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By Charles W. Smith

I

Taxation is indeed a prosaic subject. There is nothing in it to stir the imagination to poetic heights, to fill the fancy with dreams and visions, or to inspire the emotions with feelings sublime, for no one was ever known to go into ecstasy over the payment of his taxes. The subject is devoid of romance; it is cold and sometimes cold-blooded. It lacks the appeal of human-interest topics; it is, in other words, a part of economics.

The science of economics is generally divided into five classifications or headings, viz., consumption, production, distribution, exchange and public finance. Public finance, in turn, is divisible into two broad sections, public expenditure and public revenue, treated in the order named from the time of the publication of Adam Smith's *Wealth of Nations*, the first genuine treatise on economics. Governments, unlike business institutions, look first to what they deem it advisable to spend and only then to the means of procuring sufficient revenue to cover the proposed expenditures.

The sources of government revenues are varied, but the chief sources are taxes, fees, commercial revenues (such as water rents), gifts, fines and penalties. Taxes are by far the most important item and probably in the last decade have provoked more sweating, more profanity, more suffering and yet more prosperity in the accounting profession than any other single phase of economics ever caused that profession. But without the aid of taxation there would probably be no accounting profession, for there would probably be no governments. "Taxes," says Cicero, "are the sinews of the Commonwealth." Commercial intercourse within nations and on the seven seas could not be conducted in an orderly manner—in fact, all of the benefits of established government would not have come into existence—were it not for what has been termed this "potent engine." Civilization and taxation seem to go hand in hand. The former refuses to advance without the latter. So if we are to be civilized it seems we must pay for it. "Taxes and gruel," says a Hindu proverb, "continually grow

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thicker." And we are given a doleful reminder by Dickens that there is nothing certain but death and taxes.

No genuinely comprehensive definition of the word "taxation" seems available. None is needed. We all have felt the meaning better than it can be expressed. The idea of compulsion, however, pervades the word and is its chief characteristic. Dr. Ely says " . . . taxes are one-sided transfers of economic goods or services" and this agrees with Professor Taussig's statement that "there is no quid pro quo." The fact that there is no quid pro quo is probably the psychology back of Emerson's assertion that " . . . of all debts, men are least willing to pay the taxes. . . . Everywhere they think they get their money's worth except for these."

The economic aspects of taxation are probably few in number, but so deep, complex and involved as to have attracted some of the profoundest thinkers. The views and conclusions of authorities are not always in agreement and it is not to be expected that one of my humble attainments could arrive at solutions that would be worthwhile. Consequently, I shall content myself with reviewing the recognized principles of taxation, without any attempt at valuation.

First, there are two theoretical explanations of the justification of taxation. One is the benefit theory and the other the faculty theory. The benefit theory was the first to be advanced by statesmen and economists and holds that the tax should be levied according to the benefit conferred by the sovereign state. This does not mean that the tax should be assessed in equal proportion for it was considered that some individuals, men of wealth, receive larger benefits than others and should bear a larger share of the tax burden. But the relative benefit of human life defies measurement and as the protection of life is the first function of government, it follows that the benefit theory had to give way. With changes in the social order, the benefit theory was succeeded by the faculty theory. This theory holds that a tax should be levied not according to the benefits conferred, but according to the ability, or faculty, to pay. There have been three criterions of faculty: wealth, expenditures and income. The faculty theory is the one currently accepted and gives the ethical basis of the income-tax laws especially.

While the faculty theory is regarded as of more recent application, nevertheless its principle is old. Reference to such a basis is made in the "Laws of Manu," Manu being a divine character in

Hindu mythology. This code, which is said to be the highest authority in Indian law courts today, was probably written around the twelfth century B. C. Manu's maxim was, in part, ". . . to make the burden of taxes equal, it should be made to press with equal severity upon every individual. This is not effected by a mere numerical proportion. The man who is taxed to the amount of one tenth . . . of an income of 100 rupees per annum, is taxed far more severely than the man who is taxed an equal proportion of an income of 1,000 rupees." In other words, taxes, to be equitable, should be proportional to the faculty, or ability, to pay.

We next come to the consideration of the principles, or canons as they are called, of a good tax measure. There has been very little improvement on the canons which Adam Smith enunciated in his *Wealth of Nations*, published in 1776. These canons are: (1) equality; that is, the subjects of every state should contribute toward the government as nearly as possible in proportion to their respective abilities; (2) certainty, which means that the tax each individual is bound to pay should be certain and not arbitrary; (3) convenience; every tax ought to be levied at the time or in the manner which is most convenient for the contributor; and (4) economy; that is, the cost, etc., of collecting the revenue should not be large. Add to these one more maxim—elasticity, or the quality of being able to yield large revenues with slight basic changes—and you have what are today considered to be the main canons of taxation.

Another feature of taxation which has caused considerable controversy is direct versus indirect taxation. Without going into the controversy at all, and without attempting to portray the earlier meaning of these terms, suffice it to say that direct taxes are those which are levied with the intention of having them borne by the contributors, whereas indirect taxes are those that are levied in the belief that they will be shifted. Income taxes and property taxes are direct; customs duties and excise taxes indirect.

Taxes are either proportional, progressive or regressive. If the rate is stationary, the tax is proportional; if the rate increases with the increase in wealth, income or other faculty, the tax is progressive; and if the rate decreases with increases in the faculty, the tax is regressive.

Finally, we come to the incidence of taxation, or, in other words, who ultimately pays any tax. This, too, is a moot question and involves severe economic reasoning. We all know that some taxes are shifted, but which are shifted and how much and to whom are questions the answers to which are not within the scope of this paper. It might be said, in passing, that the income taxes are generally borne by the contributors and the excise taxes borne by the consumers, but further than this it is not safe to go.

Thus, to summarize, the chief economic aspects of taxation are five in number: the theories of justification (benefit and faculty); the canons of a good tax measure (equality, certainty, convenience, economy and elasticity); proportional, progressive or regressive taxation; the direct versus the indirect tax; and the incidence of taxation.

II

We now turn to the historical aspects of taxation. In the earliest times there was, of course, no taxation. Each individual was a sovereign unto himself—there was no state and, therefore, no need for public revenue. With the development of individualism into a social order states came into existence and with the states came some sort of public expenditure. The needs of the first states were probably supplied by contributions of labor and later by contributions of labor and property. When states went to war in such a condition of society, the soldiery fitted out themselves and depended upon plunder to keep them going. We are told that the great Socrates, because of the condition of his purse, went to war with poor accoutrements, but that he returned as well equipped as any.

Tribute collected from conquered peoples furnished a large part of the public income of successful states in the B. C. era and slaves performed the public labor.

With the development of commerce, coinage came into existence and the right of coinage provided the sovereign with revenue. Then we have escheat, the reversion of property to the crown, confiscation of property for various causes and the right to wrecks, as means of increasing the public purse.

We know that both Athens and Rome had property taxes before the end of their cultured and glorious days, but during the so-called dark ages this method of deriving revenue apparently was not employed.

In feudal times, no genuine tax systems were in effect. In legal theory the lands belonged to the king, but they were in the possession of feudal lords and we know that only a small part of the produce of lands was enjoyed by the vassals. The vassals, as a condition to their land tenure, also owed military service to their lieges so that between the produce of land and military service of his knights and their vassals, the king was enabled to meet the expense of his office. When the nature of the economic fabric of feudal times is understood, it can readily be seen that direct and indirect taxation would have been of no avail for there was, broadly speaking, no private property. However, the king had certain aids which helped fill his coffers. Stephen Dowell says the rolls of the exchequer show the following revenues to have been collected: "Robert Bardolph fines for pardon of the king's ill-will in the matter of the daughter of Geldewin de Doll. The Bishop of Winchester owes a tonnel of good wine for not reminding the king about a girdle for the Countess of Albemarle. Robert de Vaux fines in five of the best palfreys that the king would hold his tongue about the wife of Henry Pinel."

With the breaking up of the feudal system and the emergence of monarchical governments, numerous fees and charges were inaugurated and then, as governments became more firmly established and the right to tax was conceded by the taxed, indirect and, later, direct taxation came into prominent use. Direct taxation was the last method tried. From the earliest times, it was considered a disgrace for freemen to be taxed directly and it has taken centuries for direct taxation to overcome this prejudice. Direct taxation seems to have advanced as governments became more democratic and the explanation of this probably lies in the fact that in democracies the individual is directly concerned with the conduct of government and therefore feels an ethical obligation to support the government directly.

The development of the direct-tax systems culminated in the greatest of all tax schemes—the scheme with which we are all familiar—the income tax. A great many of us like to think of the income-tax scheme as of comparatively recent origin, but a little delving into the history of taxation shows this conclusion to be totally untenable. The date of the first income-tax law will probably never be determined to the satisfaction of all. Some writers say income taxes were collected in the B. C. period, but a study of some of the references discloses the taxes to have been on gross, instead of net, income, particularly taxes in kind, such as the tithes. According to Professor Seligman, the first income-tax law was adopted by the Florentines in 1451, 41 years before Columbus sailed from Palos. This was a straight percentage tax at first, but later a graduated or progressive tax.

The real precursor of our own income-tax statutes, however, was the act passed by England in 1799. Some of the provisions of that act justify consideration. Incomes of less than £60 were exempt; incomes from £60 to £200 were subject to progressive rates beginning with five sixths of one per cent. and incomes over £200 were subject to a straight tax of 10 per cent. Income of residents of England was taxed regardless of its geographic source and income from securities issued by the sovereign government was nontaxable. Returns were required from all taxpayers. Merchants filed their returns with "commercial commissioners" who were reputed skilled in determining the income of such taxpayers. Thus the modern revenue agent is not a new creature, or monster, if you prefer, after all. Regulations, too, were issued, under the pretentious caption of "A plain short, and easy Description of the different clauses of the Income Tax so as to render it familiar to the meanest capacity." How badly the writer of these regulations was needed in 1917! Credits were allowed for children, the amount of the credit varying with the size of the income. The tax was payable in instalments. The return, like the returns we know today, listed first the items of income and then the items of deduction. The yield for 1799 was a little more than £6,000,000.

Passing over the attempts of other European countries to use an income tax, omitting a discussion of the faculty taxes of the colonies, which some have confused with income taxes, and leaving out of consideration the state income tax-laws in the first half of the nineteenth century (including the income-tax law of Maryland in 1841) we come to the first federal income-tax statute. The first income-tax law passed by the federal government was in August of 1861, but this was amended before going into effect by the law of 1862. The act of 1862 was amended almost every year until 1870 and ceased to be a law in 1872. The tax was levied on individuals alone, separate taxes being levied against corporations. The rates varied in different years. Part of the time incomes from $600 to $5,000 were taxed at 5 per cent. while those over $5,000 were taxed at 10 per cent. Profit on the sale of real estate purchased more than two years previous was considered to be a capital transaction which resulted in no taxable income, under at least one of the acts. Depreciation apparently was not allowed.

The returns were not secret and in 1865 the taxpayers and their respective taxes were published by many of the leading newspapers. This feature provoked a discussion similar to that we experienced a few years ago when the publicity feature was in effect.

In 1894 another income-tax statute was passed. This tax applied to corporations as well as individuals and provided, inter alia, a 2 per cent. tax on individual incomes in excess of $4,000. The constitutionality of this law was tested in court, with the taxpayers' side represented by a grand array of celebrated counsel. The supreme court handed down a decision, by a five-to-four vote, that the tax was a direct tax and therefore unconstitutional. It will be recalled that paragraph 4 of section 9 of article I of the constitution provides that "No capitation, or other direct tax shall be laid, unless in proportion to the census or enumeration hereinbefore directed to be taken."

In 1909 congress passed a joint resolution providing for the sixteenth amendment (the income-tax amendment) to the constitution. The amendment was ratified on February 28, 1913, thus giving rise to that horde of cases involving valuations, etc., as of March 1, 1913. The rest is very modern history—contemporaneous history. We know that an excise tax was levied on corporations in 1909, that income-tax laws were passed in 1913, 1916, 1917, 1919—the others are so well known that I will not run the risk of mentioning them.

A word about the revenues yielded by the different acts. The largest amount yielded by the Civil War acts in any single year was in 1866 when $73,000,000 (round figures) was collected. In the fiscal year 1914, $60,700,000 was collected; 1916, $124,900,000; 1917, $359,700,000; 1918, $2,800,000,000; 1919, $2,600,000,000; 1920, $3,900,000,000; 1921, $3,200,000,000; 1926, $1,900,000,000; 1927, $2,200,000,000.

Thus the famous "billion dollar congress" of 1890 (the first congress to appropriate a billion dollars) is shadowed into insignificance. Wars, of course, take their heavy toll of taxes. It was probably a study of war revenues that led Southey to write:

> "Satan gave thereat his tail
> A twirl of admiration;
> For he thought of his daughter War
> And her suckling babe Taxation."