

# Redesigning Federal Taxation

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"Faith is a fine invention  
For gentlemen who see;  
But microscopes are prudent  
In an emergency!"

*Emily Dickinson*

**I**N these hard, critical days the words of a New England poet may be full of salutary suggestion. They may be applied to the whole kaleidoscopic international situation. They may be addressed as well to the fluctuating national scene, including the problem of financing national defense. The necessity of paying for continuing to live in a civilized society will put an indescribable strain upon our tax system. In such an emergency, shall we trust to blind faith, or shall we add to our faith as Americans the prudent use of microscopes?

The vaguenesses of preliminary discussion have recently been clarified by concrete figures on the subject of financing national defense.<sup>1</sup> The total cost of the projected expansion of military and naval plant, exclusive of maintenance, has been crudely estimated at between \$16,000,000,000 and \$18,000,000,000. These figures are sufficiently challenging, even for twentieth century thresholds of sensation. They mean that the United States must pay the equivalent of the asset value of eighteen General Motors corporations as the price of adequate defense. But even more arresting are the estimates of annual maintenance and operation cost of the new military plant when completed. Here many imponderable factors, such as airplane

<sup>1</sup> "Exploring the Financing of National Defense and Its Economic Consequences," 21 *Savings Bank Journal* 8 (October, 1940).

<sup>2</sup> This is about the sum which may be spent in the fiscal year 1941 for increased plant. Leon Hender-

obsolescence and military vacillations, preclude precise estimate, and dictate a range estimate of from \$5,500,000,000 to \$8,000,000,000. This sum may be compared with less than \$1,000,000,000 of Army and Navy expenditures in the Government fiscal year 1940. At the very least we shall, therefore, have to increase our annual governmental expenditures by \$4,500,000,000 when our military plant is completed. Probably the increase will be nearer \$5,000,-000,000.<sup>2</sup> And these sums may be underestimates.

Such necessities bring incalculable problems. To what extent shall such a program be financed by borrowing? To what extent shall it be financed by taxation? What is necessary to adapt our Federal tax system to the inevitable strain of providing its share of the necessary funds? Questions of such staggering importance need calm, objective, non-partisan discussion. Our wisdom will depend upon our detachment. If there is too much heat, there may be too little light. And there cannot be too much light upon a problem that will be with us for so long a time. For we have not only the financial problem of building up defense during the next few years, but also the vital long-run questions of post-defense fiscal policy in connection with the problem of permanent cost of maintenance and operation of an extended military plant.

Whether many are right in their assertion that we may borrow freely with-  
son, 21 *Savings Bank Journal* 46 (October, 1940);  
Richard V. Gilbert, 21 *Savings Bank Journal* 9  
(October, 1940). It is not a simple task to spend  
money.

out undue risk need not be debated now; we have no other choice for the moment.<sup>3</sup> Ultimately we shall have to deal with this question as a matter of long-run policy. And we shall also have to decide whether to increase our taxes. The problem is, however, far larger than a question of increased taxation. It may well be that taxes should be used moderately until we have achieved a full utilization of our resources.<sup>4</sup> It may also be that pressures of national morale will require us quickly to increase tax rates beyond the levels achieved by the two revenue acts of 1940.<sup>5</sup> However these questions may be answered, the grim necessity of a searching re-analysis of our existing tax system is knocking hard at the door. That necessity will merely be emphasized by any further increase in taxes. The crucial question is with us even if increased national revenues save us from the necessity of increasing rates: To what extent and how shall our tax system be redesigned to meet an unprecedented emergency?

A tax system engaged in the task of exacting<sup>6</sup> from 8% to 10% of the national income, on top of a state and local exaction of about 10%, must be a sound tax system. Apart from its usefulness for nonfiscal ends, taxation is but a method of raising revenue to defray the expenses of government, and of fairly distributing the burden among those who must bear it.<sup>7</sup> Even if we

assume that our existing system may raise the requisite revenue under an economy stimulated to produce a national income of from \$90,000,000,000 to \$110,000,000,000,<sup>8</sup> the question remains whether its burden is equitably distributed. Only wishful apologists will claim that it is. Even in taxation, equity may be a roguish thing; but it has some principles. It rebels at a palpable failure to reach available revenue, which in turn passes avoided burdens to others. It protests, with equal vehemence, against inflexible attitudes which exact their pound of flesh without discrimination. The quality of mercy should not be strained even in the field of taxation. And a tax system must keep reasonably abreast of economic realities; it cannot live in an ivory tower apart from a changing world which it is supposed to serve.

### Defects of the Tax System

General principles do not usually decide concrete cases,<sup>9</sup> but to judge a tax system it is necessary to adopt some point of departure in terms of basic theory. There is considerable debate among our leading economists upon the question whether the chronic depression which has characterized our national economy is caused by a lack of balance between the disposition to save and available investment outlets, or has some

<sup>3</sup> See Guy Greer, "Arming and Paying for It," 181 *Harper's Magazine* 650, 653 (November, 1940); E. A. Goldenweiser, 21 *Savings Bank Journal* 12 (October, 1940); Gilbert, *op. cit.*, p. 13.

<sup>4</sup> Gilbert, *op. cit.*, p. 45; Greer, *op. cit.*, pp. 650, 652.

<sup>5</sup> Emile Despres, 21 *Savings Bank Journal* 30 (October, 1940).

<sup>6</sup> The central thought in the accepted definition of taxes is that they are an exaction of sovereignty. See Thomas M. Cooley, *Law of Taxation* (4th ed., Chicago, Callaghan & Company, 1924), pp. 61, 69; *United States v. Butler*, 297 U.S. 1, 61 (1936); *Bull v. United States*, 295 U.S. 247, 259 (1935); *Florida Central and Peninsular R.R. Co. v. Reynolds*, 183 U.S.

471, 475 (1902).

<sup>7</sup> Justice Stone, dissenting in *Great Northern Railway Co. v. Weeks*, 297 U.S. 135, 155 (1936); Felix Frankfurter, *Mr. Justice Holmes and the Supreme Court* (Cambridge, Harvard University Press, 1938), p. 42.

<sup>8</sup> See Greer, *op. cit.*, pp. 650, 653. See also 21 *Savings Bank Journal* 8 (October, 1940).

<sup>9</sup> Justice Holmes, dissenting in *Lochner v. New York*, 198 U.S. 45, 76 (1905); "Holmes, Letter to Dr. Wu, June 16, 1923," *Justice Oliver Wendell Holmes, His Book Notices and Uncollected Letters and Papers*. Edited by Harry C. Shriver (New York, Central Book Company, 1936), pp. 164-165.

less obvious cause, the elimination of which would in turn eliminate idle savings as a depressing factor.<sup>10</sup> Within the limits of a short article it is not possible to explore the validity of many available statistical studies on this subject or to appraise the significance of controversies. The discussion of proposed changes in our tax structure in this article is premised on the belief that some reduction of stagnant savings by taxation and by their reintroduction into the income stream through expenditures is desirable, and that a reduction within certain limits can be accomplished without having unintended restrictive effects more than offsetting the desired advantages.

What specifically is the matter with our tax system? If one could be Congress, what would one do to improve it? Tax talk needs to be on such a brass-tack level. Tax questions can rarely be answered with smooth generalities. Exact descriptions and bills of particulars will be a refreshing change from most tax talk. And they are a prime requisite of constructive tax discussion. They are the trees that make the forest, which incidentally must always be kept in view as a forest.

It is not difficult to be specific about

<sup>10</sup> Cf. the different points of view as represented in H. G. Moulton, G. W. Edwards, J. D. Magee, and Cleona Lewis, *Capital Expansion, Employment, and Economic Stability* (Washington, The Brookings Institution, 1940); National Bureau of Economic Research Publications, No. 34, *Commodity Flow and Capital Formation* by Simon Kuznets, and No. 35, *Capital Consumption and Adjustment* by Solomon Fabricant (New York, The Bureau, 1938); "Papers and Proceedings of the Fifty-first Annual Meeting of the American Economic Association," 29 *American Economic Review* 1-60 (Supplement, March, 1939); Alvin H. Hansen, "Progress and Declining Population," 29 *American Economic Review* 1 (March, 1939); *An Economic Program for American Democracy* by Seven Harvard and Tufts Economists (New York, The Vanguard Press, 1938).

<sup>11</sup> Our Federal tax system is also unduly complicated. It now comprises more than 100 taxes. Mabel Newcomer, *Taxation and Fiscal Policy* (New

the defects of our tax system,<sup>11</sup> for it fails to deal adequately with many of its problems. Unreasonable corporate accumulations are a common phenomenon.<sup>12</sup> The provision penalizing unreasonable corporate accumulations has been found completely wanting, because taxpayers have successfully argued that they may pile up surpluses for the mythical rainy day of the unpredictable future, or that they may in the same sort of future go into a new business in the manner of the White Knight, who kept a bee hive on his horse because he might some day wish to keep bees.<sup>13</sup> We have for years supinely failed to seek re-examination of a five-to-four decision of the Supreme Court of another day that stock dividends are not constitutionally taxable. Only comparatively recently have we ventured to tax some stock dividends, and we still shy at an attempt to tax common stock dividends upon common stock where only common stock is outstanding. In spite of recent decisions of the Supreme Court, legitimate wholesale avoidance of income and estate taxes may be accomplished by the use of trusts at the cost of a relatively low gift tax.<sup>14</sup> We do not try, in the manner of the more realistic British, to cut under this whole problem by

York, Columbia University Press, 1940), p. 17. But I hesitate to make this complaint, since so much of the complexity springs from a desire to be fair to taxpayers. See Robert B. Eichholz, "Should the Federal Income Tax Be Simplified?" 48 *Yale Law Journal* 1200 (May, 1939). Much complexity not attributable to this cause originates in the legislative desire to prevent tax avoidance.

<sup>12</sup> See Greer, op. cit., pp. 650, 660.

<sup>13</sup> See *Final Report of the Committee of the National Tax Association on Federal Taxation of Corporations, National Tax Association, Proceedings* (1939).

<sup>14</sup> As an example of this saving, it may be noted that a gift of \$10,000 from an estate that will amount to slightly more than \$1,000,000 at the death of the donor avoids a prospective estate tax of \$3,520 by paying a gift tax of only \$165. This example assumes that the donor has used the \$40,000 exemption, but has made no other gifts. It also ignores the \$4,000 exclusion.

abolishing husbands' and wives' privilege of filing separate returns. Although the Supreme Court has unshackled us from several supposed Constitutional limitations, we continue a statutory exemption of income from state and municipal securities; and in so doing we provide a haven from the sweep of the surtax, with the result that a constantly growing mass of tax-exempt securities is seriously endangering the system of the progressive income tax. Life insurance remains for the initiated a manifold instrument of tax avoidance. We have no adequate provisions to prevent escape from the estate tax by means of *inter vivos* gifts which are in fact, if not in synthetic legal theory, in contemplation of death. The estate tax is flagrantly avoided by the instrumentality of special powers of appointment.<sup>15</sup> We discriminate against earned income, such as salaries, and against unearned income, such as dividends, by continuing in effect an unduly low tax on capital gains.<sup>16</sup> And the angel of death saves many

<sup>15</sup> Erwin N. Griswold, "Powers of Appointment and the Federal Estate Tax," 52 *Harvard Law Review* 929 (April, 1939).

<sup>16</sup> See Gerhard Colm, "The Revenue Act of 1938," 5 *Social Research* 255 (September, 1938). This is, of course, a highly controversial point. Opinion ranges over a wide latitude from the advocacy of complete elimination of any capital gain tax to contentions that such gains should have no immunity. See Arthur H. Kent, "The Case of Taxing Capital Gains, The Case for Taxation," 7 *Law and Contemporary Problems* 194 (Spring, 1940); Godfrey N. Nelson, "The Case of Taxing Capital Gains, The Case against Taxation," 7 *Law and Contemporary Problems* 208 (Spring, 1940). See also George O. May, *Twenty-Five Years of Accounting Responsibility* (New York, American Institute Publishing Co. and Price, Waterhouse & Co., 1936), Vol. 2, p. 144; Henry C. Simons, *Personal Income Taxation* (Chicago, University of Chicago Press, 1938), p. 148; Robert Murray Haig, "Taxation of Capital Gains," *Wall Street Journal*, March 23, 25, 29, April 2, 8, 13, 1937; Roy Blough and W. H. Hewett, "Capital Gains," contained in *Studies in Income and Wealth* (New York, National Bureau of Economic Research, 1938, Vol. 2, p. 191); National Tax Association Conference, Report of Committee on Capital Gains, 1938. Apart from the general 10% increase effected by the first Revenue

capital gains from any tax at all because of our statutory rule that the estate of the owner of the appreciated property may take value at the date of death as the basis of the property. Finally, the estate, income, and gift taxes are wholly without integration.<sup>17</sup>

While we thus make the mistake of being tender-minded, we also disregard William James's advice by being tough-hearted. Our tax statutes are full of discriminations. The existing situation with respect to consolidated returns cries out for further study. We now permit such returns for excess profits tax purposes, but not for income tax purposes. If there is any plausible reason for this differentiation, no one has stated it on any available record. The tax effect of mortgage transactions, from the standpoint of the capital loss provision and the bad debt provision, is a morass of metaphysics.<sup>18</sup> Our rules of *res judicata*, every year a more important subject, are completely archaic.<sup>19</sup> The statute is inexcusably harsh with respect to personal

Act of 1940 we now tax long-term gains at a 15% rate as against a top surtax of 75%, which with the normal tax totals 79%. This seems to the writer too great a differentiation.

<sup>17</sup> Among the many minor blunders in our tax acts may be mentioned (1) the extension of the right to deduct for income tax purposes the market value of gifts made to religious, charitable, scientific, and educational institutions, (2) the failure to make the basis of property to be used by the distributees of an estate conform to the valuation allowed under Section 811 (j) of the Internal Revenue Code, and (3) the extension of the right to deduct for estate tax purposes claims against the estate, even though such claims may not be enforceable against particular assets of the estate, such as insurance. Randolph E. Paul, "Life Insurance and the Federal Estate Tax," 52 *Harvard Law Review* 1037, 1072 (May, 1939).

<sup>18</sup> Randolph E. Paul and George S. Allan, *Studies in Federal Taxation, Third Series* (Cambridge, Harvard University Press, 1940), p. 296.

<sup>19</sup> See Erwin N. Griswold, "Res Judicata in Federal Tax Cases," 46 *Yale Law Journal* 1320 (June, 1937); Randolph E. Paul and Philip Zimet, *Selected Studies in Federal Taxation, Second Series* (Chicago, Callaghan and Company, 1938), p. 104.

holding companies where dividends cannot be distributed.<sup>20</sup> The statute has no provision for such intelligent generosity<sup>21</sup> as a credit on account of dependents between the ages of nineteen and twenty-one years, or a limited deduction for personal medical expenses.

### Consumption, Income, and Estate Taxes

Even if we corrected ourselves in these respects, we should fall short—far short—of the goal of a sound tax system. For our existing system is conceived *in vacuo*. Our predominant philosophy is the shop-worn notion that taxation is for revenue only.<sup>22</sup> Such a philosophy contradicts experience, which is the best teacher of all.<sup>23</sup> The use of taxes, with incidental and even nonfiscal motives, is sanctioned by precedents as old as our Constitution.<sup>24</sup> Whether we like it or not, we know that every tax is in some measure regulatory, since it interposes “an economic impediment to the activity taxed as compared with others not taxed.”<sup>25</sup> But we hesitate to view our tax system as part of an entire economy. We act upon the charming fiction that its only function is revenue raising, when we know that our choice of taxes affects our whole economy. This is particularly

<sup>20</sup> The same situation exists under the discarded undistributed profits tax where there has been an impairment of capital. *Helvering v. Northwest Steel Rolling Mills, Inc.*, decided by the Supreme Court, November 12, 1940.

<sup>21</sup> See John M. Maguire, “Capitalization of Periodical Payments by Gift,” 34 *Harvard Law Review* 20, 49 (November, 1920).

<sup>22</sup> An exception is our Federal estate tax, which is avowedly for the purpose of wealth redistribution. See remarks of Congressman (later Vice President) Garner in 65 *Congressional Record* 3122 (1924); remarks of Congressman LaGuardia (now Mayor of New York City) in 75 *Congressional Record* 6678 (1932). See also Message of President Roosevelt, June 19, 1935, quoted in H.R. Rep. No. 1681, 74th Cong., 1st Sess., CB 1939-1, Part 2, p. 642.

<sup>23</sup> See Gerhard Colm, “Full Employment Through Tax Policy,” 7 *Social Research* (November, 1940).

<sup>24</sup> See Robert Murray Haig, “Taxation,” 14 *Encyclopaedia of the Social Sciences* 533 (New York, The

true in relation to our election of substantial consumption taxes instead of taxes upon savings.

Our tax system is now overloaded with consumption taxes. In the fiscal year 1940 our consumption taxes totaled \$1,813,000,000, or about 33% of our total receipts, as compared with \$1,210,000,000 in 1929. These taxes have been increased by the first Revenue Act of 1940, and it is probable that consumption taxes will reach the unprecedented total of \$2,240,000,000 in the fiscal year 1941. A recent TNEC study<sup>26</sup> demonstrates the effect of these consumption taxes. Families with incomes of \$500 and under, pay taxes amounting to 25% of their total income. Families with incomes from \$500 to \$10,000 pay between 18% and 20%. In the lowest income families the process is to take money out of one of their pockets and to put it back into the other pocket.

Regressive consumption taxes provide the easiest administrative way of raising revenue. But they are primarily a levy on the poor, violating the first canon of progressive taxation, the principle of ability to pay.<sup>27</sup> In addition, and in terms of “things and results,”<sup>28</sup> their effect on our economy may be extremely

Macmillan Company, 1934); Alfred G. Buehler, “Regulatory Taxation,” 17 *HARVARD BUSINESS REVIEW* 138 (Winter, 1939); Chester T. Crowell, “Taxation Not for Revenue,” 176 *Harper’s Magazine* 89 (December, 1937). See also *St. Louis Poster Advertising Co. v. St. Louis*, 249 U.S. 269 (1919), justifying a high tax to discourage billboards.

<sup>25</sup> *Sonzinsky v. United States*, 300 U.S. 506, 513 (1937); *Pacific American Fisheries v. Alaska*, 269 U.S. 269, 277 (1925).

<sup>26</sup> Gerhard Colm and Helen Tarasov, *Who Pays the Taxes?*, Monograph No. 3, Temporary National Economic Committee (1940).

<sup>27</sup> Henry S. Dennison, Lincoln Filene, Ralph E. Flanders, and Morris E. Leeds, *Toward Full Employment* (New York, Whittlesey House, McGraw-Hill Book Company, Inc., 1938), p. 215; Newcomer, op. cit., pp. 22, 37, 39, 40.

<sup>28</sup> Oliver Wendell Holmes, *Collected Legal Papers* (New York, Harcourt, Brace and Company, 1920), p. 282.

damaging, because they seriously affect the incomes and welfare of all persons, including taxpayers in the upper brackets. Any form of taxation

... takes money out of somebody's pocket and entails some decrease in expenditures of that person. Taxation diverts funds from the taxpayer to the Government. The expenditure of these funds by the Government in general merely replaces expenditures by individuals and business firms, and does not add to the stream of national income and thus to the volume of employment. Only in the event that taxes divert to the Government funds which would otherwise be hoarded can tax-financed expenditures have a net expansive effect upon the income stream and the volume of employment.<sup>29</sup>

Consumption taxes, including such mass luxury taxes as the taxes upon tobacco and gasoline, should be a last resort in a modern tax system.<sup>30</sup> There may come a time—such time has come in Great Britain—when consumption taxes will have to be used to curtail the production of peacetime commodities.<sup>31</sup> The primary function of consumption taxes should be to control production, not to raise revenue. With unemployment at present levels it looks as though it will be a long time before this country has to adopt Goering's slogan of guns, not butter, unless bottlenecks intervene. But as if this were not true, we are using consumption taxes to raise revenue when we should be holding them in reserve to act as a control upon production. The effect is to repress the expansion of the economy. We thus take two steps forward, and then one step backward. What we should do is finance less by consumption taxes and more by taxes upon the

<sup>29</sup> Gilbert, *op. cit.*, p. 13.

<sup>30</sup> Dennison, Filene, Flanders, and Leeds, *op. cit.*, p. 237. A case may be made for the gasoline tax upon the ground that it proportions highway cost to use.

<sup>31</sup> Gilbert, *op. cit.*, pp. 36, 46; Jerome Frank, *Speech*

moderately high income groups and, as a practical matter, upon corporations.<sup>32</sup> While taxes on moderately high incomes have some repressive effects upon investment and thus upon employment, they operate to reduce idle savings. From the standpoint of the whole economy, they are therefore much more desirable than consumption taxes, which reduce the spending power of individuals in the lower brackets. And even if the supply of goods available to consumers must be reduced because of the requirements of national security and defense, it is more than ever necessary that the sacrifices should be borne by those whose consumption can be reduced without impairment of health or efficiency. Full employment provides no justification for regressive taxation for the purpose of raising revenue.

If we look at our tax problems without the pressure of interest in our own personal pocketbooks, what is the true situation? Our existing individual income taxes, even under the rates of the first Revenue Act of 1940, and even including state taxes,<sup>33</sup> are insignificant compared with British income taxes under the rates proposed in the new British budget. The effective rate for a married person with no dependents having a fully earned income of \$3,000 a year is 21.9% in Great Britain and only 1.5% in combined United States Federal and New York State income taxes. In other words, such a person pays \$658 in Great Britain and only \$45 in the United States. A person with an income of \$10,000 pays \$3,621 in Great Britain and only \$854 in the United States. The same story holds until we reach the high

before the Army Industrial College, April 8, 1940.

<sup>32</sup> As to the taxation of corporations see, however, comments in note 35.

<sup>33</sup> The single British tax is heavier than the combined Federal and state taxes in the United States. Newcomer, *op. cit.*, p. 23.

brackets<sup>34</sup> or the corporate field.<sup>35</sup> Many corporations, particularly corporations with high earnings in the period from 1936 to 1939, will be relatively immune from the excess profits tax imposed by the Second Revenue Act of 1940. On the other hand, corporations with low invested capital and low earnings during this period will be unduly penalized. New corporations, the growth of which it may be desirable to encourage, may also be handicapped.

In the estate tax field we have no such taxes as are imposed by the British. The United States taxes a net estate of \$50,000 before exemptions at the effective rate of 0.44%. Great Britain taxes such an estate at the rate of 6%. A United States net estate of \$100,000 pays a tax rate of 4.6% as against a British tax of 10.8%. The pendulum does not swing the other way until we reach extremely large estates when, finally, our estate taxes do become larger than the British taxes.

To the extent that they are unsuccessful at avoidance, persons in the upper income brackets pay their share of taxes. The middle and moderately high income groups do not. And the poor

pay more than their share, with the result that the need for relief is increased. Such a tax program is fantastically unrealistic. Redistribution of the load is essential both from the standpoint of equity and in terms of economic consequences. Certainly the solution of our unemployment problem depends in large part upon intelligent action in this direction. And a relatively heavier burden of income, estate, and gift taxation in the middle and moderately high brackets may be the only thing that will save our savings.

Space is not available to discuss further deficiencies of our tax system and their more ephemeral remedies. We have given little thought to the whole subject of incentive taxation,<sup>36</sup> and the use of taxation as an instrument of economic control. Much can be said in favor of a flexible rate schedule which would rise along with, but at a faster rate than, the level of productive activity measured by the indexes of the Federal Reserve Board and the Bureau of Labor Statistics.<sup>37</sup> And, finally, Mr. Keynes has suggested to his countrymen an ingenious plan for financing war.<sup>38</sup> Unfortunately Mr. Keynes has called his plan "radical."

<sup>34</sup> It may be that in the upmost brackets our income taxes are at the point of diminishing returns. The answer to this question is elusive; the subject needs more study than has been given to it.

<sup>35</sup> Many advocate the virtual elimination of our impersonal corporate taxes. The elimination of these taxes, except possibly the excess profits tax, may be highly desirable, but so far none of the substitutes offered seems workable. See *Facing the Tax Problem* (New York, Twentieth Century Fund, 1937), pp. 164, 307; Dennison, Filene, Flanders, and Leeds, *op. cit.*, p. 233; Greer, *op. cit.*, pp. 650, 660.

<sup>36</sup> For a detailed discussion of incentive taxation, see Gerhard Colm, "Full Employment Through Tax Policy?" *7 Social Research* (November, 1940). On November 21, 1938, a Senate finance subcommittee began a series of hearings to explore the idea that business may be induced to employ certain practices beneficial to labor and industry as a whole by giving corporations conforming to such practices some reduction in tax. The hearings were held until the middle of December, 1938.

<sup>37</sup> Greer, *op. cit.*, pp. 650, 657-658. See Gerhard Colm, *21 Savings Bank Journal* 47 (October, 1940), suggesting that the absence of a flexible tax upon consumption in a period of full mobilization of productive forces is "like driving a high speed motor car equipped only with an old hand brake." See also Dennison, Filene, Flanders, and Leeds, *op. cit.*, p. 9.

The difficulty is that we do not know long in advance when a state of *practically* full employment will be reached. It is probable that expansion may be limited by a lack of facilities or of workers of specific skill at a time when there are still some millions unemployed. Such a limitation may then be removed by the construction of new facilities and the training of skilled workers which will permit further expansion until a new ceiling is reached. Such are the questions leading to the flexible tax policy proposal. See Gerhard Colm, *Fiscal Policy and Recovery* (New York, National Tax Conference, 1940).

<sup>38</sup> John Maynard Keynes, *How to Pay for the War* (New York, Harcourt, Brace and Company, 1940).

Such nomenclature may be enough to condemn the plan in some quarters. As a matter of fact, the plan is not radical in any invidious sense; rather it should be called far-reaching. It is a combination of an income tax and forced loan, or, as Mr. Keynes later termed it, a delayed payment of wages. A contribution, fairly high in relation to total income, is levied. Part of the contribution is regarded as a bank credit to, or loan by, the taxpayer, to be evidenced by securities repayable in installments after the termination of the war. The proportion of the total contribution credited to the taxpayer and repayable to him is in inverse ratio to his income. The higher the income, the lower is the portion credited and repayable.<sup>39</sup> Certainly it is worthy of serious consideration whether such a plan would be adaptable, with modifications, to conditions which may later arise in this country.<sup>40</sup>

### Conclusion

It is not easy for those who pay to swallow a heavy dose of increased taxation. Medicine that does good is rarely pleasant to take. But friends of the capitalistic system should not act like protesting children when their most vital interests are at stake. If they refuse to accept the requisite dose of income, estate, and gift taxes, their own interests will suffer more than any other interests. For it is they that have the financial stake in the capitalistic system. If they will not consent to a balanced use of consumption taxes and taxes on savings, it will be their savings, not the savings of those who pay consumption taxes,

<sup>39</sup> Jerome Frank, Speech before the Army Industrial College, April 8, 1940. See also 21 *Savings Bank Journal* 52 (October, 1940). Mr. Keynes has also urged a capital levy after the war, but this suggestion is independent of the so-called Keynes Plan, and should not be considered inherent in that plan.

<sup>40</sup> John Maynard Keynes, "The United States and the Keynes Plan," *New Republic*, Special Section,

that will stand in peril of complete disappearance. It is as clear as anything may be in these opaque times that an undue burden of consumption taxes will halt, and perhaps break, our national economy. It will prevent the economy from rising to meet the emergency. The rest of the story will be increased unemployment and the hardship for the many that goes with undue deflation. This is the real threat to the capitalistic system. The part of wisdom in such an emergency is graceful acceptance of the inevitable and an intelligent control over what is only difficult. As an Englishman, who knew America better than many Americans know their country today, observed in another less eventful century, "To yield a little may be prudent, for the tree that cannot bend to the blast may be broken."<sup>41</sup>

The final point may be one of attitude. In taxation there is always a school of thought which cloaks timidity in the garb of further research necessities. Some will urge "finicky limitations" and "doctrinaire formulas" drawn from the general language of the Constitution "as a means of circumscribing the discretion of legislatures in the necessarily empirical process of tapping new revenue or stopping new devices for evasion."<sup>42</sup> But we cannot be Constitutional pedagogues when emergency calls for action; nor can we be too hot for absolute certainties when delays have dangerous ends. At such a time we may do better to call upon our Constitution's larger spirit and true theory, which is experiment.<sup>43</sup> The eventualities of intelligent experiment are unlikely to be as perilous as those inherent in paralysis.

p. 156 (July 29, 1940).

<sup>41</sup> James Bryce, *The American Commonwealth* (New York, The Macmillan Company, 1910), Vol. 1, p. 274.

<sup>42</sup> Felix Frankfurter, *Law and Politics* (New York, Harcourt, Brace and Company, 1939), p. 78.

<sup>43</sup> Justice Holmes, dissenting in *Abrams v. United States*, 250 U.S. 616, 630 (1919).