The Income Tax Amendment: Most Thought It Was a Great Idea in 1913

. . . in this world nothing can be said to be certain, except death and taxes.
—Benjamin Franklin (1706–1790)

In 1913, the 16th Amendment to the U.S. Constitution was ratified. It allowed the federal government to levy an income tax. Most people at the time thought an income tax was a great idea.

Before 1913, federal government revenues came mainly from taxes on goods—tariffs on imported products and excise taxes on items like whiskey. The burden of these taxes fell heavily on working Americans, who spent a much higher percentage of their income on goods than rich people did. When a tax takes a larger percentage of a poor person's income than a rich person's income, economists refer to it as "regressive." But in 1913 when Congress passed an income tax law after the ratification of the 16th Amendment, the tax burden shifted to the rich—at least for a while.

Roots of the Income Tax

Although an income tax was proposed as early as 1812, Congress did not enact one until 1861, when the Civil War began. The enormous costs of waging war had plunged the Union into debt ($75 million in 1861) forcing Congress to seek a new source of revenue.

When the Union debt reached $500 million in 1862, Congress next passed the nation's first graduated income tax. Those with an annual income between $600 and $10,000 were taxed at the rate of 3 percent while those earning over $10,000 paid 5 percent. Thus, individuals with more ability to pay were taxed at a higher rate. This graduated tax structure is often called a "progressive" tax.

During the war, Congress raised the tax rates. After the war, however, Congress reduced income tax rates and then finally abandoned the income tax altogether in 1872. The federal government once again depended on "regressive" tariff duties and excise taxes as its chief sources of revenue.

Several attempts were made in Congress over the next 20 years to restore the "progressive" income tax. Support came largely from Southern and Midwestern populists who attacked the wealthy for flaunting their millions by building mansions and spending extravagantly while barely paying any taxes at all.

The election of 1892 produced a Democratic president (Grover Cleveland) along with Democratic control of both houses of Congress. This ended the long reign of the Republicans who had opposed restoring the income tax. In 1894, the Democrats succeeded in passing a 2-percent income tax on those earning $4,000 or more a year, less than 1 percent of the population at the time. Unlike the Civil War income tax, this one was not graduated. Everyone with an income over $4,000 paid the same 2-percent tax rate. This type of income tax is sometimes called a "flat tax."

Opponents of the new income tax claimed that it was a socialistic confiscation of wealth by the federal government. Barely a year after it was enacted, the Supreme Court declared the tax unconstitutional. In a 5-4 ruling, the high court decided that the income tax was forbidden by Article I, Section 9, of the Constitution. This prohibits direct taxes on individuals unless apportioned on the basis of the population of each state. The majority of justices ruled against the 1894 tax law even though the Supreme Court had earlier upheld the similar Civil War income tax. [Pollock v. Farmer's Loan and Trust Co. (158 U.S. 601 (1895).]

The Income Tax Amendment

As the progressive reform movement began to gain strength at the turn of the century, interest in the income tax revived. One of the supporters of the income tax was Cordell Hull, a Democratic congressman from a poor rural district in Tennessee. Hull (who later became President Franklin D. Roosevelt's secretary of state) put together a coalition of progressive Democrats and Republicans. They tried to attach income tax bills to tariff legislation making it more difficult to pass. Most Americans disliked tariffs since they drove up the price of many goods.

In 1909, Hull worked out a deal with the Republican president, William Howard Taft. Hull and his allies promised not to stall the passage of tariff laws, while Taft came out in favor of a corporation tax and a constitutional amendment authorizing Congress to enact a federal income tax.

A constitutional amendment was necessary because the Supreme Court had struck down the earlier income tax as unconstitutional. But the process of amending the Constitution made this difficult. First, the income tax amendment would have to pass both houses of Congress by two-thirds majorities. Then, three-fourths of the state legislatures would have to ratify it. Only after ratification would Congress have the clear power to pass an income tax law.

At first, few thought the income tax amendment had much of a chance surviving a vote in Congress. But the unpopularity of high tariffs eased the amendment through both the Senate and the House. In just a few days during the summer of 1909, the proposed 16th Amendment was approved by the Senate (77-0) and the House (318-14).

Thirty-six state legislatures had to ratify the 16th Amendment before it could go into effect. The public and most newspapers seemed to favor it. The main argument for ratification was that the amendment would force the wealthy to take on a fairer share of the federal tax burden that had in the past been largely carried by those earning relatively little. Only a few critics spoke out forcefully against the amendment. John D. Rockefeller, one of the country's richest men, stated: "When a man has accumulated a sum of money within the law. . . the people no longer have any right to share in the earnings resulting from the accumulation."

Ratification moved slowly but steadily through the state legislatures. Some of the states had already passed income tax laws of their own in seeking new ways to finance public schools and other social needs. Surprisingly, the income tax amendment drew widespread support in cities and in rural areas alike, from both Democrats and Republicans, and in all geographical regions. Even New York ratified the amendment despite the state's reputation as the capital of "money power" with numerous millionaires among its residents (including John D. Rockefeller). By early 1913, 42 states (six more than needed) had ratified the income tax amendment. Only six states rejected it.

"The Fairest and Cheapest of All Taxes"

Rep. Cordell Hull introduced the first income tax law under the newly adopted Sixteenth Amendment. He proposed a graduated tax starting with a 1-percent rate for incomes between $4,000 and $20,000 increasing to a top rate of 3 percent for those earning $50,000 or more. The House Ways and Means Committee called upon citizens to "cheerfully support and sustain this, the fairest and cheapest of all taxes. . . ."

The first tax collection day under the new law took place on March 1, 1914. Since the average worker earned only about $800 a year, few people actually had to pay any federal income tax. Less than 4 percent of American families made an annual income of $3,000 or more. Deductions and exemptions further shrank the pool of taxpayers. Nevertheless, the federal government collected $71 million that first year. Millionaire John D. Rockefeller alone paid an estimated $2 million.

All in all, most Americans thought the new tax was a great idea. One taxpayer wrote to the Bureau of Internal Revenue, "I have purposely left out some deductions I could claim, in order to have the privilege and the pleasure of paying at least a small income tax. . . ."

Abolish the Income Tax As We Know It?

A few years after the income tax amendment was ratified, the United States entered World War I. As in the Civil War, Congress turned to the income tax to quickly raise large amounts of revenue. In 1917, Congress lowered the standard exemption to $1,000 for individuals thus expanding the taxpayer pool. At the same time, the lawmakers increased the base tax rate from 1 percent to 2 percent. Those earning over $1 million were taxed at the unheard of rate of 50 percent (this rose to 77 percent by the end of the war).

With the income tax increases, federal receipts climbed from under $1 billion in 1917 to nearly $4 billion in 1918. At war's end, about 60 percent of federal tax money came from the income tax. It replaced tariff duties and excise taxes as the main source of revenue for the U.S. government. Tax rates were reduced after the war. But Congress had discovered how easy it was to pump enormous amounts of money into the U.S. treasury.

Today, more than 80 years after the ratification of the 16th Amendment, the income tax has changed dramatically. Unlike 1913, most Americans today must pay some federal income tax. Instead of the $71 million collected in 1913, the federal government currently collects over $500 billion in income taxes each year (plus another $117.5 billion from corporations). The 15-page tax code has expanded to more than 1,000 pages. And today, more people grumble about paying income taxes.

Some critics call for replacing the complicated graduated income tax with a much simpler "flat tax." Others want to abolish the federal income tax entirely in favor of a form of national sales tax. But the fundamental question is the same today as it was in 1913: What is the best way to tax Americans?

For Discussion and Writing

1. Why do you think the income tax was much more popular in 1913 than it is today?
2. What part has the 16th Amendment played in the expansion of the federal government in the 20th century?
3. What is the difference between a "regressive" and a "progressive" tax?
4. Which of the following income taxes—a, b, or c—do you think is the most fair? Explain your answer.

    a. everyone pays the same amount, e.g. $5,000.

    b. everyone pays a flat rate, e.g. 15 percent.

    c. everyone pays a progressive rate, e.g. $1–20,000 = 5 percent, $20,001–100,000 = 15 percent, $100,000 and up = 25 percent.

A C T I V I T Y

What is the Best Tax System?

Outlined below are three different ways to tax Americans in order to finance the federal government. For the purposes of this activity, assume that each would be the only federal tax in place and that each would produce an equal amount of revenue. Form small groups to evaluate the advantages and disadvantages of all three types of taxes. After doing this, each group should decide which tax system is the best and report its conclusion, with reasons, to the rest of the class.

In evaluating the three taxes, consider the following criteria: "progressivity" vs. "regressivity," simplicity vs. complexity, effect on consumer prices, and overall fairness.

Graduated Income Tax

Income tax reporting forms, exemptions, deductions, and regulations have grown increasingly complicated since 1913. Under the existing graduated income tax, those with higher incomes pay higher tax rates.

ADVANTAGES:

DISADVANTAGES:

Flat Tax

A flat-tax proposal by economists Robert E. Hall and Alvin Rabushka of Stanford University's Hoover Institution would establish a single income tax rate of 19 percent for all individuals regardless of what they earn. No tax would be paid on the first $25,000 earned by a family of four. But virtually all deductions, including mortgage interest, would be eliminated. Tax returns would be completed on a simple single-page form easily processed by the IRS.

ADVANTAGES:

DISADVANTAGES:

Value Added Tax

Most European countries raise substantial amounts of revenue with a value added tax (VAT). This is a form of national sales tax collected by the government at every stage that a good is produced and distributed. Manufacturers and businesses add the cost of the tax to the price that the consumer finally pays. Some European countries have a VAT rate of nearly 40 percent. To equal federal revenue now raised by the graduated income tax, the United States would have to have a VAT rate of at least 25 percent. This would show up in substantially higher consumer prices, although some products like basic food items could be exempted or taxed at lower rates. While collecting the VAT from manufacturers and businesses would probably expand the IRS bureaucracy, individuals would have no annual tax returns to file or income tax to pay.

ADVANTAGES:

DISADVANTAGES: