

A nation with no internal revenue agents: Thomas Jefferson was able to boast in 1805 that the young republic had given all federal internal revenue agents a pink slip.

Before the Income Tax: How the Federal Government Balanced the Budget Before 1913

Yes, the U.S. government did at one time run large budget surpluses, and the revenue was generated without resorting to an income tax.

by *Thomas R. Eddlem*

This year — 2013 — marks the 100th anniversary of the modern income tax, a tax that dominates the revenue scheme of the federal government today. Individual income taxes accounted for about 45 percent of all federal tax revenue in 2012, along with 35 percent for Social Security and Medicare payroll taxes (which are also a tax on income), 10 percent for corporate income taxes, and only 10 percent for all other tax sources.

It wasn't always so. Prior to ratification of the 16th (income tax) Amendment in February 1913, the federal government managed its few constitutional responsibilities without an income tax, except during the Civil War period. During peacetime, it did so largely — or even entirely

— on import taxes called “tariffs.” Congress could afford to run the federal government on tariffs alone because federal responsibilities did not include welfare programs, agricultural subsidies, or social insurance programs like Social Security or Medicare. After the Civil War, tariff revenues sometimes suffered under a protectionist policy ushered in by the Republican Party that supplemented federal income via excises on alcohol, tobacco, and inheritances. But before the war, the need for tariff revenue to finance the federal government generally kept the tariff at reasonable levels. During wartime throughout early American history, the Founding Fathers were able to raise additional revenue employing a different method of direct taxation authorized by the U.S. Constitution prior to the 16th Amendment. These

alternative taxing methods gave the young American nation embarrassing peacetime budget surpluses that several times came close to paying off the national debt.

In one instance, the U.S. government paid off its entire national debt without the existence of an Internal Revenue Service. President Andrew Jackson boasted in his veto of the Maysville Road Bill in 1830 that God had blessed the nation with no taxes (except tariffs on imports) and no national debt:

Through the favor of an overruling and indulgent Providence our country is blessed with a general prosperity and our citizens exempted from the pressure of taxation, which other less favored portions of the human family are obliged to bear.... How gratifying

the effect of presenting to the world the sublime spectacle of a Republic of more than 12,000,000 happy people, in the fifty-fourth year of her existence, after having passed through two protracted wars — one for the acquisition and the other for the maintenance of liberty — free from debt and all her immense resources unfettered!

In reality, Jackson had jumped the gun on his boast. The national debt would not be paid off for five more years, until the 1828 “Tariff of Abominations,” which were high tariffs primarily on British manufactured goods meant to protect northern U.S. industries, and as the compromise tariffs of 1832 and 1833 had created several years of massive budget surpluses. But “Old Hickory” presided over a nation where Congress had abolished all federal internal taxes, and no citizen saw a tax collector of the United States unless that citizen was in the business of importing foreign goods. And while American consumers were occasionally manipulated by outrageously high protective tariffs, especially the above-mentioned “Tariff of Abominations,” inside the United States a massive free market emerged over which the U.S. government had almost no influence. Even the Tariff of Abominations was not so high that it choked off revenue for imports from every industry.

By way of contrast, the advent of the income tax prompted some congressmen to note that this tax was designed not principally for revenue — the U.S. government had always had plenty of money from tariffs — but to manipulate the American people and their choices in the market. “The character of the argument which had been made,” Massachusetts Rep. Samuel McCall argued in a speech before the U.S. House of Representatives as Congress debated the 16th Amendment, legalizing the income tax in 1909, “leads me to believe that the chief purpose of the tax is not financial, but social. It is not primarily to raise money for the state, but to regulate the citizen and to regenerate the moral nature of man. The individual citizen will be called on to lay bare the inner-most recesses of his soul in affidavits, and with the aid of the Federal inspector, who will supervise his books and papers and business secrets, he may be made to be good,

according to the notions of virtue at the moment prevailing in Washington.” McCall’s Massachusetts constituents rewarded the Republican congressman’s efforts by electing him governor several years later.

This has been the legacy of the income tax. While the income tax has produced the type of revenue that has made a massive transfer of wealth from the productive to the unproductive possible, the incentives — through thousands of deductions and tax credits — have manipulated the American people into choices that they wouldn’t have otherwise made in a free market. These manipulations — whether in favor of “green energy” research, “cash for clunker” automobile purchases, or tobacco crop subsidies — have been chosen according to the prevailing virtue in Washington.

The conservative Massachusetts congressman had been more right in his position than even he could have guessed. And he serves as a reminder that Massachusetts once produced leaders that promoted the idea of limited government.

Massachusetts, in ratifying the 1787 Constitution, recommended the following: “That Congress do not lay direct taxes but when the moneys arising from the impost and excise are insufficient for the public exigencies, nor then until Congress shall have first made a requisition upon the States to assess, levy, and pay, their respective proportions of such requisition, agreeably to the census fixed in the said Constitution, in such way and manner as the legislatures of the States shall think best.” Statesmen from Massachusetts sought to save their fellow



A nation with no debt: Andrew Jackson boasted that the American nation had paid off the entire federal debt while abolishing all taxes, except tariffs on imports. It was the only time in American history the United States carried zero debt, though the nation came close to no national debt again in 1857 and 1892.

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citizens from the pestilence and manipulation of federal tax collectors, and even suggested that this be part of a constitutional amendment. Other founding-era leaders across the nation expressed the same hope that the states would be given an opportunity to pay direct federal taxes and avoid federal tax collectors, something that happened with most direct taxes imposed before the Civil War.

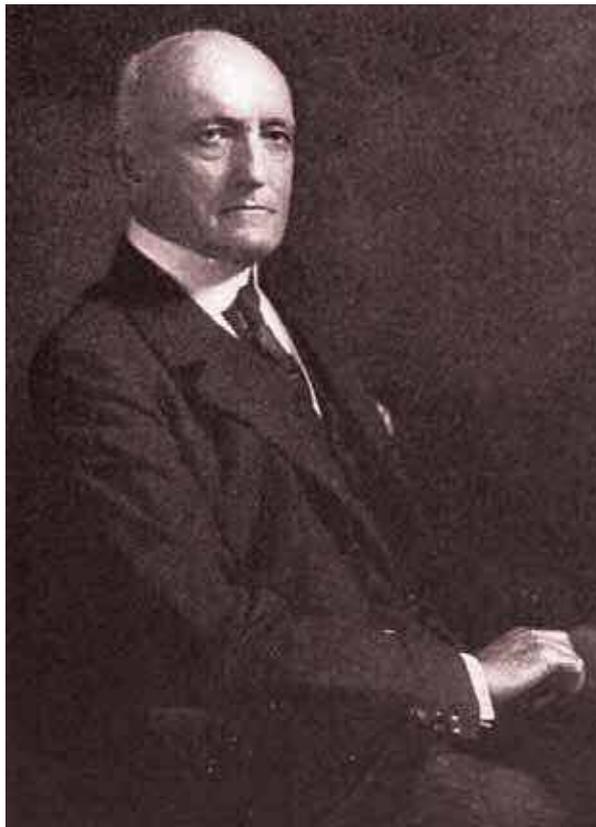
Direct taxes are taxes imposed on people or property, whereas indirect taxes are taxes on conditional events such as retail sales. The U.S. Constitution granted Congress the power to impose direct or indirect taxes, except a tax on exports, so long as the indirect taxes were “uniform” and direct taxes were imposed within states in proportion to population. The U.S. Constitution, Article I, Section 2 stipulates: “Representatives and direct taxes shall be apportioned among the several states which may be included within this union, according to their respective numbers.”

Paying Off the Revolutionary War Debt

The Founding Fathers sought to pay off the massive debt from the War of Independence by imposing taxes on imports (tariffs) as well as taxes on the sale of alcohol and tobacco (which are called “excises”). The tax on alcohol prompted farmers in Western Pennsylvania to start a tax revolt, now called the “Whiskey Rebellion,” as whiskey had come into use among poor frontier traders as money in lieu of scarce gold and silver coin. Faced with the rebellion, and several federal tax collectors being shot at by the rebels (whom today would almost certainly be branded “terrorists”), President George Washington put down the rebellion in a way that would have enraged today’s neoconservatives who believe in a “unitary execu-

tive.” Washington first asked permission of Congress to call up the state militia and enforce the internal revenue laws. When congressional leaders agreed, Washington marched out at the head of the Virginia and Pennsylvania militia and negotiated with the “terrorists,” who agreed to put down their arms. And when two civilians were shot accidentally by militiamen, Washington handed the soldiers over to local prosecutors to be tried for murder charges. (Both were exonerated after an investigation.) President Washington then pardoned most of the rebels. Washington would today probably be branded by neocons as being a weak executive who didn’t “support the troops.” Though unpopular in some parts of the country, the tax on alcohol continued through the end of John Adams’ presidency.

A 1794 tax law also levied a tax on car-



Massachusetts, the conservative heart of the U.S.?

Massachusetts was at the heart of opposition to the federal income tax. Mass. Congressman Samuel McCall was the only member of Congress to vote against both the 1894 income tax and the 16th Amendment. The people of Massachusetts later promoted him to the governor’s office.

riages that tested the meaning of what was a “direct” tax and what was an “indirect” tax. The law used the following language: “There shall be levied, collected, and paid upon all carriages for the conveyance of persons, which shall be kept by or for any person for his or her own use, or to be let out to hire or for the conveyance of passengers, the several duties and rates following.” The language prompted Massachusetts Federalist Fisher Ames to claim that “the duty falls not on the possession, but on the use” and was therefore an indirect tax. But James Madison — then a Virginia congressman — claimed that the tax was a direct tax because it was not on the use but against everyone who “kept” a carriage, regardless of whether it was used. And since the tax on carriages was not apportioned among the states, Madison labeled the tax an “unconstitutional tax.” Madison regarded a direct tax as one imposed directly on a person or property,

while an indirect tax was a tax imposed upon a transaction or conditional event. The Supreme Court ultimately claimed the carriage tax was an indirect tax in the 1796 case of *Hylton v. United States*.

There has been some legitimate historical confusion over the definition of direct taxes. When Rufus King of Massachusetts asked during the 1787 constitutional convention “what was the precise meaning of direct taxation,” James Madison recorded in his notes on the convention that “No one answered.”

The Supreme Court seemed to rule on the propriety of the carriage tax in the *Hylton* case, rather than the constitutionality of it. “The truth is that the articles taxed in one state should be taxed in another,” the court ruled. “A tax on carriages, if apportioned, would be oppressive and pernicious. How would it work? In some states there are many carriages and in others but few. Shall the whole sum fall on one or two individuals in a state who may happen to own and possess carriages? The thing would be absurd and inequitable. In answer to this objection, it has been

observed that the sum, and not the tax, is to be apportioned, and that Congress may select in the different states different articles or objects from whence to raise the apportioned sum. The idea is novel. What, shall land be taxed in one state, slaves in another, carriages in a third, and horses in a fourth, or shall several of these be thrown together in order to levy and make the quoted sum? The scheme is fanciful. It would not work well, and perhaps is utterly impracticable.”

In the *Hylton* decision, the court ignored remarks made by John Marshall (who became U.S. Supreme Court chief justice a few years later in 1801) during Virginia’s ratification convention on the U.S. Constitution: “The objects of direct taxes are well understood: they are but few: what are they? Lands, slaves, stock of all kinds, and a few other articles of domestic property.” At the time of Marshall’s remarks, Virginia had imposed a tax on carriages that was locally considered a direct tax.

Today, Supreme Court justices have tried to define direct taxes virtually out of existence in order to avoid the constitutional requirement for apportionment of direct taxes. Justice Ruth Bader Ginsburg

argued in her concurrence in the Supreme Court’s ObamaCare decision, *National Federation of Independent Business v. Sebelius*, “Even when the Direct Tax Clause was written it was unclear what else, other than a capitation (also known as a “head tax” or a “poll tax”), might be a direct tax.... The meaning of the Direct Tax Clause is famously unclear.” The ObamaCare tax — imposed on citizens for doing nothing, specifically “not” purchasing health insurance — would be classified as a direct tax under a traditional understanding of the term, a fact acknowledged by four of the nine members of the Supreme Court in the 2012 ObamaCare case.

By 1798, the United States was engaged in a quasi-war with revolutionary France, and the Adams administration asked Congress to fund a small navy to punish French naval piracy. Although U.S. privateers had captured or sunk some 76 French ships, Congress complied, paying for it with the nation’s first apportioned direct tax. The direct tax of 1798 imposed taxes on “lands, houses and slaves” totaling \$2 million over the next two years, apportioned to states in amounts according to representation (as measured in the U.S. census).

The young American nation quickly settled a peace with France, its ally during the War for Independence, and the United States began racking up huge budget surpluses by the end of the Adams presidency. In response, Congress abolished all internal taxes. From 1802 through 1812, the federal government subsisted on low tariffs as the only federal tax, supplemented by sale of government lands and postal receipts (the latter being operated informally as a revolving fund to pay for the postal service). By the time of his second inaugural address in 1805, President Jefferson was able to boast that “the suppression of unnecessary offices, of useless establishments and expenses, enabled us to discontinue our internal taxes.... The remaining revenue on the consumption of foreign articles, is paid cheerfully by those who can afford to add foreign luxuries to domestic comforts, being collected on our seaboard and frontiers only, and incorporated with the transactions of our mercantile citizens, it may be the pleasure and pride of an American to ask, what farmer, what mechanic, what laborer, ever sees a tax-gatherer of the United States?”



Wimp-in-Chief? That’s how some neocons today would label George Washington’s measured response to the Whiskey Rebellion, where he first got the permission of Congress to march, then negotiated with the “terrorists,” handed his own soldiers over for prosecution, and pardoned the offenders. The result was that the rebellion dissolved completely.



Paying for the War of 1812

The advent of a second war against Britain in 1812 necessitated a resumption of internal taxes, especially as a British naval blockade of American ports drastically reduced customs tariffs. Congress enacted a variety of excise taxes and a direct tax of 1813 of \$3 million against land, houses, and slaves.

Following Massachusetts' request during the ratification process, Congress offered states a discount of up to 15 percent if they collected the tax and paid it to the Treasury early. Seven of the 18 states elected to collect the tax themselves and forestall the pestilence of federal tax collectors during the 1813 tax. As the war went poorly for America, Congress enacted a second direct apportioned tax in 1815 for \$6 million, also upon land, houses, and slaves. Four states opted to collect the tax themselves while the other 14 states did nothing, and the federal government ap-

pointed tax commissioners in those 14 states to collect the tax. The U.S. government added substantial debt during the war, but within a few years after the war, President Monroe advocated a repeal of all internal taxes. Congress complied, again funding the federal government exclusively through tariffs and the sale of federal land. By Andrew Jackson's presidency, the federal government had paid off the entire national debt.

Paying for the Mexican-American War

Although Henry David Thoreau was reportedly jailed for failing to pay a poll tax (a "head" tax) enacted to support the Mexican-American War, Thoreau had actually refused to pay for a municipal tax, not a federal tax, which had nothing to do with the war. The U.S. government never had to raise internal taxes for the Mexican-American War, instead choosing to pay for the war by quadrupling the national debt from \$15.5 million to \$63 million between 1846 and 1849. In addition, the federal government received increased tariff revenue from the Walker Tariff law passed in 1846, the year before the

Oh no, he didn't: Henry David Thoreau was reportedly jailed for refusing to pay a poll tax to protest the federal war against Mexico. But in reality, the poll tax was a local tax unconnected to the war. In fact, the federal government funded the war on tariffs and borrowing alone, never bothering to create any kind of internal tax to pay for the war.

war. The Walker Tariff was actually a tax cut on tariffs, the "revenue-only" tariff drawn up by President Polk's treasury secretary. It increased international trade so dramatically that federal tax revenue increased from \$27 million in 1846 to \$40 million in 1850. The massive increase in tariff revenues — despite the lower rates — meant that the U.S. government began running huge budget surpluses beginning in 1849, and paid off nearly all of the national debt. By 1857, the national debt had been reduced to \$23 million — less than one dollar per person in the country — and Congress passed the Tariff of 1857, a huge tax cut that brought a few years of deficits but economic prosperity in the lead-up to the Civil War.

Paying for the Civil War

The advent of the Civil War in 1861 brought more direct taxes, at first also in the mold of the taxes from the War of 1812. The 1861 tax assessed \$20 million, with the same plan, including a 15-percent deduction for states who collected the tax themselves. All of the union states except Delaware and the Colorado territory volunteered their assessment of the 1861 direct tax, but political support for an income tax and other taxes ended the assessment of the apportioned direct tax. In addition, Congress imposed excise taxes on many goods, including alcohol, tobacco, jewelry, and "legacies" (inheritances).

By 1864, the new income tax was five percent on incomes over \$600 (equal to about \$48,000 in current dollars) and up to 10 percent on incomes over \$10,000 (\$800,000 in current dollars). After the war, the rates were reduced to a flat five-percent rate, and imposed only on incomes over \$1,000. After the war, clamor for repeal of the income tax increased dramatically among citizens, business groups, and prominent newspapers and politicians. In addition to the commissioner of the Internal Revenue Service, the *New York Times*

New York Democratic Congressman William Bourke Cockran railed against the income tax in congressional debate.

opened on January 19, 1871, “We have reached the time when the income tax can be no further defended. The people demand its repeal with one voice, and repealed it should be.” Indeed, America’s first income tax was abolished the next year.

The post-war Congresses were dominated by protectionist Republicans who often kept tariffs so high that revenue suffered, so they retained excise taxes on alcohol and tobacco to make up the revenue difference. Most federal revenue was nevertheless raised by tariffs between 1866 and 1913. By 1892, Congress had paid off two-thirds of the \$2.7 billion Civil War debt that the U.S. government had assumed by 1866.

1894 Income Tax and More

Populist influence in a resurgent Democratic Party prompted Congress to enact a tax on incomes over \$4,000 at two percent, roughly the equivalent of \$320,000 today when measured against the gold standard of the day. “The imposition of such a tax is but a gentle, playful exercise of a dangerous power. It is merely showing demagogues the path of demagogy,” New York Democratic Congressman William Bourke Cockran railed against the income tax in congressional debate. “The men who offer this amendment as a sop to the discontented will be swept away by the rising tide of socialism. They will discover, when too late, that in overturning the barriers which separate liberty from anarchy they have liberated ten thousand furies who will sweep over them in a mad procession of anarchy and disorder.” Citing the nation’s history under the Jefferson presidency, Cockran proclaimed support for abolition of all the postbellum excise taxes.

But Cockran’s argument was in vain. Congress passed the law anyway, and it was challenged in the Supreme Court as an unconstitutional unapportioned tax. In the 1895 case of *Pollock v. Farmers Loan and Trust Company*, the court ruled that a tax on rent or income from real estate

is a direct tax, because “the whole beneficial interest in the land consisted in the right to take the rents and profits.” In addition, the court ruled that taxes on stock and municipal bonds were direct as well. Ironically, the Supreme Court in the *Pollock* case did not rule that taxing income earned through labor was essentially a tax on people, a capitation tax. Nonetheless, the court struck down the entire 1894 income tax in the *Pollock* case, necessitating a constitutional amendment in order to enact a federal income tax.

When the Spanish-American war started in 1898, Congress enacted a variety of excise taxes as a means of paying for the cost of the war, and Congress reduced debt to the \$1.2 billion pre-war debt level by 1900. Interestingly, the telephone tax of three percent on long distance calls — then affecting only the wealthiest families — was not abolished until 2006, 108 years after the war started.

As agitation for a new income tax increased in the progressive era at the beginning of the 20th century, Congress enacted a one-percent corporate income tax (on income over \$5,000) in 1909. Congress also passed the 16th Amendment out to the states for ratification that year. The latter

would open up a vast new revenue stream for government, in addition to a means for the federal government to stick its nose into every family’s business.

American history before Congress enacted the income tax in 1913 (first imposed the following year) demonstrates that the federal government was able to pay its bills, keep the nation largely out of debt, and respect the privacy of American citizens. Even during wartime, Congress had a method of imposing direct war taxes that respected states’ rights and American citizens’ privacy.

The Congress did largely limit its legislating to constitutionally enumerated powers of the federal government during that time period. Only the multiplication of unconstitutional federal offices, along with the demand by Congress to manipulate decisions of American consumers, has necessitated imposition of the income tax. Or, conversely, the imposition of the income tax made a massive increase of federal offices possible. Ironically, despite the imposition of the income tax, Congress has more often engaged in deficit spending and racked up a massive peacetime debt since enactment of the 16th Amendment. ■



Import taxes: Unlike our own times, in most of the early years of the Republic Congress sustained the federal government by taxing imports alone, freeing Americans from the harassment of internal revenue agents.