THE PROPOSAL TO REDUCE HIGH SURTAXES

II. THE CASE AGAINST REDUCTION

HAROLD M. GROVES

"Cut taxes and balance the budget" might seem to be a paradoxical program but it has sober proponents at the present time. Particularly it is said that 79% on what an individual makes in excess of $5,000,000 is too high a tax in the United States, 1940.

Are millionaires exploited by the tax system? Is it after all the ultra-rich who are underprivileged? Not a few would answer these questions affirmatively. These questions have to do with that vague concept called justice which means a great deal in taxation but often means different things to different people.

It will probably be granted that the present period is an emergency. To be sure it is a very prolonged emergency. We have been through an era of intense economic strain; even now there are some eight or nine million unemployed. Half of the world is at war and our own safety is considerably threatened. In times of emer-

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2 In this article the author attempts to state the case for retaining the present high surtaxes on high incomes. He does not attempt to present the other side of this matter because that role has been assigned to another writer. He admits that there are two sides.

3 Federal surtax rates begin at 4% on net income above $4,000 and not exceeding $6,000; they rise gradually through the brackets up to $14,000; then more rapidly, reaching 51% on income in the bracket from $80,000 to $90,000, 60% on the bracket from $150,000 to $200,000, and 75% on income in excess of $5,000,000. In addition a normal tax of 4% is levied.

In several respects these schedules are not as severe as they appear. The rate schedules apply to portions of income falling within the stated brackets and not to income as a whole. Actual effective rates on taxable income are reported by the Federal Administration as follows:

<table>
<thead>
<tr>
<th>Income Bracket</th>
<th>Actual Effective Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>$350,000 - 300,000</td>
<td>52.87%</td>
</tr>
<tr>
<td>$300,000 - 400,000</td>
<td>56.18%</td>
</tr>
<tr>
<td>$400,000 - 500,000</td>
<td>59.38%</td>
</tr>
<tr>
<td>$500,000 - 720,000</td>
<td>63.29%</td>
</tr>
<tr>
<td>$720,000 - 1,000,000</td>
<td>66.86%</td>
</tr>
<tr>
<td>$1,000,000 - 1,500,000</td>
<td>69.54%</td>
</tr>
<tr>
<td>$1,500,000 - 2,000,000</td>
<td>71.67%</td>
</tr>
<tr>
<td>$2,000,000 - 3,000,000</td>
<td>73.08%</td>
</tr>
<tr>
<td>$3,000,000 and over</td>
<td>75.85%</td>
</tr>
</tbody>
</table>

U. S. BUREAU OF INTERNAL REVENUE, STATISTICS OF INCOME FOR 1937, PRELIMINARY REPORT OF INDIVIDUAL INCOME TAX RETURNS FILED IN PERIOD JANUARY THROUGH AUGUST, 1938 (1939) 4-5.

The figures make no allowance for income not taxed.

About two thirds of the states have state income tax laws with tax rates usually confined to a maximum of 6% but in some cases rising to as high as 15%. State income taxes often allow the deduction of state and federal income taxes paid in the previous year as an expense to be subtracted from the current year's income.
ergency, the nation like the family should be entitled to draw upon all the resources of its members. Some may be expected to encounter high danger and great discomfort when they are called upon to man the nation's defenses in war. Others may make hardly less sacrifices when they are confronted with forced unemployment and perhaps the indignities of the relief system. These are real burdens. They have no tax equivalents, not even in figures which run to seven digits. But the most conspicuous beneficiaries of established institutions can be expected at least to contribute rather handsomely toward common ends in emergency periods.

It may be said of course that certain leaders and parties are to blame for the emergency and that it is their problem and not the nation's. Assessment of blame and allocation of responsibility will not contribute much to dispel the emergency. We have been confronted with grave problems upon which reasonable men may differ as to the proper solution. If priming the pump were conceded to have been a wild error, what about the legitimate purpose of spending in times like these to provide opportunity for the unemployed?

Even a reasonable solidarity among our people calls for large financial sacrifices toward common interests and ends. Naturally those who have the satisfaction of every important want secured and whose interest in additional income is mainly a matter of wasteful consumption or economic power must be expected to contribute a heavy portion of their surplus.

From the point of view of social policy the case for the surtaxes is very strong indeed. The forefathers who laid the corner-stones of our traditions and institutions foresaw the dangers of economic concentration and inequality. They regarded potential plutocracy as a great threat to democracy. In our own day Walter Lippmann has expressed this social interest as follows: "Since the time of Aristotle it has been recognized by the wise that extremes of riches and poverty, that spectacular differentials of income, are dangerous and pernicious in any society. The enlargement of the middle class as against the poor and the rich must, therefore, be sought by anyone who wishes a society to live soundly and endure long." Among the serious social consequences of great concentration are the control of such opinion-forming institutions as churches, newspapers, radio and cinema. Moreover the existence of extreme inequalities is one of the strongest incentives for revolutionary change. It is argued for the Fascist regime in Germany that though the general standard may have suffered at least relative inequalities are less. The Share-the-Wealth program of Huey Long may have been fantastic but it had a popular appeal. The surtaxes were a skilful sublimation of a very natural urge. The chief beneficiaries of the status quo might well regard "onerous" taxes as insurance against something a great deal worse.

Many opponents of high surtaxes will concede the above arguments and take their stand on the proposition that the surtaxes are not practical from an administra-

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8 BEARD, ECONOMIC BASIS OF POLITICS (1922) 39-42.
tive and fiscal standpoint. It is true that a tax of 79% gives a powerful incentive to avoid and evade. The rewards of evasion and avoidance are ample to enlist the best legal talent in the country. But wouldn’t surtaxes of half the present level also be ample for this purpose? It is true that the corporation and the trust can be used in numerous subtle ways to avoid taxes. These legal entities are used to save and reinvest income which is thus kept out of the hands of individuals subject to surtax. But these institutions and the laws which tax them are not immutable. Moreover, income left in business corporations is at least invested in supplying the economic needs of the country and is not devoted to conspicuous consumption. It is true, that tax-exempt securities are an open invitation for the avoidance of high surtaxes by the rich. The answer here is to rid the country of the tax-exempts, a development which is long over-due on many other grounds and which is now especially appropriate in view of recent changes in opinion expressed in several decisions of the United States Supreme Court.*

Despite avoidance and evasion the fiscal productivity of the high surtaxes is considerable and we can ill afford to pass up the revenue which they supply at a time when the gap between receipts and expenditures is still a matter of great national concern. Statistics for returns filed in 1938 show that 49 incomes in excess of $1,000,000 paid taxes of $61,458,000 as compared with $78,058,000 paid by 2,607,901 taxpayers returning net income of $5,000 or less.\(^8\) It can be argued of course that lower taxes would lead to more economic progress and thus indirectly to greater fiscal results. This will be considered presently. Only on this ground certainly ought we to talk of reducing taxes at the present time. Of course it is true that broadening the income tax base and higher taxes in the middle brackets may have more fiscal possibilities than the high surtaxes. But this is not to say that the latter should be abandoned. The case for raising tax rates in the lower and middle brackets is very strong. Quite possibly these people should pay on a scale more commensurate with those at the top. But if any leveling is to be done it should be up and not down.

The trump argument of many surtax critics is that these high tax rates retard economic progress. What does this mean precisely? It is argued first that the surtaxes discourage saving and consume potential savings which are necessary to equip our economic system with capital goods. But where is the evidence that our productive equipment has been under-built? Before the depression of the Thirties our saving was ample to supply an expanding consumption, equip American industry considerably beyond its current needs and invest quite substantial sums abroad. What could we do with further savings except to invest them abroad? But our tariff policy has been an indication that we do not intend to satisfy consumption wants and improve our standard of living by encouraging imports. What then is the value of foreign investments, socially speaking? They may give the investors considerable power over foreign production but what good to our people is that?

* U. S. BUREAU OF INTERNAL REVENUE, loc. cit. supra note 2.
With our banks now loaded with surplus lending power and nearly all investing companies competing madly to find an outlet for surplus funds can we credit the old fears about inadequate capital? On the contrary, is it not the high incomes rather than the high taxes which are the economic menace?

But it is said that though there is no general shortage of investment funds there is a shortage of capital seeking venturesome investments. It is the people of large means who should do the risk-taking for society. They can afford to gamble. The high surtaxes drive these people out of stocks and into bonds, or worse yet into government bonds, or worst of all into hoarding. If their rewards are largely appropriated by the government, these people devote themselves merely to protecting their principal. This is a cogent argument. However, there is no evidence known by the author which establishes the fact that large estates are predominantly invested in government securities. If they aren’t invested in government securities they certainly are not hoarded. If it is thought undesirable that these estates should be invested in government bonds, we might try taxing the latter rather than relieving the former. Similarly it might not be beyond our ingenuity, if it appeared necessary, to tax idle, hoarded funds. It probably would be socially desirable for the owners of large estates to keep their investments in stocks, but more active investors with smaller incomes, whose fortunes are on the make, may have sufficient capital to finance new stocks. Much new capital, venturesome and otherwise, can be supplied by corporations in the form of depreciation reserves and corporate earnings.

Do the high surtaxes discourage new ventures and thus slow down the rate of economic progress? It may be doubted if technological progress has shown many signs of slackening. At any rate it is for the consumer that the economic system is supposed to be operated. There is no evidence that the productive equipment of our economic system is inadequate to supply consumers’ orders. We need not build new equipment just for its own sake. To be sure new gadgets might be developed which consumers could be induced to demand. The overwhelming need, however, is more essentials for consumers who cannot afford them. There is no reason to believe that a greater supply of capital would solve this problem. A greater demand for it would help—but the sound stimulus for demand would be an indication that consumer’s orders will soon encounter an inadequate source of supply.

But it is said that it is profits and the margin of profits which makes an economic system go. Of course the high surtaxes are not usually levied on profits (most of which take the form of corporate earnings) but it is said that the former affect the latter indirectly. Certainly business profits were greatly improved in 1937 and again in 1939. If the theory that good profits insure future prosperity were tenable the improvement should have led with all sureness to a further stimulation of business. Undoubtedly, business confidence is an important element in economic recovery. But the absence of confidence may not be caused entirely by the lack of adequate

current profits. The diffidence may not be mainly a matter of government policy at all. It may be due to doubts about the future of consumer demand, or the maintenance of peace or the stability of the economic system itself. Reducing surtaxes would not do much to counteract most of these causes of diffidence and it might positively encourage some of them.

There is a considerable disposition on the part of some to conclude that the captains of industry will not play ball unless they are more liberally compensated. It is thought idle to expect them to play ball for the love of it or for the sake of the team. They must be freed from “socialistic” regulation, collective bargaining and taxation. Government must be placed in the hands of their own henchmen. This is the dangerous and cynical conclusion to which some good people have descended. More hardy critics refuse to accept this conclusion. And were they to be confronted with the proposition that only by restoring the carte blanche privileges and the inequalities of the late Twenties will the private profit system provide decently for the consumer and offer adequate opportunities for the unemployed, they would probably put their endorsement behind a program of direct action by consumers and unemployed through the cooperative movement or government production.

It may be true that one of the most important causes of business diffidence is the unbalanced budget. There is some plausible basis for alarm in the talk about a perpetual deficit and an ever-mounting public debt. It is an exceedingly difficult task to make ends meet by cutting expenditures. The cuts not only directly cause unemployment but have a deflationary effect on the entire economy. In addition they may undermine the morale of large sections of the population and sacrifice other important social values.

If a Herculean effort to balance the budget is soon to be made it may prove easier and better to raise taxes than to cut expenses. It may be necessary to do some of both. If tax rates are to be raised it will probably be the lower and middle brackets which will bear the brunt of the increase. This innovation will be easier to take if the tax rates in the highest brackets are at least maintained where they are. The present administration is criticized for gambling on a much improved national income to balance the budget. Shall we gamble even further on the proposition that reduced taxes will prove so stimulating economically that lower rates will actually yield more revenue? Cutting taxes is always the easiest policy to follow, but is it the safest? It has been well observed that if rational and democratic government in the United States is to give way to some totalitarian regime, the refusal of the American people to tax themselves adequately will probably be an important cause of the tragedy. To reduce surtaxes now would be a bold first step in the wrong direction.