

## The Origins of Republican Tax Policy

[S]ocialism, communism, [and] devilism.

—Senator John Sherman of Ohio (1894),  
denouncing the new federal income tax of 1894

It will be an evil day for us when we enter on confiscation of property under the guise of taxation. . . . [T]o have the Government undertake, for vindictive reasons, to punish a man simply because he has succeeded and has accumulated property by thrift and intelligence and character, or has inherited it honestly under the law, is entering upon a dangerous path. It would convert this tax from the imposition of a tax to a pillage of a class.

—Senator Henry Cabot Lodge of Massachusetts (1913)

The Republican party has enjoyed a long history and mixed fortune in American politics. The dominant political organization in the United States during the Civil War, and then again in the late nineteenth and early twentieth centuries, the GOP was reduced to a distinctly secondary role in the new national party system that emerged during the 1930s. Virtually without a presence in the solidly Democratic South, and elsewhere overwhelmed by the New Deal coalition of organized labor, immigrants, and racial minorities, the Republican party endured for decades following the New Deal by holding on in its enclaves in the Midwest and Northeast. Even after making significant inroads in the South and West in the 1960s and 1970s, as well as winning the White House in a majority of postwar presidential elections, the post–New Deal Republican party remained the perennial minority party in Congress. That would change dramatically in 1994.

Within the Republican party itself, the conservative Right Wing (what used to be referred to as the “Old Guard”<sup>1</sup>) has generally been a minority faction dominated by a moderate center and checked by the liberal wing of the party. However, periodically the conservative Right Wing has held the reins of the party, and at times set the legislative agenda in Congress. That was the case in the 1920s, from 1946 to 1954, and then again following the 1980 Reagan electoral

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landslide. It happened again in 1994 when the Republican party took control of both houses of Congress for the first time in forty years. It is from within this conservative faction of the GOP that the most vocal and committed antitax rhetoric has emanated. In prior decades, the Right Wing also obsessed over the Soviet Union and the spread of communism. Indeed, anticommunism was the dominant concern, as well as the bread-and-butter political issue for the Right Wing in the immediate postwar era. With the demise of East European Communism beginning in 1989 and the subsequent collapse of the Soviet Union and its military threat, the Right Wing turned inward, focusing on domestic policy issues. By the 1990s, hostility to federal taxes emerged as the driving force of contemporary conservative ideology, which came to direct the thinking of the Republican party itself.

Antitax sentiment in the GOP dates back to the Civil War, when Republicans from New England opposed a federal income tax, even while the majority of the party was willing to accept the impost as a necessary means of financing the Northern war effort. Likewise, in 1894 and 1913, Progressives and moderate “centrists” within the GOP supported, or at least acquiesced, in a relatively minor assessment on personal income. On the other hand, Old Guard conservatives remained firm in their opposition to *any* federal income tax or inheritance tax. For the next eighty years, conservatives in the GOP remained consistently opposed to federal income taxation. For much of that time, antitax conservatives were kept in check within their own party by the moderate center. However, that changed dramatically with the decisive election of Ronald Reagan to the presidency and then the unexpected and dramatic victory of conservative Republicans in the 1994 elections. With that victory, the conservative antitax faction came to the forefront of the party. By then, the liberal wing of the GOP was virtually extinct and moderates were reduced to a minority faction. The antitax campaign of conservatives got an additional boost when George W. Bush won the November 2000 presidential election. A major tax cut followed less than five months later.

The current Republican antitax campaign has its origins and antecedents in the long and complicated history of the Republican party as it evolved after the Civil War. The party itself changed dramatically in the 1890s when it achieved preeminence in the political system, and then again when it was reduced to minority status with the rise of an overwhelming Democratic majority in the 1930s. Notwithstanding these significant changes in the party system, there remained a remarkable consistency and depth to antitax principles within the Republican party.

### **Republicans and the Civil War Income Tax**

With the election of Abraham Lincoln in 1860, the Republican party won the White House in only its second national presidential campaign, just six years

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after the founding of the party. Lincoln's election also provoked the boldest proponents of secession in South Carolina, who knew exactly where the new President stood based on the widespread publicity given his speeches from the Lincoln-Douglas debates. When Southern Democrats departed the Congress and seven Southern states (soon joined by four more) asserted their right to secede from the Union, Lincoln formed his government and the Republican party effectively took control of the entire government in Washington. The party of opposition (a ragtag coalition of former Whigs, anti-Nebraska Democrats, and "Free-Soilers" in the North) became the governing party.<sup>2</sup>

Ultimately, the great national dispute over slavery and states' rights was settled on the battlefields of the Civil War. There the Union ultimately prevailed, and the Republican party emerged as the dominant political organization in the United States. But that was years later. During the first year of the Civil War, the new Republican administration faced a grave crisis of public finance—funding the war effort. Traditional nineteenth-century sources of revenue for the national government proved inadequate, and a new income tax was proposed by moderates within the Republican party. Therein began the long and stormy relationship between the Republican party and the federal income tax.

During the first year of the Civil War, Lincoln and his secretary of treasury, Salmon P. Chase, faced a mounting revenue crisis as the government geared up for the war effort. To make matters worse, the federal government had already run three successive deficits following the Panic of 1857, mounting a deficit of \$50 million by the end of fiscal year 1860. Thus, the financial resources of the Republic were already severely strained by the time hostilities broke out. Ultimately, the war effort drove up annual government spending from less than 2 percent of gross national product to an average of 15 percent.

The administration initially believed that the war could be funded through a combination of public borrowing and regressive consumption taxes—namely, the tariff and a handful of other federal excise taxes imposed on consumer goods. In July 1861, Treasury Secretary Chase issued a report calling for \$20 million more to be raised by direct taxes, internal duties, and excise taxes. Confronting unprecedented spending for the military campaign and a resulting budget deficit, congressional Republicans approved legislation to raise the tariff. In fact, tariff rates were increased every year throughout the war. Still the deficit mounted as revenue continued to lag behind war expenditures. Republican congressional leaders worried that excessive reliance on the tariff would turn Western and border states against them. There also was some sentiment for a national property tax—at the time, the main source of local government revenue. Thaddeus Stevens of Pennsylvania, powerful Republican chairman of the House Ways and Means Committee, proposed a direct land tax to be allocated to each state in proportion to its population—the latter, a constitutional requirement.<sup>3</sup> Treasury Secretary Chase supported Stevens's proposal for a national property tax. On the other hand, Stevens's proposal for a direct tax on land provoked intense opposi-

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tion among representatives from the South and West, where agricultural interests with much to lose were predominant.

In response to calls for tariff increases or a national property tax, Justin Morrill, an abolitionist, co-founder of the Republican party in Vermont, and important member of the House Ways and Means Committee, offered a compromise proposal in July 1861 that included a minor federal income tax to supplement the tariff. Most Republicans in Congress preferred Morrill's compromise proposal for an income tax over a national property tax or further tariff increases. Republicans from the Northeast remained strongest in their opposition to the income tax proposal; however, they too finally acquiesced. By a vote of seventy-seven to sixty, the bill passed the House. Thereafter, the bill passed the Senate, and Lincoln signed it into law on August 5, 1861. The new income tax imposed a 3 percent tax on all income above a \$800 personal exemption. The income tax on U.S. citizens residing abroad was 5 percent, and the tax on interest income from securities was reduced to 1.5 percent. Because of the generous exemption, only the wealthiest citizens were initially subject to the impost. The editors of the *New York Times* subsequently praised this new tax, "levied upon a person's purse," as "probably one of the most equitable and bearable taxes that can be imposed."<sup>4</sup> Of course, newspaper men are not among the most generously paid or wealthiest citizens, and their own salaries were not likely to exceed \$800 a year, and hence were beyond the reach of the tax.

Owing to difficulties implementing the statute, the income tax of 1861 was never actually put into effect by the Treasury Department and never raised a single dollar of revenue. Subsequently, a new income tax was passed by the Republican Congress and signed into law by Lincoln on July 1, 1862,<sup>5</sup> as part of a wide-ranging revenue act that also imposed a tax on the gross receipts of railroads, banks, trust companies, and insurance companies. As part of the same revenue package, the Republican Congress enacted a national gift tax and a 5 percent inheritance tax on the receipt of property in the form of "legacies." The income tax of 1862 called for a 3 percent tax on the "annual gains, profits or incomes" above \$600 of anyone residing in the United States, "whether derived from any kinds of property, rents, interest, dividends, salaries or from any profession, trade, employment or vocation carried on in the United States or elsewhere, or from any source whatever." The tax rate increased to 5 percent on income in excess of \$10,000 and on all income earned by citizens residing abroad. The provision provided for withholding on the salaries of government employees and also expressly allowed limited business deductions.

Justin Morrill defended the new Republican income tax as the "fairest" means for raising revenue for the war effort: "The income tax is an inquisitorial one at best; but upon looking into the considerable class of state officers, and the many thousands who are employed on a fixed salary, most of whom would not contribute a penny unless called upon through this tax, it has been thought best not to wholly abandon it. Ought not men, too, with large incomes, to pay more in

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proportion to what they have than those with limited means, who live by the work of their own hands, or that of their families?”<sup>6</sup> Morrill, a key Republican with considerable experience in public finance, had no qualms about adopting an income tax *per se*. However, he objected to a progressive rate structure that imposed a disproportionately high burden of the income tax on the wealthy. As always, “fairness” is in the eye of the beholder, and most conservative Republicans from the Northeast viewed a graduated income tax with considerable suspicion, if not outright disdain.

As the war progressed, tax rates were repeatedly raised and the tax base further expanded. Republicans were successful in enacting such taxes because the wartime crisis gave the government considerable leeway in steering national economic policy. Taxes that were highly unpopular in prior decades (in particular, the tariff) or opposed by powerful economic interests (i.e., the income tax) were accepted by all sides during the wartime crisis without provoking great opposition or popular resistance. During the Civil War, the Republican party (which totally dominated national politics on account of the withdrawal of Southern Democrats from the government) successfully integrated its own partisan organization and interests with those of civil society and the emerging national state.<sup>7</sup> In this way, the party served an important integrative function during a crucial period of state-building in America. During the period of wartime fiscal crisis, the party itself was also unified. For example, Republicans who otherwise would have opposed the income tax begrudgingly accepted the impost—at least, for the duration of the war.

A far more comprehensive income tax was proposed in the spring of 1864. The Ways and Means Committee reported a bill for a flat income tax of 5 percent. However, the House followed the recommendations of the commissioner of Internal Revenue in favor of a progressive rate structure.<sup>8</sup> This provoked intense objections among a number of Republicans on the grounds of the injustice the graduated tax would inflict upon the wealthy. Representatives Stevens and Morrill led the opposition to the graduated rate structure. Stevens denounced the graduated tax as a “strange way to punish men because they are rich.”<sup>9</sup> Morrill declared that progressive rates “punish men because they are rich,” and amount to nothing less than “seizing the property of men for the crime of having too much.”<sup>10</sup> Morrill’s opposition was significant given that he was an original supporter of the income tax. It was the progressive rate structure with which he could not abide.

In the end, the need for revenue was too great. A progressive tax rate with a high exemption is the only way to raise significant revenue from the wealthy without imposing an excessive tax burden on the poor and middle classes. Accordingly, Congress enacted a new income tax in 1864, imposing a tax of 5 percent on income over \$600, rising to 7.5 percent on income over \$5,000, and reaching 10 percent on income over \$10,000. With these tax rate increases, the income tax became a major source of government revenue during the Civil War.

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Revenue from the income tax increased from \$2.75 million in 1863 to \$20 million in 1864, \$61 million in 1865, and \$73.5 million in 1866.<sup>11</sup> Historian Elliot Brownlee estimates that by the end of the war, as many as 10 percent of all Union households (perhaps as many as 15 percent in the Northeast) were paying the income tax.<sup>12</sup> On the other hand, the inheritance tax never contributed very much. Following the war, once the government's revenue demands eased dramatically, the much despised inheritance tax was repealed in July 1870.<sup>13</sup> Likewise, income tax rates were reduced significantly after the war and a "sunset" expiration date of 1872 was added to the income tax statutes.

During this postwar period, Senator John Sherman of Ohio, the influential Republican chairman of the Finance Committee (who subsequently authored the most important federal antitrust statute), exerted considerable effort trying to make the federal income tax permanent. Why were Republicans such as Sherman among those campaigning to keep the income tax *after* the wartime revenue crisis was over? After all, it is one thing to accept an income tax during years of military and revenue crisis, but it is something else to vote to retain the tax once the crisis has past. These actions of Sherman and other Republican leaders have long puzzled those attempting to portray the Republican party as a monolithic organization opposed to any form of income tax. The intriguing explanation presented by historian Robert Stanley is that such efforts were taken by "centrists" in the Republican party who were willing to accept a minor income tax (i.e., low rates and only mildly progressive) as a strategic means for deflecting rising populist agitation for more extreme measures to redistribute wealth. As Stanley puts it: "[T]he early [income] tax was designed to preserve imbalances in the structure of wealth and opportunity, rather than to ameliorate or abolish them, by strengthening the status quo against the more radical attacks on that structure by the political left and right."<sup>14</sup> So the centrist Republicans adopted a pro-income tax strategy purely for instrumental purposes, willing to accept the known evil rather than face that which they truly dreaded further down the line. Contrary to this strategy, determined opposition from conservative Republicans responding to wealthy constituents in the Northeast blocked all such attempts by party centrists to retain the impost, and the Civil War income tax was allowed to expire in 1872 under the previously enacted sunset provision.

With the expiration of the income tax, the federal government again turned to the tariff for most of its revenue. Indeed, throughout years of peacetime during the nineteenth century, the tariff (supplemented by customs duties, excise taxes, and the sale of public land) supplied more than enough revenue to operate the federal government—admittedly, a government of limited functions. In the decades following the Civil War, the tariff by itself raised far more revenue than the government in Washington spent annually, providing the luxury of unprecedented and seemingly endless budget surpluses. A considerable portion of that surplus revenue was doled out by successive Republican Congresses in the form

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of military pensions for veterans of the Union army, thereby solidifying veterans as a core constituency within the GOP.<sup>15</sup>

### **GOP after the Civil War**

After the Civil War, the Republican party continued to dominate the national political arena, as well as most state governments—at least, those outside the South following Reconstruction.<sup>16</sup> In the post-Civil War decades, Democrats would control the White House for only two terms, and this resulted more from defections in the GOP than strengths of the Democratic candidate. Democrat Grover Cleveland, former governor of New York, won the presidency in 1884 and then again in 1892.<sup>17</sup> The Democratic party remained competitive in Congress by virtue of the party's stranglehold on the South, where a one-party system prevailed for more than a century following the Civil War.<sup>18</sup> Between 1874 and 1894, Democrats and Republicans alternated in control of the Congress and White House. During this so-called Gilded Age, a competitive two-party system flourished within the nation's capitol, with each of the parties generally dominating their respective local territories.

In 1893, with strong support from Populists in the South and West, Democrats took control of both houses of Congress. The next year, bowing to strong pressures from the Populists, Democrats instigated a campaign to reinstate a federal income tax—this time, with a steeply graduated rate structure. The platforms of the Greenback Party in 1877 and 1878 called for a progressive income tax, as did that of the National Greenback Party in 1880. The Greenback Labor and Anti-Monopoly Parties adopted similar proposals in 1884, and the Union Labor Party espoused the progressive income tax in 1888. Grangers, Knights of Labor, and the Farmers Alliance all demanded restoration of a progressive income tax, as did the Populist Party in each of its platforms. From 1874 to 1894, sixty-eight bills were introduced in Congress to restore an income tax of some sort. Needless to say, these were not Republican initiatives.

Support for a new income tax was strongest in the South and Midwest. In 1893, the chairman of the House Ways and Means Subcommittee on Internal Revenue, Democrat Benton McMillin of Tennessee, introduced tariff legislation that also provided for a new income tax. William Jennings Bryan of Nebraska led the campaign on the floor of the House. While some Progressives in the Republican party joined in supporting the measure, most Republicans were strongly opposed. This was largely because the income tax was now presented in the context of the broader Populist attack on wealth and privilege. Most important, the newly proposed income tax had a graduated rate structure that posed a genuine threat to the existing social order—at least, in the minds of those who possessed a sizable share of the nation's wealth. Among those Republicans who

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now actively opposed the new income tax were Justin Merrill of Vermont, who had sponsored the first Civil War income tax, and John Sherman, the prominent Republican senator from Ohio who had also supported the Civil War income tax. Sherman, one of the most important politicians of the 1870s and 1880s, and the chief architect of Republican economic policy during the period, emphatically denounced the new Populist graduated income tax as “socialism, communism, [and] devilism.”<sup>19</sup> All Republican members of the House Ways and Means Committee voted against the tax. Notwithstanding their opposition, the campaign in Congress prevailed. A relatively minor income tax was enacted within the context of a broader compromise over tariff reduction (another important goal of farmers in the South and Midwest). Democratic President Cleveland readily signed the measure into law.

The new federal income tax of 1894 imposed a flat 2 percent tax on the gains, profits, and income of individuals above the \$4,000 exemption, and a comparable 2 percent tax on the “net profits” or income of all corporations, companies, and associations doing business for profit in the United States. Again, on account of the high exemption, only a small number of very wealthy individuals were subject to the tax. After all, \$4,000 was a considerable sum in those days, and the vast majority of Americans (even those who were quite prosperous) were totally unaffected by the imposition of the new income tax. The tax was indeed an impost on the rich.

Republican opposition to the income tax of 1894 festered even after the bill was signed into law. Soon enough, the political opposition was rendered moot as the U.S. Supreme Court heard a constitutional challenge to the new income tax in the 1895 case of *Pollock v. Farmer's Loan & Trust Co.*<sup>20</sup> Up until the 1890s, the Court had taken the position that only two taxes (capitation and real estate) were “direct” taxes subject to the apportionment requirement of the Constitution. In *Pollock*, this settled view was abandoned, and the Court held the new income tax unconstitutional as an unapportioned “direct” tax.<sup>21</sup> The year after the Court's ruling in *Pollock*, the Republican party regained control of the White House with the election of William McKinley. Indeed, Republicans not only took back the presidency in 1896, but they also secured control of both houses of Congress. Their coalition of Midwestern farmers, Northern industry, urban workers, Negroes, and small businessmen formed the basis for a dominant political party. The heyday of the Republican party commenced.

### **Republican Hegemony**

McKinley and his manager Mark Hanna ran what was in many respects the first modern electoral campaign. Relying upon new methods of raising political money and a well-oiled party organization, Hanna crafted an impressive electoral machine for McKinley. The election took place in the wake of the severe depression of

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1893. Responding to Bryan's central campaign theme (the advocacy of silver currency), McKinley moved away from his intended agenda of support for protectionism and the tariff to one based on the gold standard. Bryan's Populism proved no more appealing to a majority of the electorate the third time around, and he and the Democrats suffered a devastating electoral defeat in 1896—the party's worst since the Civil War. Indeed, the election signaled a major “realignment” of the post–Civil War party system. Democrats retained their monopoly in the South, but after the election Republicans held an even more solid and significant monopoly in the industrial-urban centers in the Northeast and Midwest that gave them overall dominance in the party system. In only a handful of states were the parties still truly competitive. The long decline of partisanship within the electorate, as well as that of the national party system itself, had begun.

Republican hegemony established by the election of 1896 continued into the twentieth century. However, Democrats took advantage of the opportunity presented to them by former President Theodore Roosevelt, who bolted his party in 1912 and ran for President as the standard bearer of his own Bull Moose Party against the incumbent, Republican Howard Taft. The Democratic candidate, Woodrow Wilson, benefited from the split in the Republican vote and won the presidency with a historic low of 42 percent of the popular vote. With the election of Wilson (only the second Democrat to occupy the White House since the Civil War), a resurgent Democratic party claimed majorities in both houses of Congress as well.

With their party's position secure in Washington, Democrats turned their attention to a new constitutional amendment sanctioning an income tax—this necessitated by the Supreme Court's decision in *Pollock*. A constitutional amendment had been ratified by Congress in 1909 by a coalition of Democrats and Progressive Republicans. Ironically, the income tax amendment was proposed by Republican Senator Nelson W. Aldrich, chairman of the Senate Finance Committee, and supported by the Republican president, William Howard Taft, with the intent of deflecting the mounting campaign for a progressive income tax. Taft was particularly sympathetic to the Supreme Court's tenuous position, fearing any weakening of its legitimacy from lingering controversy over the unpopular *Pollock* decision.<sup>22</sup> Accordingly, he supported Aldrich's proposal for a constitutional amendment, hoping to settle the matter once and for all in favor of a federal power to tax income.<sup>23</sup> The campaign gathered increased momentum at the state level following the Democratic electoral victory in 1912. Alabama was the first state to ratify; other states, such as Pennsylvania, never did approve the amendment. Ratification by the requisite three-fourths of the states was achieved in February 1913, and the Sixteenth Amendment, which authorizes Congress to impose a tax “on income, from whatever source derived,” became part of the U.S. Constitution.<sup>24</sup>

Following his inauguration in March, Wilson immediately proposed a reduction in tariff rates and a new federal income tax statute to be enacted under

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the authority of the Sixteenth Amendment. Republicans were not uniformly hostile to the idea. After all, Taft and Progressives in the Republican party had supported both tariff reduction and an income tax during the 1908 presidential campaign—as had Roosevelt four years earlier. In 1913, “insurgent” Republican Progressives again joined congressional Democrats to support a proposal for an income tax as part of a new tariff reduction bill. These Progressives had previously supported Roosevelt’s efforts to regulate monopolies and break up the large “trusts,” as well as the creation of the first generation of independent regulatory agencies in the first decades of the twentieth century (e.g., the Food and Drug Administration in 1906 and the Federal Trade Commission in 1914, as well as the revitalization of the Interstate Commerce Commission in 1906 under the Hepburn Act).<sup>25</sup>

To be sure, Old Guard conservatives remained united in their opposition to *any* income tax, as well as the creation of most of the new regulatory agencies.<sup>26</sup> However, moderates within the party were considerably more temperate in their opposition. With the ratification of the Sixteenth Amendment, some form of income tax had become a foregone conclusion. The question was, What *kind* of income tax would be enacted? Once again centrist Republicans viewed the income tax as a preferred alternative to more radical Populist proposals. A moderate income tax would effect only a very slight redistribution of wealth, even while deflecting radical egalitarian impulses and preserving all the basic institutions and hierarchies of the established social order. Although firmly opposed to a steeply graduated rate structure, centrist Republicans, Progressives, and conservative Southern Democrats were willing to tolerate a moderate income tax similar to what had been previously enacted in 1894.

A House tariff reform bill provided the perfect vehicle for introducing an income tax to offset the revenue loss. The Senate added a slightly more progressive rate structure to the income tax included in the House tariff bill (rejecting Wisconsin Progressive Robert La Follette’s pleas for a steeply graduated tax). A graduated income tax was justified by Democrats, Populists, and Progressives as a “fairer” source of revenue than the tariff—which was generally recognized as adverse to the economic interests of the basic constituencies of these parties. All recognized that the very high personal exemption would effectively exempt all but the wealthiest citizens from income taxation. This too was defended by Democrats, Populists, and Progressives on grounds of justice and equity, which were conveniently defined in terms of imposing taxes that only reached the wealthy. In the words of Democratic representative William H. Murray of Oklahoma: “The purpose of this tax is nothing more than to levy a tribute upon that surplus wealth which requires extra expense, and in doing so, it is nothing more than meting out even-handed justice.”<sup>27</sup> A mild version of this brand of “justice” was something that moderate Republicans could live with, but not so the Old Guard. Senator Henry Cabot Lodge of Massachusetts warned that the progressive income tax represented the “pillage of a class.”<sup>28</sup> It was Lodge’s class

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that was under direct assault from radical egalitarians, and the Senator understood it full well.

Notwithstanding protests from the Old Guard, a good number of Republican members of Congress viewed the final proposal as moderate and tolerable, if not exactly desirable. With remarkably little fanfare, the Senate bill was approved on October 3, 1913, and the income tax became law pursuant to the Tariff Act of 1913. The new income tax (which has been in place ever since) began as a 1 percent tax on income exceeding a \$3,000 personal exemption. The tax included a 1 percent surtax that reached 6 percent on income over \$500,000—an enormous sum in those days, and even today, enough to put a taxpayer comfortably in the top 1 percent of those filing returns. At such levels, only the very wealthy were subject to the new tax, as the income of the vast majority of Americans was well below the \$3,000 minimum threshold for taxation. (At the time, per capita income was roughly \$333 a year.) Only some 2 percent of U.S. households paid *any* income tax during the first several years following its enactment.<sup>29</sup>

The enactment of the income tax in 1894 and 1913 can only be understood within the context of the broader debate over the tariff—despised by Southern and Western farmers and favored by Northern manufacturing and industrial interests. The income tax was supported by Populists and Progressives not only because it directly imposed a charge on the wealthy, but also because it represented relief from the tariff. That was always the political calculation behind revenue reform legislation in the 1890s and early 1900s: tariff relief was coupled with a mildly progressive income tax. While the more extreme proponents of income taxation definitely viewed the income tax as a means for redistributing wealth, those in Congress who actually voted for the more moderate versions of the tax were hardly wild-eyed, radical egalitarians. Instead, they saw the income tax as providing enough revenue to allow for tariff relief, while at the same time deflecting a good deal of the more extreme measures from radical quarters that they feared even more.

Despite the relatively innocent origins of the income tax of 1913, significant changes were made to the rate structure of the tax beginning in 1916. Wilson and his secretary of treasury, William McAdoo, bowed to further pressures from Southern Populists (led by the powerful chairman of Ways and Means, Claude Kitchin of North Carolina) to use the income tax more vigorously as a tool to redistribute wealth. This, of course, was always how Populists and Progressives wanted to use the tax. But it was actually wartime pressure for revenue, rather than such ideology, that most dramatically changed the rate structure of the new federal income tax. Taxes on the wealthy were increased because the government needed more revenue. The Revenue Act of 1916 imposed a “normal” tax of 2 percent, with a surtax of 1 percent on income in excess of \$20,000, rising to a rate of 13 percent on income in excess of \$2 million. Furthermore, a highly progressive estate tax was added to the arsenal of the federal government in 1916.

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Wilson won his bid for reelection in 1916, defeating the Republican candidate, New York governor Charles Evans Hughes, by 594,188 popular votes and the narrow margin of 23 electoral votes. In one respect, it did not matter who won the election. Tax rates would have increased even under a Republican administration as the nation faced an impending revenue crisis with the outbreak of war in Europe and the subsequent entry into the conflict by the United States. Soon after Wilson's second inauguration, Congress passed the War Revenue Act of 1917, which provided for a wartime surtax that reached 50 percent on individual income in excess of \$1 million, and augmented the 1916 normal 2 percent tax with an additional 2 percent on income in excess of \$3,000 for single persons and \$4,000 for married persons. Personal exemptions were lowered to \$1,000 for single taxpayers and \$2,000 for married taxpayers (down from the \$3,000 and \$4,000 levels set by the 1916 act).<sup>30</sup> The normal corporate rates were raised, and the excess profits tax rates were increased as well. A wartime revenue bill was also passed in 1918. This further increased tax rates on individuals and corporations in an attempt to raise additional revenue for the war effort. Other taxpayer-friendly provisions in the original income tax law (such as an exclusion for \$20,000 of dividends received by an individual) were repealed to raise revenue. Between 1913 and 1920, during the period of Democratic party rule, Congress also strengthened the Bureau of Internal Revenue (increasing personnel from 4,000 to nearly 16,000) and added a professional staff of experts in taxation, accounting, economics, and law. The result was a new tax regime that could be used at once to collect considerable revenue for the federal government *and* redistribute wealth among the various classes of society.

For Democrats, the new tax regime created during Wilson's second administration reflected a desire to *both* redistribute wealth and, at the same time, preserve the basic elements of the capitalist system that produced the wealth in the first place. Despite the dire warning of Henry Cabot Lodge, there was less interest in "pillaging" the upper classes than in taxing their wealth and using the revenue to finance a modern administrative/regulatory state. As Elliot Brownlee puts it: "Redistributional taxation . . . became a major element of the Wilson administration's program for steering between socialism and unmediated capitalism."<sup>31</sup> The aim of Wilson's "New Freedom" program was to tame capitalism for the benefit of the common man. This is precisely how liberal Democrats have viewed the income tax ever since—as a tool for effecting a mild redistribution of wealth for the benefit of the middle and lower classes, without otherwise seriously disturbing or disrupting the basic free-market economic system that produces most of the national wealth. The purpose of the income tax is to even out the economic inequality that inevitably comes with an economic system of "unmediated capitalism." Republicans centrists were in basic agreement. In the end, the difference between Wilsonian Democrats, Progressives of all persuasions, and centrist Republicans was merely a matter of a few percentage points at the margin of the new income tax. On the other hand, the difference between the

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Old Guard and Populists such as William Jennings Bryan was considerably greater—no less than a dispute over the very legitimacy of the federal tax system.

In 1916, the Supreme Court addressed the specific question of the constitutionality of the graduated rate structure of the new income tax. In *Brushaber v. Union Pacific Railroad Co.*,<sup>32</sup> the Supreme Court held, among other things, that the graduated rate structure did not violate the “due process” clause of the Fifth Amendment. Notwithstanding claims that persist among fringe right-wing elements to this day, the main constitutional questions regarding the income tax were settled over eighty years ago with the ratification of the Sixteenth Amendment and the blessings of the Supreme Court. After the Court’s decision in *Brushaber*, the Old Guard wisely gave up challenging the constitutionality of the income tax and moved the attack from the federal courts back into the political arena. There the focus became reducing tax rates, rather than repealing the tax outright. During World War I, when the income and estate tax rates skyrocketed as the government scrambled for additional revenue, even the Old Guard accepted the high rates. After the war, conservatives fought back, attempting to withdraw the wartime tax regime. However, as the income tax replaced the tariff during World War I as the principal source of revenue for the federal government, even the most conservative Republicans recognized that it was no longer feasible to repeal the tax outright. They would have to settle for tax cuts. That became one of the prime objectives of the Republican party in the twentieth century.

The reign of the Democratic party from 1912 to 1920 proved to be a short-lived interruption of Republican domination of national politics. There was no long-term realignment of the electorate or reconstitution of the party system. The rift occasioned by Roosevelt’s break from the Republican party healed following World War I. In 1918, propelled by a backlash among business leaders and corporations, the GOP regained control of both houses of Congress. After Wilson’s two terms as president (during the last two years of which Wilson was seriously incapacitated), the Republican candidate, Warren G. Harding of Ohio, easily won the White House in 1920. The margin of victory was decisive, with Harding capturing over 60 percent of the vote over the Democratic candidate, James Cox. Republicans held an astounding 303 to 131 majority in the House and a 24-seat margin in the Senate. Congress and the White House were again in Republican hands, the Progressive movement had spent its course, and conservatives dominated the GOP. The 1920s belonged to the Old Guard.

### **Return to Republican “Normalcy”**

At its birth, the Republican party was a political organization comprised of a wide spectrum of social, economic, and regional interests. While the party’s greatest strength was in the Northeast and Midwest, nevertheless, it was a broad-

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based political coalition that ran on a national party platform. After all, the Republican party was created at its inception as a “fusion” party of varied interests united in their opposition to the extension of slavery into free territories and the preservation of the Union. However, in the decades following the Civil War, the GOP became more closely associated with sectional interests and the old established order of wealth, business, and industry. During the 1870s and 1880s, new manufacturing and industrial interests in the Northeast and Midwest gravitated toward the party. In the election of 1888, the Republican party instituted a new system of party finance. Deprived of the benefits of the patronage system by the Democratic Cleveland administration, the out-of-office Republicans turned to big business and industry to finance its electoral campaign. The Republican National Committee worked with newly created businessmen’s “advisory committees” to aid in raising funds for the party. Among the most successful of these was Philadelphia department store merchant John Wanamaker, who worked closely with the Manufacturers’ Club of Philadelphia to raise substantial sums for the Republican party.<sup>33</sup>

By the turn of the twentieth century, the post-McKinley Republican party was very much the party of wealth, order, and privilege. Even still, the Republican coalition also included Midwestern farmers, urban workmen, Negroes who voted in the North, and small businessmen all across the country. The wealthy Northern patricians and industrialists were generally represented in the GOP by the conservative Old Guard faction. New England was the bastion of the Old Guard, with strongholds in Maine, Massachusetts, Connecticut, New York, New Jersey, Pennsylvania, and Delaware. In general, the party leadership also reflected the Old Guard conservative ideology. The party had its moderate center, as well the remnants of the Progressive Roosevelt wing. But with the close of Wilson’s second term in 1920, the GOP was returned to power in a landslide victory, and the conservative faction controlled the party.

Harding and his secretary of treasury, Andrew Mellon, pursued a conservative fiscal and tax policy designed to bring a “return to normalcy.” In the domain of public finance, this meant reducing income tax rates to prewar levels. Except among a small minority faction, there was no sentiment within the GOP for repealing the income tax outright. The goal was to strip it down to a form and structure closer to what centrist Republicans had accepted in 1894 and 1913. The 6 percent surtax imposed under the original 1913 income tax had only slightly increased in the initial years prior to the outbreak of war in Europe. However, as soon as the United States entered the fray, income tax rates skyrocketed. The surtax on higher income levels was repeatedly raised throughout the war years. By 1918, the top marginal rate (including the surtax) reached a staggering 77 percent on personal income over \$1 million. So the return to normalcy translated into cutting income tax rates dramatically—something that Harding and Mellon set out to accomplish in the first year of the administration. In a speech before a joint session of Congress on April 12, 1921, Harding declared: “I know of no

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more pressing problem at home than to restrict our national expenditures within the limits of our national income, and at the same time measurably lift the burdens of war taxation from the shoulders of the American people.”<sup>34</sup>

In November 1923, Mellon proposed a 25 percent reduction in income tax rates, reducing the “normal” tax from 4 percent to 3 percent for low-income taxpayers and from 8 percent to 6 percent for high-income taxpayers. Mellon worried that the wealthy were moving their assets into tax-exempt state bonds to avoid the 65 percent income tax surtax.<sup>35</sup> This arrangement (which was, and remains perfectly legal, although not necessarily economically productive) could significantly lower tax bills for the wealthy, and accordingly, reduce government revenue. Mellon’s strategy of reducing income tax rates (a policy that he adopted after failing to stimulate interest in a constitutional amendment to remove the exemption for interest paid on government bonds) proved effective in expanding the tax base. When tax rates were lowered (eventually to a maximum rate of 25 percent), the incentive to purchase tax-exempt bonds decreased, capital remained in taxable investments, and government revenue actually increased. Budget surpluses were generated for the rest of the decade.

During Mellon’s long tenure at Treasury, conservative tax and fiscal policy reigned supreme. Marginal tax rates were slashed, the wartime excess profits tax was repealed, a preferential rate for long-term capital gains was introduced, and the burden of the federal estate tax was significantly reduced. All this made the Republicans popular with their pro-business constituents and won them elections. Still Mellon resisted pleas from more conservative Republicans to repeal the income tax altogether, or replace it with a national sales tax—as was sought by the most conservative Old Guard Republicans (for example, Utah Senator Reed Smoot). Overall, there was remarkably little enthusiasm within Congress or the administration for repeal of the income tax. This reflected the extent to which the income tax, in less than a decade, had become so deeply ingrained in the federal revenue system, as well as the American political system itself. Mainstream Republicans were willing to accept a mildly progressive income tax coupled with an estate tax for the super-rich in order to appease the prevailing popular sentiment for wealth redistribution. Only the Old Guard conservatives still dreamed of a system of public finance based entirely on regressive consumption taxes such as the tariff or a national sales tax.

Under Mellon’s tutelage in the 1920s, the strongest antitax sentiments of the Old Guard Republicans were kept in check, a federal income tax with low tax rates was retained, and still the nation enjoyed economic prosperity and budget surpluses—in short, Republican fiscal paradise! Then came the Depression, Franklin D. Roosevelt, and the end of the long era of Republican hegemony.