Table 8

FEDERAL EXCISE TAX AND CORPORATE INCOME TAX BURDEN AS A PERCENTAGE OF TOTAL INCOME[a]

By Money Income Classes

Calendar Years 1948 and 1954

Money Income Classes (Thousands)	Excise Taxes			Corporate Income Tax		
	1948		1954	1948		1954
	Tucker's Estimates	Musgrave's Estimates[b]	Musgrave's Estimates	Tucker's Estimates	Musgrave's Estimates	Musgrave's Estimates
All Classes	4.0%	3.7%	3.1%	6.3%	6.1%	5.7%
Under $1	4.2	3.8	4.4	4.9	4.6	3.2
$1 - $2	4.5	4.4		4.3	4.4	
2 - 3	4.3	4.4	4.0	4.6	4.2	3.4
3 - 4	4.4	4.5	3.7	4.6	4.2	3.0
4 - 5	4.2	4.0	3.5	5.1	4.2	2.9
5 - 7.5	4.0	3.7	3.4	6.5	4.2	3.3
7.5 and over	3.3	2.6	2.2	10.0	11.2	10.6
7.5 - 10	4.3	(c)	3.1	6.8	(c)	3.8
10 and over	(c)	(c)	1.9	(c)	(c)	13.5
10 - 15	4.4	(c)	(c)	6.5	(c)	(c)
15 - 20	3.5	(c)	(c)	7.3	(c)	(c)
20 and over	2.0	(c)	(c)	14.8	(c)	(c)

a. Money income plus income in kind plus imputed income. The latter is the unshifted part of the corporation income tax in Tucker's estimates, and, in addition, undistributed corporate profits in Musgrave's estimates. There are also minor differences in the definition of money and non-money income.

b. As revised in "Rejoinder to Dr. Tucker."

c. Not available.

Source: R. S. Tucker, "Distribution of Tax Burdens in 1948," National Tax Journal, September 1951. R. A. Musgrave, for 1948 estimates, "Rejoinder to Dr. Tucker," National Tax Journal, March 1952; for 1954 estimates, "The Incidence of the Tax Structure and Its Effects on Consumption," in Federal Tax Policy for Economic Growth and Stability, papers submitted by panelists appearing before the subcommittee on tax policy, Joint Committee on the Economic Report, 84th Congress, 1st Session, Nov. 1955.

the excise tax burden, but in this respect his estimates for 1954 are not as reliable as his estimates for 1948.[2]

At high income levels the burden of excise taxes is low in relation to income however the burden is measured. Tucker's estimates indicate that in 1948 the excise tax burden amounted to 2.0 percent of income for families with incomes of $20,000 and over (Table 8). This relatively small excise tax burden reflects the fact that at high income levels the income tax takes such a large slice of income that consumption expenditures are necessarily a small fraction of the individual's income.[3] Tucker's estimates indicate that in 1948 the total tax burden amounted to about 62 percent of income for families with incomes of $20,000 or more.

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2. Musgrave's 1954 estimates were arrived at by less detailed methods than his estimates for 1948: For 1954 he distributed the excise tax burden among income classes according to the distribution of total consumer expenditures; in the 1948 study he distributed the revenue from each kind of excise tax as far as possible according to the distribution of consumer expenditures on the goods or services subject to that tax. Going up the income scale, total consumer expenditures decline in relation to family income to a greater extent than expenditures on goods and services subject to Federal excise taxes (See below pp. 46, 47).

3. It is interesting to note, however, that according to Federal income tax data for returns with itemized deductions the burden of deductible state and local taxes, a substantial part of which consists of sales taxes, is approximately proportional up to income levels over $100,000:

Table 9

PERSONAL DEDUCTIONS FOR TAXES AS A PERCENTAGE OF ADJUSTED GROSS INCOME ON FEDERAL INCOME TAX RETURNS WITH ITEMIZED DEDUCTIONS

By Adjusted Gross Income Classes

Income Year 1952

Adjusted Gross Income Class	Taxes Deducted As A Percentage of Adjusted Gross Income
(Thousands)	
All Classes	4.2
Under $2	4.7
$ 2 under $ 3	4.4
3 " 5	4.1
5 " 10	4.2
10 " 20	4.4
20 " 50	4.2
50 " 100	4.0
100 " 500	4.2
500 and over	3.5

Source: Treasury Department and National Bureau of Economic Research.

At the very lowest income levels the burden of excise taxes is high in relation to individual or family income.[4] But special circumstances, such as age, mental or physical disability, account for a substantial part of the families and individuals at the bottom of the income scale.[5] These problems are dealt with under various government programs--health, education and training, public assistance, and other social security programs; but their relevance to matters of broad tax policy is remote. Such problems cannot be appropriately handled by tax legislation. This is evident even under the income tax with the additional personal exemption of $600 for people of 65 years and over. Unless such a person's income is substantially over $600 a year, he or she gets no benefit from the additional exemption. Similarly the retirement income credit enacted in 1954 is of no benefit to a person whose income is under $1,200.

In other words general tax policy is concerned with broad classes of taxpayers and the extent to which the special circumstances of individuals can be taken into account is limited. Since the burden of excise taxes is approximately proportional to income for the vast majority of taxpayers, there is nothing particularly unfair or unjust in the use of excise taxes.

2. Overemphasis on the Question of Regressivity vs. Progressivity.

The degree of regressiveness of the excise tax burden has often been exaggerated. Moreover, the importance of this consideration in tax policy has also been overemphasized.

In the first place, it is often overlooked that many kinds of taxes have wide public support despite the fact that their burden is regressively distributed. This is the case with various special purpose taxes, the most important of which is the O.A.S.I. tax. This tax is one of the most regressive because it is paid only on the first $4,200 of wages and salaries. Its fairness, of course, is defended on the grounds that there is some relationship between the taxes paid and the benefits to be received.

The excise taxes on motor fuels have been justified in part on the benefit principle. With current proposals for increases in these taxes, as well as in taxes on motor vehicles and parts, to support an expanded highway aid program, this justification will probably become more important.

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4. At very low income levels, as at very high income levels, there are special difficulties in measuring the weight of the tax burden because of the problem of defining income. Income in kind is particularly important at low income levels. In Tables 7 and 8 both Tucker's and Musgrave's estimates are based on income including income in kind; but the distribution of spending units (families) is by money income classes, and no adjustment of this distribution was made to allow for the inclusion of non-money income in "total income."

5. The Bureau of Labor Statistics Survey of Consumer Expenditures in 1950 showed that 64 percent of the heads of families with incomes under $1,000 were not gainfully employed and 59 percent were 65 years of age and over. (Characteristics of the Low-Income Population and Related Federal Programs, selected materials assembled by the staff of the Subcommittee on Low-Income Families, Joint Committee on the Economic Report, 84th Congress, 1st Session, 1955, p.32)

In addition to such special purpose taxes, liquor and tobacco taxes have wide public support. Tobacco taxes clearly weigh more heavily on the low than on the high income classes, since consumption does not increase in proportion to income. To a lesser extent the same thing is true of taxes on alcoholic beverages.

Taxes on liquor, tobacco, motor fuels, vehicles and parts, which are defended on special grounds despite their possible regressivity, account for about three-quarters of total Federal excise tax receipts. Thus the part of the excise tax system to which the "regressivity" argument is particularly pertinent accounts for only about one-quarter of present revenue.

Second, fairness in the distribution of the tax load by income classes depends mainly on the distribution of the total tax burden rather than on that of a particular tax. It is of little significance to one person that his excise tax burden is relatively small if his other taxes are relatively high. As the Committee on Federal Tax Policy expressed it, "Opposition to excise taxes because of their regressivity...would...be on stronger ground if it were proposed to support the Federal government entirely by such taxes."[6] The total Federal tax burden is sharply progressive and would remain so even with much greater reliance on excises. According to Musgrave's estimates for 1954, the total Federal tax burden rose from 16 percent of income for families with incomes from $2,000 to $3,000 to 22.6 percent on families with incomes from $7,500 to $10,000, and 31.8 percent on all families with income over $10,000 (the last percentage becomes 34.5 if undistributed corporate profits are not imputed as family income).

Third, the argument on regression is seldom applied to the corporate income tax. Yet Tucker's and Musgrave's estimates show that the burden of the corporate income tax is very similar to that of excises both in amount and in distribution on people in the middle and lower income groups (Table 8). Musgrave's estimates for 1954 indicate that the corporate income tax burden amounted to about 3.4 percent of income for families in the $2,000 to $3,000 income class as compared with 4.0 percent for the excise tax burden.

Tucker's and Musgrave's estimates of the distribution of the corporate income tax burden are very similar because the former assumes that half, and the latter that one-third, of the corporate tax burden is passed on to consumers. This shifted portion of the corporate income tax is distributed in approximately the same way as the burden of excises. Since excise tax receipts amount to about half of corporate income tax receipts, an argument on the distribution of the excise tax burden should apply with equal force to the corporate tax as long as one assumes that a substantial part of the latter is passed on in higher prices of corporate products.

Fourth, an argument with regard to progression or regression can hardly amount to more than a subjective opinion on whether the tax burden should be more or less equally distributed. Unfortunately, "there is no scientific way to tell whether the progression is too steep or not steep enough or is justified at all."[7] In 1952, the most extensive and detailed examination of theories of progressive

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6. A Tax Program for a Solvent America, Second Report 1947, pp.154,155.

7. Committee on Federal Tax Policy, Federal Finances, #3 The Tax Program, New York 1954, p.12.

taxation made in recent years was published.[8] The study concludes that none of the theories offered to support progressive taxation is convincing or satisfactory.

Fifth, in the determination of tax policy, opinions on the ideal distribution of the tax burden must often receive a low priority as compared with such considerations as the amount of revenue to be raised and the economic and other conditions of the time. These are discussed in the following section.

B. Other Considerations Involved in Tax Policy

1. Amount of Revenue Required

In the late 1920's, the Federal budget amounted to about 4 percent of the national income. At that time the one percent of the population at the top of the income scale received about 15 percent of the national income.[9] A large share of Federal revenue could thus be obtained from the upper income groups. In fact in 1929 about 25 percent of total Federal revenues came from the income tax on individuals with incomes over $25,000.

Today the Federal budget amounts to about 20 percent of the national income, and the one percent of the population at the top of the income scale receives less than 10 percent of the national income. The size of the Federal budget in recent years has in fact exceeded the total income reported by individual income taxpayers with incomes of $7,000 or more. With present levels of Federal spending, a substantial part of the burden must be borne by the middle and lower income groups. According to Musgrave's estimates for 1954, two-thirds of the total Federal tax burden is borne by people with incomes under $10,000.

Since about one-third of the total Federal tax burden is borne by people with incomes over $10,000, the amount of shifting in the distribution of the tax burden that could conceivably be done by substituting still higher income taxes for excise taxes is very limited. Under the present income tax schedule, rates of 38 percent and up apply to taxable income in excess of $10,000 for single persons and in excess of $20,000 for married persons; rates of 50 percent and up apply to taxable income in excess of $16,000 for single persons and $32,000 for married persons. The top bracket rate is 91 percent. Clearly, even the arithmetical room for increasing these rates is extremely small--a 10 percent increase in the top rate would make it 100 percent. The amount of income left to tax in the taxable brackets above $10,000 is likewise very small. For example, a 10 percent increase in the present tax rates on taxable income in excess of $10,000 (thus making the top bracket rate 100 percent) would yield less than $700 million. A more realistic possibility of, say a one percentage point rise in all the taxable brackets above the first (0-$2,000), would yield only $400 million. But the yield of excise taxes is over $9 billion. Any proposal for a substantial shift from excises to the individual

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8. Walter J. Blum and Harry Kalven, Jr., The Uneasy Case for Progressive Taxation, The Law School, University of Chicago, Reprint and Pamphlet Series, Number 11.

9. Simon Kuznets and Elizabeth Jenks, Shares of Upper Income Groups in Income and Savings, National Bureau of Economic Research, New York 1953, pp.xxxv, 46.

income tax would, at present and prospective levels of the Federal budget, require chiefly an increase in the first bracket rate (on taxable income from 0-$2,000). Under the present tax schedule 67 percent of total taxable income and 71 percent of the taxable income after tax are in the first tax bracket.

It is for this reason that proposals for sharp reductions in excise taxes at present levels of the Federal budget, usually are forced to rely on "closing the loopholes" as a means of making up the prospective loss in revenue. But for such a purpose the "loopholes" have to be defined so broadly that they involve major issues of tax policy such as the question of income splitting on joint returns, a measure passed in 1948 to equalize the tax burdens on people in the "community property states" (where the equivalent of income splitting is provided by state law) and other states. It was a measure designed to remove a serious inequity, and it is unlikely that Congress would now revoke it.

The dividend credit has also been labelled a "loophole." But like the income splitting provision, it was passed in order to reduce a serious inequity in the tax system, and it merely adds further confusion to the discussion of issues to propose repeal of this provision as an alternative to excise taxation.

The question of greater or less reliance on excise taxes is not so much one of the redistribution of the tax burden as between high and low income groups as it is one of a shift between the income and excise tax burdens on the great majority of taxpayers.

2. Diversity in Revenue Sources

Diversity in revenue sources is desirable to prevent excessive rates on a few bases, for high rates on narrow bases distort economic activity, stimulate attempts at tax avoidance and evasion, and make for instability of yield.

In the United States, income taxes have been relied on to a dangerous degree. Since 1943, they have produced some three-fourths of Federal tax collections (Table 4). By contrast, it is notable that in Canada only 54 percent and in the United Kingdom only 47 percent of central government revenue comes from the individual and corporate income and profits taxes. As recently as 1940 in the United States income taxes produced only 37 percent of the Federal tax collections.

It has already been noted that individual income tax rates now go as high as 91 percent, and that rates of 50 percent or more apply to taxable income in excess of $16,000. The corporation income tax rate of 52 percent leaves corporations with less than half of their net incomes to dispose of as they and their shareholders see fit. Such a level of rates is bound to distort taxpayers' incentives and stimulate tax avoidance. With tax rates at present levels the incentive is strong to shift expenditures from non-deductible to deductible items, to use debt rather than equity financing, to invest in tax-exempt rather than taxable securities; in short to narrow the role of monetary incentives at the very points where those incentives are supposed to provide the guide lines for economic activity.

Moreover, the level of rates over the last decade has increased the pressures on Congress to ease the burden of such rates by special provisions favoring particular kinds of income or economic activity. The result of this tendency is to narrow the income tax base and produce even more pressures for favored treatment.

The stability of excise tax yield as compared with that of income taxes is discussed below (p. 29).

3. Non-Revenue Purposes

Whether or not taxation for non-revenue purposes is considered desirable, non-revenue purposes have had and no doubt will continue to have a strong influence on the character of the tax system and on the distribution of its burden. Such considerations are often given more weight than the distribution of the tax burden.

During most of the 19th century and parts of the present century, customs duties provided a large share of Federal revenue, and tariffs are to a large extent devised for the purpose of "protection" rather than revenue. During World War II and the Korean War many excise taxes were adopted or raised in part for the purpose of restricting civilian use of materials and facilities essential to the national defense. During World War II the Federal administration urged state and local governments, as an anti-inflation measure, not to reduce their taxes, despite the regressivity of these taxes in many states. During the Korean War the staff of the Joint Committee on the Economic Report in its report, Inflation Still a Danger, recommended that "The additional revenue, for maximum anti-inflationary effect, should be derived largely from groups in the $3,000 - $10,000 income brackets."

Another influence which has contributed to our present income tax rate structure has been the desire to equalize the distribution of wealth and income. As expressed by Mr. Roy Blough, "There is an important distinction between, on the one hand, deliberately using tax and expenditure measures to reduce the incomes of people because these are deemed to be too high, and on the other hand, looking around for the best place to impose taxes that have to be levied on someone."[10] In 1942 President Roosevelt proposed that tax rates be set so as to limit income after taxes to $25,000. He also issued a short-lived order limiting salaries after taxes to that level. While his proposals were not adopted, such opinions undoubtedly contributed to the wartime structure of income tax rates.

Today the major non-revenue purpose at issue in tax policy is whether or not the tax system should be used as an instrument for controlling or mitigating the ups and downs of business activity. Many proponents of "compensatory fiscal policy" argue that income taxes should be relied on to a still greater degree because of their instability of yield. With income taxes now providing over three-fourths of Federal revenue, a serious depression would mean large scale deficit financing and additions to the Federal debt. To rely even further on income taxes would mean even further loss of control over the Federal debt in the event of a decline in business activity. On the other hand, to rely to a greater extent on excise taxes would make the problem of depression-caused deficits more manageable even though it would not eliminate the possibility of deficits. When a government's major sources of revenue dry up, the resort to inflationary borrowing

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10. "Basic Tax Issues," in The History and Philosophy of Taxation (Conference Papers, College of William and Mary, 1955), p. 23.

through creation of money is inevitable. The history of the last quarter century indicates that attempts at using government finances as a means of insuring "full employment" lead to a long-run tendency toward inflation. The surpluses supposed to be accumulated in good times are never enough to offset the accumulated deficits of bad times.

4. Overlapping with State and Local Taxes

With the growth in the total tax burden overlapping taxation has become an increasingly important problem. Duplication of collection machinery, multiple reporting by the same taxpayers, and mutual limitations on expansion of revenues from the same sources, demand attention. Finding a solution is difficult because what is appropriate for one kind of tax, may not be appropriate for other kinds of taxes. Also the problem of overlapping taxation cannot be entirely separated from the question of the allocation of expenditure functions.

Overlapping of sales and excise taxes was not of much significance until the 1930's. It was then that both the Federal and state governments really began to exploit this field of taxation. The repeal of prohibition quickly brought both levels of government into the liquor tax field. The number of states taxing cigarettes and admissions increased rapidly. The Federal Revenue Act of 1932 established the first extensive peacetime system of Federal excises and included for the first time a tax on gasoline. By 1939 a form of the sales tax was being used by 24 states. Particularly since the end of World War II, overlapping down to the local level has become significant, with many local governments now levying sales, cigarette and amusement taxes (as well as income taxes).

In terms of revenue, overlapping of sales and excise taxes is more important than in the case of other taxes. In the fiscal year 1954 excise and sales taxes accounted for about 20 percent of all Federal, state and local tax revenue. Out of total excise and sales tax revenue of $17 billion, 58 percent was collected by the Federal government, 38 percent by state governments and 4 percent by local governments. However, in other respects, such as duplication of taxpayers' returns and the piling of separate rates on nearly identical bases, overlapping of sales and excise taxes may be of less significance than in the case of other taxes.

There have been many proposals for a reallocation of special excises between Federal and state governments. It has been said that gasoline and amusement taxes are particularly appropriate for state and local use, while the Federal government has prior historical claims in the taxation of liquor and tobacco. At present there is little likelihood of any such reallocation. The Federal gasoline tax seems more likely to be increased than to be repealed. The fact that the Federal excises are collected largely from a relatively small number of manufacturers while state and local taxes are mainly collected from retailers and wholesalers means that there is little duplication of the burdens of compliance. Avoidance of excessive rates at both the Federal and the state and local levels would minimize the problems of overlapping while leaving more fiscal freedom to the various levels of government.

C. Advantages of Excise Taxes

1. Stability of Yield

The stability of excise as compared with income tax collections can be seen in Table 3. In most years, however, comparison is difficult because of the changes in excise and income tax rates. But in the period from fiscal 1930 to fiscal 1932 changes in rates were negligible, and income tax collections fell by 56 percent while excise tax collections fell by only 20 percent. Rate changes were also negligible from fiscal 1949 to fiscal 1950 when income tax collections fell by 5 percent while excise tax collections showed a slight increase.

Income tax collections are particularly sensitive to changes in prices and incomes. With inflation of prices and wages, income moves into higher tax brackets, and conversely, with deflation of prices and wages income moves into lower tax brackets. Consequently, the effective rate of the income tax on all income automatically rises and falls with prices and income.

Moreover, the individual income tax base is a residual--gross income less business deductions, personal deductions and exemptions. While deductions change approximately in proportion to income, per capita exemptions are fixed in amount unless changed by law. Since the total amount of exemptions is nearly as large as total taxable income (see below pp. 32, 33), the tax base fluctuates proportionately more than does total individual income. In the period 1946-1952 the annual percentage changes in taxable income have been nearly twice as great as the percentage changes in total personal income (Table 10).

Corporate profits also are a residual which fluctuates more than gross corporate receipts. In the period 1940-1952, the average annual percentage change in total corporate receipts was 13 percent as compared with an average annual change of 22 percent in corporate net income (Table 11). Since corporate profits can fall off to such a degree (even to zero and negative figures in the 1930's), the corporation income tax is the most unstable source of revenue.

Many excises, on the other hand, are a given percentage of the selling price of an article, so that collections change in about the same proportion as the value of the commodities subject to tax. Some of the most important excises are levied on volume rather than value (e.g. the taxes on distilled spirits, tobacco, gasoline, transportation of coal), so that collections from these taxes ordinarily change less than in proportion to the value of the commodities taxed.

Excise tax collections, then, can be an important buffer for Federal revenues when national income falls. And with income taxes accounting for the major part of Federal tax collections, the budget is especially vulnerable to a decline in business activity.

2. Reaching Income Not Directly Subject to the Income Tax

In recent years the individual income tax base (i.e. taxable income) has amounted to only about 40 percent of total personal income. Part of the difference between these totals is due to the differences in the definition of personal income for purposes of the national income accounts, and adjusted gross income as reported

Table 10

TOTAL PERSONAL INCOME AND TAXABLE INCOME UNDER FEDERAL INDIVIDUAL INCOME TAX

Calendar and Income Years 1946-1952

	Personal Income		Taxable Income	
Year	Amount (Billions)	Percentage Change Over Preceding Year	Amount (Billions)	Percentage Change Over Preceding Year
1946	$178.0		$ 55.9[a]	
1947	190.5	+7.0	65.7[a]	+17.5
1948	208.7	+9.6	74.6	+13.5
1949	206.8	-.9	71.6	-4.0
1950	227.0	+9.8	83.9	+17.2
1951	255.3	+12.5	100.1	+19.3
1952	271.1	+6.2	107.8[b]	+7.7
Average Annual Percentage Change 1946-1952[c]		7.7		13.2

a. Adjusted for changes in exemptions and deductions under the Revenue Act of 1948.

b. Preliminary estimate.

c. Simple arithmetic average computed without regard to sign.

Source: Department of Commerce, National Bureau of Economic Research, and Joseph A. Pechman, "Yield of Individual Income Tax During a Recession," National Tax Journal, March 1954.

Table 11

TOTAL COMPILED RECEIPTS AND NET INCOME OF CORPORATIONS UNDER FEDERAL CORPORATION INCOME TAX

Income Years 1940-1952

	Total Compiled Receipts[a]		Net Income[b]	
Year	Amount (Billions)	Percentage Change Over Preceding Year	Amount (Billions)	Percentage Change Over Preceding Year
1940	$148.2		$11.2	
1941	190.4	+28.5	18.1	+61.6
1942	217.7	+14.3	24.1	+33.1
1943	249.7	+14.7	28.7	+19.1
1944	262.2	+5.0	27.1	-5.6
1945	255.4	-2.6	22.2	-18.1
1946	289.0	+13.2	27.2	+22.5
1947	367.7	+27.2	33.4	+22.8
1948	411.0	+11.8	36.3	+8.7
1949	393.4	-4.3	30.6	-15.7
1950	458.1	+16.4	44.1	+44.1
1951	517.0	+12.9	45.3	+2.7
1952	531.3	+2.8	40.4	-10.8
Average Annual Percentage Change 1940-1952[c]		12.8		22.1

a. Includes receipts on returns with no net income.
b. On returns with net income.
c. Simple arithmetic average computed without regard to sign.

Source: Treasury Department.

for tax purposes. The latter excludes a substantial amount of receipts, such as social security and veterans' benefits, government relief and pensions, which are not reportable for income tax purposes. In addition, personal income includes a substantial amount of income in kind which is not reportable for tax purposes; the most important item of income in kind is the imputed rent of owner-occupied farm and nonfarm dwellings. There is also a large amount of interest imputed to individuals as part of personal income but not actually received by individuals. On the other hand, there are certain kinds of income or receipts which are reportable for tax purposes but are excluded from personal income as shown in the national income accounts; the most important of such items are contributions for social insurance and capital gains. In 1952 the net difference between total personal income and adjusted gross income was $55 billion (Table 12).

The more important part of the difference between total personal income and taxable income consists of deductions and exemptions, which together amounted to $108 billion in 1952--a sum equal to the total of taxable income.

Deductions were originally designed to meet the special circumstances of particular individuals and to favor certain kinds of expenditure such as philanthropic contributions. But with the adoption of the optional standard deduction, most taxpayers merely pay at a higher rate on a smaller taxable income than they would with a more restricted use of deductions.

Table 12

RELATIONSHIP OF TOTAL PERSONAL INCOME TO TAXABLE INCOME UNDER FEDERAL INDIVIDUAL INCOME TAX

Calendar and Income Year 1952

(Billions)

Personal Income		$271
Less:	Personal Income Not Reportable	39
	Personal Income Reportable But Not Reported	25
Plus:	Income Included In Adjusted Gross Income But Not In Personal Income	8
Equals:	Adjusted Gross Income	216
Less:	Deductions	27
	Exemptions	81
Equals:	Taxable Income	108

Source: Department of Commerce and National Bureau of Economic Research.

Total exemptions in 1952 amounted to $81 billion. The personal exemption is in part a device for administrative simplification. It means that those earning less than the exemption do not have to file returns and the Treasury does not have to bother with the expensive procedure of collecting from or handling returns from people with very low incomes.

The personal exemption is also a device to increase the progressivity of the income tax. Even with a flat rate on taxable income the personal exemption would leave some degree of progression. And with graduated rates the exemption makes the progression even steeper than it appears from the statutory bracket rates.

Another reason for the personal exemption is to exempt at least partially the income required for the "necessities of life." Exemptions are important particularly in reducing the tax burden on families. It is obviously difficult to specify how much income is required for the "necessities of life." However, even if a clear dividing line were possible between necessities and luxuries, the use of the personal exemption on this ground alone would imply that government programs fall on the luxury side of the line. When two-thirds of Federal expenditures go for national security programs, such an implication cannot be justified. Until a radical change occurs in international affairs, "guns" will be as much of a necessity as "butter."

Congress has in fact reduced the level of personal exemptions almost directly as the need for security expenditures increased. The exemption for a married couple was reduced from $2,500 in 1938 to $1,500 in 1941 and $1,000 in 1944. In 1948 the exemption for a married couple was raised to $1,200, where it has remained ever since. In fact, the sharp increase in the income tax bite since before World War II has been due more to the decrease in exemptions than to the increase in statutory rates. In 1939 the effective rate of tax on all taxable income was 11 percent. In 1952 the effective rate on all taxable income was 26 percent--slightly more than twice as high as in 1939. However, in 1939 taxable income amounted to only 15 percent of total income and in 1952 taxable income was 50 percent of total (adjusted gross) income--over three times as large a share of total income as in 1939 (Table 13). Most of the increase in the ratio of taxable income to total income was due to the decrease in the level of exemptions. In 1939 exemptions removed 72 percent of total income from the tax base, while in 1952 only 38 percent of total income was so removed. Thus have personal necessities been reduced in favor of national necessities.

In summary, part of personal income is not taxable because personal income is defined more broadly than adjusted gross income. Part of personal income is not taxable because some persons receive less than $600 of reportable income, and some do not report all of their reportable income. Part of personal income is not taxable because of deductions and exemptions. Thus, a considerable number of persons pay no income tax, and those who do pay a tax pay the tax on only a portion of their total income.

As shown by the number of exemptions on taxable returns in 1952, individual income taxpayers and their dependents represented about two-thirds of the total population. The remainder of the population was not touched by the income tax.

Table 13

RELATIONSHIP OF TAX BASE TO TOTAL INCOME, AND EFFECTIVE TAX RATE UNDER FEDERAL INDIVIDUAL INCOME TAX[a]

Income Years 1939 and 1952

	1939		1952[b]	
	Amount (Billions)	Percentage Distribution	Amount (Billions)	Percentage Distribution
Total Income (Adjusted Gross)	$ 57.3	100.0	$215.8	100.0
Income Removed from Tax Base due to				
Personal Deductions	4.3	7.5	26.8	12.4
Personal Exemptions	41.4	72.1	81.3	37.7
Earned Income Credit	3.1	5.4	--	--
Tax Base	8.5	14.9	107.8	50.0
Tax	.9	1.6	28.0	13.0
Effective Tax Rate (Tax as a Percentage of Tax Base)	10.9		26.0	

a. Detail will not necessarily add to totals because of rounding.
b. Preliminary estimates.

Source: Treasury Department and National Bureau of Economic Research.

Excise taxes are a means of reaching those individuals and that income not touched by the income tax. "All citizens should be called upon to make some direct contribution to the support of their government."[11] And with the individual income tax base amounting to about 40 percent of total personal income while the nation's total tax bill amounts to about one-third of total personal income, it is clear that income other than individuals' taxable income must bear part of the tax burden.

3. Convenience for the Taxpayer

Excise taxes have some definite advantages from the taxpayer's point of view. First, they permit the taxpayer to pay his tax by installments as he spends his income; he is not suddenly confronted with a large lump sum payment to be made. Moreover, his payments are current; under the income tax, the majority of people find either that they are currently paying too much into the Treasury and

11. Committee on Federal Tax Policy, Federal Finances: #3 The Tax Program, New York 1954, p. 24.

have to wait several months after the close of the tax year to receive their refunds, or else they find a substantial additional tax due on filing their returns. In 1951 $2.2 billion in refunds were paid on 30 million individual returns, while 18.6 million taxpayers had a total of $3.7 billion of tax due at the time of filing their returns.

In addition excises give somewhat greater leeway to the taxpayer. The average taxpayer cannot vary his income to avoid income to avoid income tax. But he can reduce his excise tax burden by spending less or by shifting from taxable to nontaxable goods and services.

D. Conclusion

It has been shown that the burden of excise taxes is approximately proportional to income over the range of income in which the vast majority of taxpayers are found, that the burden of excises is distributed in about the same way as the shifted part of the corporate income tax, and that there is no special unfairness or inequity in the use of excises. It has also been shown that the question of the distribution of the tax burden is often overemphasized, and that other considerations may have priority in determining tax policy.

Perhaps of primary importance today is the very high level of present and prospective Federal government spending in relation to national income. The level of government spending is such that most of the revenue must come from the middle and lower income groups whatever forms of taxation are used. Moreover, the base of the individual income tax is so narrow in relation to total personal income that rates have been raised to dangerously high levels. Excise taxes are a means of reaching those people and that income not directly touched by the income tax.

The possibility of war or of a further increase in defense expenditures also calls for a strengthening of the Federal excise tax system. For a sharp increase in the defense effort, as shown by past experience, cannot be financed by the already overworked income taxes. A strong excise tax system may have special advantages in wartime as a means of checking civilian consumption. In the event of a serious depression, a strong excise system would provide an important buffer for Federal revenues and insurance against overwhelming deficits.

Excise taxes also provide certain advantages for the taxpayer. They permit current, "installment" type payment on the part of the consumer, and they allow some choice as between spending or not spending on taxable items.

Given that heavy revenue needs are here to stay, excise taxes for the above reasons should be an important, permanent part of the Federal tax system. In recent years excise taxes have provided approximately 14 percent of total Federal tax collections. This is perhaps the smallest ratio of such taxes to the total budget to be found in any country. In view of the distorting effects of high income tax rates, and the likelihood of a continued high level of Federal spending for defense purposes, a share of 20 or 25 percent for excise tax revenue would seem more defensible. A shift toward greater reliance on excise taxes would mean little change in the distribution of the total Federal tax burden, while it would diversify Federal revenue sources, increase the stability of total Federal revenues, and reduce the distorting effects of the present tax system on economic activity.

CHAPTER IV

THE PRESENT EXCISE TAX SYSTEM

The present excise tax system consists of more than 50 different taxes which may be grouped into three broad categories. First are the sumptuary taxes on liquor and tobacco; these now account for about 47 percent of total excise tax receipts. Second are the various taxes on transportation and communication which have been justified in part on the "benefit" principle of taxation but which are mainly emergency taxes justified on grounds of their substantial revenue yield and ease of administration; these taxes account for about 40 percent of excise tax receipts. Third are the remaining taxes on miscellaneous goods and services which in most cases have been selected as "luxury" items; these taxes account for 12 percent of total excise tax receipts (Table 14).

A. Liquor and Tobacco Taxes

Liquor and tobacco taxes have been a permanent and important part of the Federal tax system since 1862. In some periods they have provided nearly half of total Federal receipts. In fiscal 1955 revenue from these taxes amounted to $4.3 billion or 6.7 percent of total Federal receipts.

Apart from various licenses on producers and dealers, these taxes are imposed on three major kinds of alcoholic beverages and three broad types of tobacco products at widely different rates as shown in Table 15.

Few would propose that these taxes be abolished. It is evident that they will continue to provide an important source of Federal revenue. The major issue is the level of rates, and the primary consideration here has been total Federal revenue requirements. In the post war years, liquor and tobacco taxes have been lowest on the priority list for tax reduction. Rates were not reduced after World War II--on the contrary, they were substantially increased during the Korean War and since then scheduled reductions have been postponed for three successive years. For a period of five years the tax on distilled spirits has been 17 percent higher, and that on cigarettes 14 percent higher, than the peak levels of World War II. Nearly all the states and many localities also have relatively heavy taxes on liquor and tobacco. The case for a reduction in the high Federal rates thus appears to be strong.

B. Taxes on Transportation and Communications

Taxes on transportation and communications were levied during World War I but were repealed in 1922. Most of the present taxes date from the Revenue Act of 1932, although the taxes on transportation of persons and property and on local telephone service were adopted in the early part of World War II.

These taxes now produce about 40 percent of total excise tax revenue. Their rates are shown in Table 16. (For revenues by type of tax, see Table 14.)

Table 14

FEDERAL EXCISE TAX COLLECTIONS BY DETAILED SOURCE

Fiscal Year 1955

	Amount (Millions)	Percentage Distribution
Total	$9,211	100.0
Liquor and Tobacco Taxes	4,314	46.8
Liquor	2,743	
Tobacco	1,571	
Taxes on Transportation	3,163	34.3
Highway User and Related Taxes	2,524	27.4
Gasoline	947	
Diesel Fuel	25	
Lubricating Oils	70	
Automobiles and Motorcycles	1,048	
Trucks, Buses and Trailers	135	
Parts and Accessories for Automobiles	137	
Tires and Inner Tubes	164	
On Transportation Services	639	6.9
Transportation of Property	398	
Transportation of Oil by Pipeline	43	
Transportation of Persons	197	
Taxes on Communications	520	5.7
Local Telephone Service	290	
Toll Telephone, Telegraph, Leased Wires, etc.	230	
Taxes on Miscellaneous Goods and Services	1,099	11.9
Jewelry, Furs, Toilet Preparations, Luggage, Handbags	292	
Admissions, Cabarets, Club Dues, Bowling Alleys, Wagering Taxes, Coin-operated Amusement Devices, Business and Store Machines	271	
Radio and Television Sets, Phonographs, Records, Musical Instruments, Playing Cards, Cameras, Film and Lenses	178	
Stock and Bond Transfers, Issues of Securities, Deeds of Conveyance, Leases of Safe Deposit Boxes	111	
Electric, Gas and Oil Appliances, Refrigerators, Air-conditioning Units, Electric Light Bulbs	108	
Sporting Goods, Firearms, Shells, Cartridges, Pistols and Revolvers	27	
Matches, Fountain and Ball Point Pens, Mechanical Pencils	14	
Coconut and Other Vegetable Oils, and Sugar Tax	97	
Other	1	
Excise Tax Receipts Not Classified by Source	115	1.2

Source: Bureau of the Budget.

Table 15

RATES OF FEDERAL EXCISE TAXES ON ALCOHOLIC BEVERAGES AND TOBACCO

January 1956

Item	Rates	Tax as Approximate Percent of Retail Price Including Tax
Alcoholic Beverages		
Distilled spirits	$10.50 per proof gallon	43%
Wines, Liqueurs, etc.[a]	17¢ to $3.40 per wine gallon depending on alcoholic content	4-26½
Beer	$9 per barrel	16-17
Tobacco Products		
Cigarettes (small)	$4 per 1,000	37
Cigars	$2.50 to $20 per 1,000	9
Tobacco, chewing and smoking, and snuff	10¢ per pound	Various

a. Not over 24 percent alcohol content by volume.

Source: Treasury Department.

The taxes on transportation may be divided into two categories. First are the taxes on motor fuels, vehicles and parts (highway user and related taxes), and second are the taxes on transportation services. The latter may be considered together with the taxes on communication services.

1. Highway User and Related Taxes

These taxes have been justified on at least three broad grounds; first, on the benefit principle (mainly the taxes on motor fuels), since the Federal government provides certain services for transportation and also funds for highway construction; second, during wartime periods as a means of restricting civilian use of facilities and materials necessary for the war effort; and third, as taxes on "luxuries," or simply as sources of substantial revenue which would not unduly burden individual consumers.

The strength of the arguments for these taxes may be reflected in the increased rates since 1932. At least there has been a steady upward trend. The gasoline tax was 1¢ per gallon in the 1930's, 1½¢ per gallon from 1940 to 1950, and has been 2¢ per gallon since 1950. The tax on automobiles was 3 percent of the manufacturer's price in the 1930's, 7 percent from 1940 to 1950, and has been 10 percent since 1950. The tax on tires was 2¼¢ per pound in the 1930's, and has been 5¢ per pound since 1940. It is to be noted, however, that with the exception of the

Table 16

RATES OF FEDERAL EXCISE TAXES ON TRANSPORTATION AND COMMUNICATIONS

January 1956

Item	Rates		Tax as Approximate Percent of Retail Price Including Tax
Taxes on Transportation			
Highway User and Related Taxes			
Gasoline	2¢		8%
Diesel Fuel	2¢	per gallon	14
Lubricating Oils	6¢	a	(b)
Automobiles, Auto Trailers, & Motorcycles	10%	of manufacturer's	7
Trucks, Trailers, Buses, Road Tractors	8%	price	(b)
Parts and Accessories	8%		(b)
Tires	5¢	per pound	7
Tubes	9¢		8
Transportation Services			
Transportation of Property	3%		3
Transportation of Oil by Pipeline	4½%	of amount charged	4
Transportation of Persons	10%		9
Taxes on Communications			
Local Telephone Service	10%	of amount charged	9
Toll Telephone, Telegraph, Leased Wires, etc.	10%		9

a. Tax not to exceed 10 percent of price for which sold.
b. Not estimated.

Source: Treasury Department.

taxes on vehicles and parts, these taxes are "specific," i.e. levied on volume rather than value. The increases in the rates of these specific taxes have in fact been no more than the increases in consumers' prices since before World War II. But it must also be noted that the price of gasoline has increased much less than other consumers' prices since before World War II.

The recent development of plans for an expanded highway program has emphasized the benefit principle behind these taxes. In fact it is now proposed that some of these taxes be increased in order to pay for an expanded program of Federal highway aid. A bill[1] now before Congress provides for an increase from 2¢ to 3¢ per gallon in the tax on motor fuels, an increase from 5¢ to 8¢ per pound in the tax on tires, and an increase from 8 percent to 10 percent in the tax on trucks, buses and trailers, plus the imposition of a tax of 3¢ per pound on retread rubber. The future of these taxes is in effect tied up with the future of an expanded Federal highway-aid program.

The other justifications for these taxes would not now support an increase in, or even maintenance of their present rates. Defense needs do not require restriction of private use of the materials and facilities involved; and highway transportation is much more of a necessity than it was 20 years ago.

2. Taxes on Transportation and Communication Services

The chief argument for these taxes appears to be their substantial yield and ease of administration. The major part of the burden of these taxes falls in the first instance on business costs. When finally passed on to consumers, the burden is now relatively small, except possibly in western states where transportation and communication costs may be more important for consumers than in the East.

A substantial reduction in these taxes was made on April 1, 1954, when the rates which previously exceeded 10 percent were reduced to that level. Previously, the rate on toll telephone, telegraph and cable charges was 25 percent, that on local telephone service and transportation of persons was 15 percent. These rates had been in effect since April 1944. The tax on transportation of property is 3 percent of the amount charged; this rate has been unchanged since 1942. The tax on transportation of coal has been 4¢ per ton and that on the transportation of oil by pipeline has been 4½ percent since 1940.

C. Taxes on Miscellaneous Goods and Services

These taxes now account for about 12 percent of excise tax revenue. The Excise Tax Reduction Act of 1954 introduced greater uniformity of rates by reducing to 10 percent nearly all the rates that previously exceeded that level.

The present variation in rates on these goods and services seems to bear some relation to a rough standard of "necessity" or "luxury" (Table 17). Club membership and horse and dog races are possibly more of a "luxury" than most

1. H.R. 10660, 84th Cong., 2d Sess. (1956).