonwealth.

This amendment will do what even the 14th and 15th Amendments did not do — it will extend the Federal power so as to reach the citizens in the ordinary business of life. A hand from Washington will be stretched out and placed upon every man’s business; the eye of a Federal inspector will be in every man’s counting house.

The law will of necessity have inquisitorial features, it will provide penalties. It will create a complicated machinery.

Under it, businessmen will be hauled into courts distant from their homes. Heavy fines, imposed by distant and unfamiliar tribunals, will constantly menace the taxpayer. An army of Federal inspectors, spies and detectives will descend upon the state. They will compel men of business to show their books and disclose the secrets of their affairs. They will dictate forms of bookkeeping. They will require statements and affidavits. On the one hand the inspector can blackmail the taxpayer and on the other, he can profit by selling his secret to his competitor.

When the Federal government gets a strangle hold on the individual businessman, state lines will exist nowhere but on the maps. Its agents will everywhere supervise the commercial life of the states.... I am not willing by any voluntary act to give up revenue which the State of Virginia herself needs, nor to surrender that measure of state's rights which was, and the construction of the Federal courts have permitted to remain.

In 1910, New York Governor Charles Evans Hughes opposed the income-tax amendment. While he supported the idea of a federal income tax, Hughes believed the words "from whatever source derived" in the proposed amendment implied that the federal government would have the power to tax state and municipal bonds. He believed this would excessively centralize governmental power and "would make it impossible for the state to keep any property." Support for the amendment did not relent, however. All three candidates in the 1912 presidential election — Progressive, or "Bull Moose candidate" Teddy Roosevelt, Republican William Howard Taft, and Democrat Woodrow Wilson — supported the tax. The ratification was complete on February 3, 1913. The Revenue Act of 1913 was enacted shortly thereafter to impose a new progressive tax, but it was a far cry from the tax burden Americans face today. Annual income below $20,000 (or about $460,000 in 2012) was taxed at one percent with an exemption of $3,000 (or nearly $70,000 in 2012); many Americans effectively paid no federal income tax. A "super tax" was instituted to really soak the rich, with an additional one-percent tax on successive income brackets over $20,000 up to $500,000. Thus, an individual earning $500,000 (nearly $11.6 million in 2012) would effectively pay a seven-percent federal income tax.

"Progressive" Purpose

While certainly not oppressive when compared to today's income-tax schedule, the new federal income tax represented a radical departure from the type of government Americans had lived under prior to the income tax. It gave the federal government access to potentially huge amounts of revenue that the government could then tap to finance various programs, very much including unconstitutional programs. Of course, even with increased funds available via the income tax, spending money on unconstitutional programs is still unconstitutional, but with the federal government now possessing the means to siphon vast streams of money out of the pockets of the American people into the coffers in Washington, the temptation to tap this resource to empower Washington was clearly too great to resist. The transfer of revenue and power to Washington not only strengthened Washington but also weakened the states, which themselves are republics (not provinces) in our federal system of government and possess powers not transferred to the national government by the U.S. Constitution. The very fact that the income tax now imposed on the American people is a *progressive* tax means the tax serves the purpose not only of providing the U.S. government with a powerful means of obtaining revenue, but also enables the government to redistribute the wealth. And with the creation of a *de facto* central bank (the Federal Reserve), also in 1913, the federal government has been essentially freed from budgetary restraints, since it can now simply print money to cover operating expenses if revenue is insufficient.

In 1946, Beardsley Ruml, then chairman of the Federal Reserve Bank of New York, wrote an article in *American Affairs* in which he explained the real function of the income tax. The article was entitled, interestingly, "Taxes for Revenue Are Obsolete." Ruml theorized that with the Federal Reserve, an institution and mechanism were in place to provide the federal government with a constant and virtually unlimited flow of dollars. That, of course, is inflationary, so Ruml believed that income taxes served the purpose of dampening inflation by lowering demand, a measure achieved by reducing the purchasing power of the masses by taking money out of their paychecks.

That was but one purpose of taxation, according to Ruml. The other was the redistribution of wealth from one class of citizens to another. Though done under the banner of social justice and equality, the real purpose was to supplant the decisions of a free people in a free market with the rule of the masters of a planned economy. As Ruml put it in his own words:

> The second principal purpose of federal taxes is to attain more equality of wealth and of income than would result from economic forces working alone. The taxes which are effective for this purpose are the progressive individual income tax, the progressive estate tax, and the gift tax. What these taxes should be depends on public policy with respect to the distribution of wealth and of income. These taxes should be defended and attacked in terms of their effect on the character of American life, not as revenue measures.

For a while the populist pipe dream of taxing the rich seemed a reality, but soon the true socialist agenda of eliminating the bourgeois middle class became evident. By 1920, only 12 percent of the adult population paid an income tax. By 1940, that percentage had doubled. In 1942, the "temporary measure" of automatic withholding was instituted but never ended. Withholding gives the federal government the first crack at everyone's income. The government now takes what it wants and needs for its many projects, most of them unconstitutional, and leaves the income earner the rest. By 1960, more than two-thirds of American adults were paying the income tax, with most of it withheld from every paycheck. By the 1980s, estimates were that 75 to 80 percent of the nation's adults were paying the tax and that taxes on incomes amounted to 25 percent of all earnings, with taxes from all sources — federal, state, and local — moving above the one-third mark. Though the first graduated income tax hit very high earners at only seven percent, by 1921, the effective top rate had been pushed to 73 percent for those earning over $1 million. The 1954 Tax Code contained 24 brackets beginning with a rate of 20 percent for income under $2,000 (about $17,000 in 2012) and ending with a ridiculous 91 percent on income over $200,000 (about $1.7 million in 2012). The tax rates have been subsequently lowered several times since then, but still remain oppressively high compared to what they were in 1913.

Fear the Feds

What the income tax has done to economic, social, and personal freedom in the United States is remarkable. Investigating, targeting, and auditing of individuals, many times as reprisals for public statements or political activity unwelcome by those in power, has become a staple of American social and political life. For instance, the right to privacy has had a big hole blown in it, and the power of bureaucracy has been expanded enormously. Many Americans live in fear of a tax audit, and the tyranny and terror of the IRS in some instances approaches that of the former Soviet KGB. Governments should live in fear of the people, not the other way around. That may have been the case in America at the end of the 18th century when the Constitution was adopted, but it is surely not the case now.

With a strong central government empowered by a federal income tax, American society of today would be nearly unrecognizable to those living and working before 1913. The recipients of government aid or wealth redistribution have become increasingly dependent on government. And the war machine, fueled by both the income tax and the Federal Reserve, has made the U.S. government feared throughout the world. The redistribution of wealth has even been made international through foreign economic and military aid, all paid for courtesy of the U.S. taxpayer. By the end of World War II, the master planners had created not only the United Nations, NATO, and other entangling alliances, but the World Bank and the International Monetary Fund, all useful for placing the people's money at the disposal of the master class that would use it to further their rule in the political, social, and economic life of the world. They have strong allies in the institutions that are supposed to buttress and expand the liberty and the welfare of the American people, from schools and other government institutions, to the news media and institutions of higher learning, both public and private. The greatest allies are the twin evils of ignorance and apathy.

Americans need to be made aware of the fact that the concept of a federal progressive income tax is based upon unconstitutional principles foreign to our early republican form of a limited central government with strong protections on states' rights and individual liberties. The fact that the 16th Amendment was added to the Constitution does not change those principles. The 16th Amendment must be repealed and the federal government limited to its constitutional powers for freedom to return to our Republic. The only way that this can happen is if Americans know the issues, and elect constitutionally-minded legislators. The strongest defense against institutionalized tyranny remains an educated and aroused American people.

Photo: Group of people filling out tax forms in Internal Revenue office