

TAXATION WITH REPRESENTATION 1776-1936

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This is a short history of the long process of creating and shaping our federal tax system.

Until 1763, the only taxes on the American Colonies were those which were levied by the Colonies themselves. Britain did not directly tax the Colonies until 1763, but it then changed its practices; and for a 13 year period, levied tariffs and excise taxes, coupled with punitive collection practices, all without representation in Parliament.

After declaring independence, the American people were free to create a tax system with representation. Initially, they formed a confederation of States, and adopted the Articles of Confederation as their governing instrument. The Articles reflected a strong desire by the States to retain as much sovereignty in themselves as possible and a wariness of taxation by anyone except themselves. During the ensuing 12 years, Congress had no power to tax. The confederated government needed money to pay the expenses of its operation and the sizeable debts it was incurring to fight for independence. Yet, under the Articles, Congress had no power to levy its own taxes. The States could tax and they did. Congress had to make an annual accounting to the States accompanied by a request for the States to contribute some of their own tax monies to the national Treasury. This was called a "requisition" process. And, Congress had no power to enforce its requisition if a State did not pay its share.

Requisitions were allocated amongst the States in proportion to the respective values of their lands. Valuing the lands was time consuming and expensive, not just on a one time basis, but annually as the Articles required. Sharing the burden of requisitions unequally was distasteful to higher value States, given that each State had the same number of representatives in Congress. The requisitions system did not work. None of the States contributed their full share. Two of the States, New Jersey and Georgia, failed to contribute any money at all.

The inability of Congress to levy a tax, much less collect on its requisitions to the States, contributed to its major fiscal problems. The government could not pay its debts or expenses of operation. Money was being printed, but without sufficient backing, it had little value. George Washington is said to have remarked that the value of a wagon filled with money exceeded the value of its contents. Other nations knew of these economic problems and were more than willing to take advantage. The Confederated Congress twice proposed to amend the Articles to allow it at least to enact a 5% tariff on imports, but was unsuccessful. The Articles of Confederation required all States to approve any amendment. Rhode Island, which relied on

trade from abroad, did not want a federal tariff to interfere with its importing businesses; so it vetoed both tariff proposals.

Lack of money was not the only problem facing the government. Steps had to be taken to prevent protectionist trade barriers that States were erecting between themselves, and Congress had no power over interstate commerce. Maryland and Virginia disputed each other's uses of the Potomac River. Rhode Island imposed taxes on traffic on its post roads. New York and Pennsylvania levied duties on goods passing into and out of New Jersey and Delaware.

Finally, in 1786, Congress appointed commissioners to a convention in Annapolis to develop a plan to deal with the shortcomings of the Articles. Interestingly, giving Congress the power to tax was not even on the agenda for changes. Those commissioners, representing only 5 States, recommended there be a convention, now known as the Constitutional Convention, to be held in Philadelphia, starting the following May, in 1787. Rhode Island, fearing that the gathering would work to its disadvantage, boycotted the Convention completely. Two of the three New York delegates, John Lansing and Robert Yates, were so concerned with federal encroachment on States' rights that they walked out, leaving Alexander Hamilton as New York's only remaining delegate. Hamilton actively participated in the Convention, but had no right to vote, as New York no longer had a quorum of its delegates

Over the Summer of 1787 delegates from eleven states and Alexander Hamilton discussed such topics as (1) federal powers over commerce, (2) the manner by which the lower house (house of Representatives) would be apportioned, (3) the manner by which the upper house (Senate) would be elected, (4) whether the executive (President) would be a single person or a board of three, and (5) the manner of electing the president. Still, the power of Congress to lay and collect taxes was not amongst the issues discussed. The decisions of the delegates were relegated to a Committee on Details for drafting. The Committee on Details met for a 10 day period in August. Madison's notes indicate that in the Committee on Details for the first time there was discussion as to whether to give Congress the power to tax. Some thought that Congress should have no power to tax. Others preferred to stay with the system of requisitioning the States for monies, but with some sort of penalty for failing to reach the quota requested. Those in favor of giving Congress the power to tax believed that without ready liquid resources the nation could not operate; it would not be able to pay its expenses and debts; and its credibility with others in the world would be impaired.

The first draft of the Constitution prepared by the Committee on Details gave Congress the power to levy taxes. As worded, Congress could "lay and collect taxes, duties, imposts and excises". Period. There was no explanation as to the purposes for which taxes could be laid. Perhaps this would mean that the only limit on taxes levied would be the amount needed by the government to pay its debts and the expenses it would be incurring relating to its operations

within its powers granted by the Constitution. Nevertheless, there was concern that the power to tax, without enumeration, could be exercised more broadly than in connection with the defined powers. After discussion, the Committee on Details revised its draft to say that Congress could lay and collect taxes “for payment of the debts and necessary expenses of the United States.” Still, the wording was problematic. What would be “necessary expenses of the United States”? Would this mean that taxes could only be levied to pay for expenses that were necessarily incurred for purposes for which Congress expressly had powers under the Constitution?

Roger Sherman, a delegate from Connecticut, suggested changing the “pay for expenses” portion to say that Congress could lay and collect taxes “for defraying the expenses that shall be incurred for the common defense and general welfare”. What did he mean by “expenses incurred for the general welfare”? “Common defense and general welfare” was the exact same phrase used in the Articles of Confederation for which Congress could make its requisitions to the States for monies. John Dickinson, draftsman of the Articles of Confederation, had used “general welfare” earlier in an essay criticizing the British for taxing the colonies to pay for expenses which did not benefit the colonies. Dickinson believed that, as a fundamental principal, taxes should only be levied for the general welfare of the people being taxed. As now worded, maybe this would mean that Congress could enact taxes but only for purposes specifically authorized in the Constitution so long as they were for the benefit of the people being taxed?

Another committee was created, this one called the Left Overs Committee, with 11 members, one from each of the remaining States involved with the Constitution. On September 4, the Left Overs Committee suggested nine (9) alterations to the draft of the Committee on Details, one of them being in the Congressional power to tax section. The draft preserved the “common defence and general welfare” phrase, but the Left-Overs Committee made a conceivably problematic change. Previously, the provision had allowed Congress to enact taxes for defraying expenses incurred for the general welfare. Now it would have the power to enact taxes “to provide for the general welfare”, instead of for defraying expenses already incurred for the general welfare. Was this a substantive change? Could the deletion of the word “expenses” and the addition of the “provide for” language, being futuristic, be interpreted as an additional Congressional power, a power to tax for general welfare purposes unrelated to its expressed powers?

Two restrictions were added, one of which was to cause problems. It said that “no capitation, or other direct tax shall be laid, unless in proportion to the census or enumeration herein before directed to be taken.” Article II, section 9. This was the same census formula used for allocating seats in the House of Representatives. There was no definition of what a direct tax might be. Madison’s notes indicate that Gouvenour Morris, of Pennsylvania, asked what a direct tax might be, and no one responded. Whatever a direct tax might be, it would be difficult to administer because it had to be assessed amongst the states in proportion to their respective censuses.

In September 1787, 39 of the original 52 delegates signed the Constitution as a replacement for the Articles of Confederation. The Constitution would give Congress the power to enact taxes to pay the debts and to provide for the common defense and for the general welfare of the United States, with the restriction that if it was a direct tax, it had to be levied amongst the States in proportion to their respective censuses. Ratification would require affirmative vote of nine of the States.

Delaware and New Jersey quickly and unanimously ratified because the Congressional powers to regulate interstate commerce would put a halt to taxes being levied by Pennsylvania and New York on goods in transit to or from them through those bigger states. Georgia ratified without delay (and also unanimously), perceiving that a strong national government would protect it from Seminole Indians to the West and the Spanish in Florida to the South. Pennsylvania ratified in fairly short order, as the proceedings were well orchestrated by proponents of the Constitution, such as James Wilson. Rhode Island promptly voted to reject the Constitution.

The remaining 8 States took more time to make their decisions; their representatives were divided on issues. The ratification process in these 8 States was contentious. Copies of the Constitution were circulated; essays (pro and con) appeared in pamphlets and newspapers. Those in favor of the Constitution as presented were called “Federalists”; those not in favor were called “Anti-Federalists”. There were debates in town meetings and local conventions. The public nature of the ratification process was in stark contrast to the Constitutional Convention, which had been conducted in secret. Proponents and dissenters who had participated in the Constitutional Convention offered their opinions as to what some of the provisions meant, including the tax power clause.

During the ratification debates, there were three main concerns: (1) the absence of a bill of rights, (2) lack of clarity as to the powers remaining in the States, and (3) the tax clause. Many still did not want Congress to have its own power to tax; they preferred to retain the requisitions process. People would respond more favorably to the governments of their own States than to a national government. States would levy taxes more judiciously than would a national government. People should have a right to be taxed only with the consent of representatives who knew them and understood their circumstances. Creating a fair and reasonable tax system would be a difficult task for a federal congressman with 30,000 constituents or more. Amendments were proposed (1) to keep the requisitions process, but with some sort of enforcement penalty; or (2) to give Congress the right to tax only after requisitions to the States had failed to produce the revenue requested; or (3) to expand the category of taxes which, like direct taxes, could only be assessed proportionally by census; or (4) to limit Congress’s taxing powers to excise taxes and tariffs on imports, and eliminate any internal taxes, whatever they might be. A common sentiment prevailed, namely the irony of revolting from Britain for its taxing policies, only to give that same power to the new federal government.

One Virginian, in an article in the Freeman's Journal (October 31, 1787), asked his fellow citizens whether they ever imagined they would see the day that a government other than the General Assembly of the State of Virginia would have the power of direct taxation in their state; there would be excise laws, "the instruments of tyranny", in force in the state, the excisemen would not be Virginians, but possibly be from New England, and the court to test these taxes might not be a Virginia court. He warned that the taxing power was not limited to what would be needed to enable the government to exercise the prerogatives which every friend to America would wish to see vested in it, but rather would give Congress the ability to increase taxes to any amount. He added that New England will now send revenue officers to Virginia instead of onions and apples.

The "general welfare" language in the tax clause also was a concern. Madison and Hamilton did their best to allay their concerns. They claimed that the "general welfare" clause was not meant to be a separate law making power. It only meant that the monies collected must benefit the people being taxed. This was consistent with the meaning attached to "general welfare" by John Dickinson.

It took eight months to persuade the requisite total of nine States to ratify the Constitution. In the end every State ratified the Constitution without any of the suggested amendments. The last State to ratify was Rhode Island. Initially, it had rejected the Constitution, it had voted not to ratify; but finally, after the other 12 States had ratified, and faced with the choice of joining or staying out of the Union, it accepted the Constitution, but only barely. The vote was 36 in favor to 34 against, but it could easily have gone the other way, as four anti-federalist delegates were still in transit and did not arrive in time to cast their votes.

Two years after ratification of the Constitution, Alexander Hamilton, in his efforts to create a national bank, expressed the so-called "loose construction" concept of the Constitution. He said: "Every power vested in a government is in its nature sovereign, and includes by force of the term, a right to employ all means requisite ... to the attainment of the ends of such power If the end (i.e. the purpose of the legislation) be clearly comprehended with any of the specific powers, and if the measure have an obvious relation to the end and is not forbidden by any particular provision of the Constitution, it may be deemed to come within the national authority."

Thomas Jefferson voiced his concerns with the "general welfare" clause in 1825, 8 months before he died, in a letter to fellow Virginian William Giles. He complained of the growing use of federal powers, specifically in cutting down mountains to build roads and in digging canals. He saw such actions by Congress as usurping states' rights under its Constitutional power to regulate commerce, aided, as he said, "by a little sophistry on the words "general welfare" [in the tax clause]." As he said, Congress now claims "a right to do, not only the acts to effect that,

which are specifically enumerated and permitted, but whatsoever they shall think, or pretend will be for the general welfare.”

When the first six of the Southern States seceded from the Union in 1861, they adopted their own Constitution, mostly modelled on the US Constitution, but with a few changes. One change was to the tax clause. It said that the Congress of the Confederate States could lay and collect taxes “for revenue necessary to pay the debts, and provide for the common defense, and carry on the government of the Confederate States.” No “provide for the general welfare” language.

For the rest of the 18th Century and most of the 19th Century, federal taxes consisted of tariffs on imports and excise taxes on domestic products and services. The tariff and excise tax categories expanded as needs for monies increased.

The tariff system of taxation was controversial. Tariffs protected Northern industries from competing imports. Southern and Western States wanted lower tariffs, as they had less manufacturing and were reliant on goods from the North and abroad. For a short period in 1833, South Carolina used a so-called Nullification Ordinance to prevent federal officers from collecting customs duties in the State. The 1861 Constitution of the Confederate States expressly prohibited its Congress from enacting taxes on imports which would promote any industry. By the latter stages of the 19th Century, there were as many as 4000 items covered by, or expressly excluded from, the tariff system, and the Republican Congress had raised tariff rates to as much as 50% on some items, such as wool.

The Chairman of the US Revenue Commission in 1865 likened the tax system to instructions given at a concession stand at an Irish Fair. At the Irish Fair, when you see a head, hit it. In Congress, when you see a new object, tax it.

Except for the Civil War period, there was no income tax until briefly in 1894. The absence of an income tax was a matter of preference. No country, not just ours, wanted an income tax. An income tax was expensive to administer, and involved a bureaucracy to obtain and process information and to collect the tax. Throughout most of history, keeping track of individual records was thought to be logistically impossible.

The Union enacted an income tax during the Civil War and for six years thereafter, to help pay for the War. When enacted, there was little objection. The Civil War income tax was hailed as being fair because it would reach the pockets of the wealthy, and it was the least odious of the alternatives, but, as suspected, it did create a bureaucracy, was costly to administer, and surprisingly, produced little additional net revenue. Tax collectors worked on a commission basis. By 1871, prior supporters, such as the New York Times, cried for its repeal. Congress repealed the Civil War income tax in 1871.

In 1894, Congress enacted the first non-war period income tax. The 1894 income tax was part of a compromise which would reduce tariff rates. It became part of the Wilson-Gorman Tariff Act of 1894. Even though the income tax might create a bureaucracy, its proponents believed the income tax to be fair. The income tax would reach everyone; and it would force the wealthy to contribute their fair share to the tax system.

The 1894 income tax was no sooner enacted than it was challenged and declared to be unconstitutional in *Pollock v. Farmer's Loan & Trust Company*, 158 U.S. 601. The Supreme Court, in a 5-4 ruling, struck down the 1894 income tax on the ground that it was a direct tax, and as such, it had to be apportioned amongst States on the basis of census, and it was not. Calling the income tax a direct tax was the Court's way of siding with opponents of the tax who objected to as a method of redistribution of wealth. The Supreme Court in *Pollock* reversed its rulings in three earlier cases in which it had upheld the constitutionality of the Civil War income tax, finding it to be an indirect tax, not a direct tax. *Pacific Insurance Company v. Soule* (7 Wallace 433); *Veazie Bank v. Femno* (8 Wallace 5__); *Scholy v. Rezv* (23 Wallace 331); and *Springer v. U.S.* (102 U.S. 586).

The *Pollock* decision was unpopular. The wealthy still would not have to pay their "fair share". Scholars doubted the characterization of an income tax as a direct tax. And, the decision left the government with no revenue to replace the reduced tariffs. *Pollock* galvanized the position of populists and progressives for a federal tax on accumulated wealth and high income. One historian, Andrew McLaughlin, in his 1935 *Constitutional History of the United States*, said that "probably no other case, with the exception of the *Dred Scott* case of forty years before, was so widely discussed or received so much unfavorable comment." He followed by saying that "the principle involved was so important that earnest advocates of the income tax and those filled with zeal for industrial and social reform were unwilling to retire from the struggle."

Conservatives controlled Congress for the next 14 years. Little was done about tariff reform. Then, in 1909, Democrats and progressive Republicans proposed adding an income tax measure to a tariff bill sponsored by Rhode Island Senator Nelson Aldrich. Aldrich did not want an income tax. President Taft wanted tariff rates reduced; and he also believed that an income tax system would be better for the country. Being an adept negotiator, the President arranged a compromise with the Rhode Island Senator. There would be no income tax as part of Senator Aldrich's proposed legislation, which was called the Payne-Aldrich Tariff Act of 1909, but in return, the Senator agreed to back a constitutional amendment to remove the "direct tax-census apportionment" problem from the income tax. Taft favored correcting the income tax problem by constitutional amendment, rather than by statute, so that the Supreme Court would not have to be involved again. Senator Aldrich agreed to the compromise because he believed there was no

chance of a Constitutional Amendment being approved by 2/3 of each House of Congress and by ¾ of the States.

The Senator was wrong. The House of Representatives took only one afternoon to approve the Amendment, and by a 318 to 14 margin. The Senate also acted quickly, approving the Amendment resolution by a 77 to 0 vote. Conservatives in Congress must have thought, like Senator Aldrich, that there was no chance that three quarters of the States would ratify. The proposed Sixteenth Amendment was forwarded to the State legislatures.

This was July 1909. One State, Alabama, ratified the amendment by the end of the year. Eight more states followed suit the next year, 1910. The process dragged out in the rest of the states. It was helped by Democratic victories in the 1912 elections. On February 3, 1913, the requisite 36th state, Delaware, ratified the Sixteenth Amendment. Six more states followed suit, but 6 states refused to ratify, these being Connecticut, Florida, Pennsylvania, Virginia, Utah and, surprise, Rhode Island.

The Sixteenth Amendment negated the Pollock decision, by avoiding the “direct tax” impediment, should that really have been one. The Amendment said that “Congress shall have the power to lay and collect taxes on income, from whatever source derived, without apportionment among the several States and without regard to any census or enumeration.”

Congress was free to enact an income tax, and it acted quickly. In September 1913, it passed the Underwood-Simmons Revenue Act of 1913, which contained an income tax. The 1913 Revenue Act taxed incomes in excess of \$3000. For a few more years, most federal revenue continued to come from tariffs and from excise taxes, especially on tobacco and alcohol. Only 4% of the population had incomes large enough to pay the income tax.

The enactment of the income tax, as well as inflation, pushing more income above the \$3,000 threshold, coincided with a period of expansion of activities of the national government for which it would need money. With a broader income base, and by raising rates, Congress now had a source for considerably more revenue. Its power to tax large incomes and to tax them heavily would prove to be of great importance in influencing changes in economic and social conditions. And, the federal government, with its departments and bureaucracies, was taking over functions which in earlier periods would have been the duties and province of the States. Its activities expanded into social programs.

This brings us back to the “provide for ... the general welfare” language in the Constitution’s tax clause, the wording that Anti-Federalists and Thomas Jefferson had feared, the clause that says that Congress has the power “to lay and collect taxes, to pay debts and provide for the common defence and general welfare of the United States”.

Prior to 1936, the Supreme Court had never directly addressed the meaning of the “provide for the general welfare” provision. If taxes were challenged, the Court made its decisions on other grounds, such as infringing on rights or immunities of the States. The Court finally did address the meaning of the “general welfare” clause in 1936 in *United States v. Butler*, 297 U.S.1 (1936). In *Butler*, the Court stated, in dictum, that Congress’s tax power to provide for general welfare really is an independent power to create laws for general welfare purposes that it need not derive from anywhere else in the Constitution. *Butler* was an unusual opinion, in that although it interpreted the “provide for the general welfare” clause as a separate power, it struck down the tax in question on the ground that it infringed on the rights reserved to the States to regulate this particular activity. *Butler* involved the constitutionality of the Agricultural Adjustment Act of 1933 (the “AAA”). In the Act, a tax was imposed on processors of farm products, the proceeds to be paid to farmers who would reduce their growing areas and crops. The Court said that were the regulation and control of agricultural production not reserved to the states, Congress could have imposed a tax such as this for the general welfare of the country. The *Butler* Court noted that since the adoption of the Constitution, “sharp differences of opinion have persisted as to the true interpretation of the (provide for the general welfare) phrase”. On the one hand was Madison’s view that the government is of limited and enumerated powers and the power to tax to provide for the general welfare was not an additional law making power; those were limited to the specific powers in the Constitution. On the other hand was the view ascribed to Hamilton from his “ends” justifies the “means” statement on creating a national bank that Congress has a substantive power to tax and appropriate for general welfare, not necessarily tied to other powers. The Court adopted the view ascribed to Hamilton. On the basis of the power to enact taxes, laws could be created to provide for the general welfare of the country.

Shortly after *Butler*, the Supreme Court, in *Helvering v. Davis*, 301 U.S. 619 (1937), upheld the validity of the Social Security excise tax on employers on the basis that the monies from these taxes will be conducive to the general welfare of the country. The *Davis* decision also confirmed that the concept of general welfare is not static. “What is critical or urgent changes with the times.”

Recently, M.I.T. history professor Pauline Maier said “if Congress could exercise only those powers expressly given to it, as Federalists insisted time and again, why not say that to calm people’s fears.”

Madison’s view of a government limited to express powers in the Constitution, is drawn into question by his response to Representative Thomas Tudor Tucker of South Carolina in the post-ratification discussions on the Bill of Rights. The Tenth Amendment was to say that “the powers not delegated to the United States...are reserved to the States and the people” Tucker wanted to add the word “expressly” before the word “delegated”, so that the Tenth Amendment would

say that “the powers not expressly delegated to the United States . . . are reserved to the States and the people . . .” Madison objected to this one word addition, saying that it would be impossible to confine the Government to the exercise of express powers.

After 150 years, the concerns of the Anti-Federalists in the ratification debates and of Thomas Jefferson in his death bed letter to William Giles and of the Virginian who feared losing onions and apples from New England were proved to be justified.

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