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CONSTITUTIONAL LIMITATION ON FEDERAL INCOME, ESTATE, AND GIFT TAX RATES

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FOR THE

JOINT COMMITTEE ON THE ECONOMIC REPORT

AND THE

SELECT COMMITTEE ON SMALL BUSINESS

OF THE

HOUSE OF REPRESENTATIVES

BY THE

COMMITTEE STAFFS

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LETTERS OF TRANSMITTAL

FEBRUARY 22, 1952.

To Members of the Joint Committee on the Economic Report, and Members of the Select Committee on Small Business, House of Representatives:

For the information of members of the two above-mentioned committees and others interested, there is transmitted herewith materials assembled by the staffs on the implications of the proposed constitutional limitation on Federal income, estate, and gift taxes. For the most part, the results of the study speak for themselves but we call your attention specifically to the summary and to the conclusions set forth in the letter of transmittal of the staff directors. It is understood, of course, that the materials presented do not necessarily represent the views of the committees or of their individual members.

JOSEPH C. O'MAHONEY,
Chairman, Joint Committee on the Economic Report.
WRIGHT PATMAN,
Chairman, Select Committee on Small Business,
House of Representatives.

FEBRUARY 21, 1952.

Hon. JOSEPH C. O'MAHONEY,
Chairman, Joint Committee on the Economic Report,
United States Senate.

Hon. WRIGHT PATMAN,
Chairman, Select Committee on Small Business,
House of Representatives.

DEAR SIRS: As members of the Joint Economic Committee and the Select Committee on Small Business are doubtless aware, the 14-year-old drive to put a ceiling on Federal tax rates by constitutional amendment is again being pressed, as it has been on previous occasions when tax rates have been raised to new high levels.

Proponents of the amendment assert that 25 or more States have adopted resolutions asking the Congress to call a constitutional convention to fix an effective top tax rate of 25 percent on income, estate, and gift taxes. Of the number claimed, at least seven States have later rescinded their previous resolutions; in several others the resolutions have been vetoed by the governor or are not otherwise in appropriate form. Probably no more than 15 States have resolutions still in force. Not all of the resolutions are in identical form.

Few people, including apparently many proponents of the proposed amendment, realize that the State legislatures cannot submit specific amendments; these must be submitted by Congress. State legislatures may only ask the Congress to call a convention, and such a convention, once called, could report any amendments it chose.

The proposal is, however, being continually presented to the various legislatures as they meet in regular session or are called into special session. While many months must obviously lapse before the issue becomes an immediate problem, if ever, for legislative committees of the Congress, persistence of the sponsoring campaign and the wide tentative acceptance given to the plan makes it of considerable immediate concern to the Joint Committee on the Economic Report and the Select Committee on Small Business.

In view of the implications of a constitutional limitation on tax rates, the staffs of the two committees, in cooperation with other Government agencies, have assembled and present herewith the more important factual and analytical materials dealing with the proposal.

The materials support the following conclusions:

1. Adoption of the proposed ceiling on Federal tax rates would inject a rigidity into Federal fiscal policy which would seriously impair one of the major tools upon which the Federal Government must rely in carrying out its responsibilities. The Federal Government can hardly be expected "to use all practical means * * * to promote maximum employment, production, and purchasing power" as required by the Employment Act if tax rates are substantially frozen into the Constitution.

2. Since the intent and effect of the proposal is to set a maximum rate limit on progressive income, estate, and gift taxes, the almost certain result would be to force the Federal Government to rely increasingly upon regressive sales taxes or upon deficit financing. There is not a responsible tax expert or economist in the country that advocates either (1) regressive taxes as such or (2) deficit financing as a permanent device forced upon the Nation by constitutional provisions.

3. A limitation of the kind proposed would strike a serious blow at the smaller business firms of this country. Just as it would tend to shift the individual tax burden from the rich to the poor, so it would tend to shift the corporate tax burden from the large to the small. It would increase the share borne by small companies and would provide another stimulant for concentration. By reducing the stabilizing effect of income taxation, it would increase the pressure on small firms during periods of receding business activity.

4. Since the proposed ceiling is directed only at the Federal budget, its adoption would mean that many of the services now demanded of Government by the taxpaying constituents would have to be supplied and financed at the State or local level even though this might be less efficient and more costly.

5. The calling of a constitutional convention as proposed by the advocates of limitation would amount to the opening of a Pandora's box. Inasmuch as the convention could and would in no sense be limited to discussing or acting upon the one item of tax limitation, the door would be opened to confusion, debate, and action on collateral and even unrelated issues as it might desire.

6. The more forthright and effective taxpayer and citizen movements for lightening the tax load are properly focusing today upon Government expenditures and Government management rather than on methods of shifting the tax burden from their own shoulders to others.

7. Finally, while the language of limitation currently being advocated provides for suspension of the restriction in time of actual war, the requirement for "escape" is unrealistic in that three-fourths of the total membership of each House would be required to permit even this temporary suspension. Not only would such a rule permit minority rule, but might effectively deny to Congress all possibility of providing adequate funds to defend the country except by borrowing and inflation.

The proposal is clearly revolutionary and deserves to be critically examined before being placed in the Constitution as a happy and easy solution to the problem of high taxes and high governmental expenditures.

As early as 1944 the widespread interest in the proposal led the Division of Tax Research in the Treasury Department to prepare a memorandum on the subject. At our request, the Tax Advisory Staff of the Secretary of the Treasury has prepared current materials and analysis setting forth the implications for Federal and State budgets, including estimated revenue losses and probable economic effects. These materials are incorporated in chapter III.

Since the constitutional convention procedure for amendment has never previously been used, a special chapter on its problems and the difficulties arising from lack of precedent, is included. The Legislative Reference Service, Library of Congress, has made available the services of Dr. Hugh L. Elsbree who, in cooperation with others in the Legislative Reference Service, has prepared that portion of the study, chapter VI. The staff of the Select Committee on Small Business of the House of Representatives, especially Dr. Arthur F. Lucas and Mr. Charles R. Delphenis, have contributed chapters II and V and appendixes A, B, and C to these materials. Dr. William H. Moore, of the Joint Economic Committee staff, was in general charge of the study.

Respectively submitted.

GROVER W. ENSLEY,
Staff Director, Joint Committee on the Economic Report.

VICTOR P. DALMAS,
Executive Director, Select Committee on Small Business.

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CONSTITUTIONAL LIMITATION ON FEDERAL INCOME, ESTATE, AND GIFT TAX RATES

SUMMARY

1. The proposal to amend the Constitution to prohibit the Federal Government from taxing incomes, estates, and gifts in peacetime at rates in excess of 25 percent has been discussed intermittently for over a decade. Several versions of the proposed amendment are extant. Most would provide that in time of war, by a vote of three-fourth of each House, Congress could suspend the operation of the amendment for a period of 1 year at a time. The proposal has a variety of objectives, such as reducing the role of progressive taxes, restricting the role of the Federal Government in the economy, and stimulating work and investment incentives.

2. Although represented as spreading, the tax-limitation movement has not attained the support claimed by its proponents. Since 1938, its sponsors have made several unsuccessful attempts to obtain congressional approval of a joint resolution to submit a constitutional tax limitation amendment to the State legislatures. Most of their effort, however, appears to be directed to initiating the amendment by having the legislatures of two-thirds of the States petition Congress to call a constitutional convention. This amendment method provided in article V of the Constitution has not been used heretofore.

As of the present, 24 State legislatures have enacted endorsing resolutions. Of these, seven have reconsidered their action and rescinded their resolutions; in two others, the governor vetoed the resolutions. Only 15 States have resolutions which appear to be in force at the present time.

3. It is estimated that the proposed amendment would reduce Federal tax revenues by over $16 billion, or more than 30 percent of income and estate and gift tax revenues, at calendar year 1951 income levels. Reductions in corporate taxes would account for $14 billion; individual income tax liabilities would decline about $2 billion and estate and gift taxes by more than $100 million. It would be impracticable to recover all of this revenue either from present sources or from other taxes not now used by the Federal Government. Even partial recovery would require substantially heavier burdens on low- and moderate-income groups. Lower personal income-tax exemptions, higher income-tax rates on low-income groups, higher excise taxes, and general consumption taxes might result from the amendment.

4. The taxes which would be reduced by the proposed limitation—the individual income tax, the corporation income and profits taxes, and the estate and gift taxes—are generally regarded to be the fairest sources of Federal tax revenue. Little progression would be left in the Federal tax structure if the amendment were adopted. Tax rates would be frozen at an arbitrary level, with little or no regard for dif-

ferences in taxpaying ability at different income levels. The amendment would chiefly benefit persons with large amounts of income and property, and the large, very profitable corporations.

The amendment would require individual income-tax reductions for single people with net income exceeding $8,000 and for married people with children having incomes in excess of $20,000. For a family of four, the tax reduction would amount to $754 at the $25,000 net income level, $8,588 at $50,000, and $621,224 at $1,000,000; these tax savings represent 11 percent, 41 percent, and 71 percent of present tax liabilities, respectively. In total, only about 1 percent of all individual income-tax-payers would benefit.

The proposed amendment would reduce the 30-percent normal tax on corporation profits to 25 percent, and would completely eliminate the 22-percent surtax, which applies to corporate profits above $25,000, and the excess-profits tax. Exclusive of excess-profits tax, the corporate tax savings would amount to 17 percent of present taxes at the $25,000 profit level, 46 percent at $100,000, and 52 percent at $1,000,000. For large corporations subject to the excess-profits tax, the tax savings could be as much as 64 percent.

The amendment would further weaken the estate and gift taxes which are now at very moderate levels compared with other taxes. The small number of very large estates and gifts which would benefit would enjoy substantial tax savings. For example, the tax on a $10 million estate left by a single person would be cut almost $2.4 million or about 50 percent.

5. The proposed tax limitation would impose a serious hardship on the smaller business firms. Just as it would tend to shift the individual tax burden from the rich to the poor, so it would tend to shift the corporate tax burden from the large to the small. Although the amendment would probably lead to a reduction in income taxes on all corporations, most of the resulting savings would be obtained by the larger companies.

By removing all elements of progressivity from the corporate income tax and by eliminating the excess profits tax altogether, the proposed amendment would seriously weaken the competitive position of small firms. It would force the latter to assume an inordinate share of the corporate tax burden and would provide an additional stimulant to industrial concentration. The resort to sales taxes and other excises would impose additional burdens on small firms because of their predominance in the field of retail selling.

A rigid limitation on tax rates would also increase the difficulties experienced by small firms in adjusting their activities to economic fluctuations. Profits of small firms normally vary much more widely with the ebb and flow of economic prosperity than do the profits of larger companies. By materially lessening the ability of the Government to maintain a high and steady level of employment, the proposed limitation would increase the pressure on small firms during periods of receding business activity, raise the rate of business failure, and weaken the entire economy.

6. The amendment would place a strait-jacket on the Federal revenue system and would seriously impair the Government's ability to finance essential expenditures. In permitting the tax limitation to be suspended only during wartime, the proposal gives inadequate recognition to the large defense requirements in an emergency short

of war. This consideration looms particularly large at this time when every available financial resource must be marshalled to pay for defense. The proposal also fails to recognize that part of war costs is ordinarily carried over to the postwar period and remains a burden long after the termination of hostilities. In the fiscal year 1952, expenditures for past wars and for the prevention of another World War total about $61 billion or 86 percent of the Federal budget. This includes an expenditure of $50 billion for direct military expenditures (including military and economic aid to our allies) and $11 billion for interest on the public debt and veterans' services and benefits. The two last items arise almost wholly from past wars. Some $9 to $10 billion or 14 percent of the current Federal budget will be used to carry on the remaining functions of Government.

7. Current expenditures for defense and for fixed charges place a practical floor below which Federal spending cannot go. Accordingly, the revenue loss under the amendment could be completely offset only by a cut in the defense program or by borrowing. In view of the difficulty of recapturing the entire revenue loss through alternative sources of taxation, the Federal Government would probably be forced to borrow to meet current expenses. This would mean an increased public debt. In time, this would increase interest charges substantially above the present $6 billion annual level and would make it increasingly difficult to balance the Federal budget. With a 25-percent tax limit on income, estate, and gift taxes, it would be difficult to secure a budgetary surplus to reduce the debt even when defense expenditures decline. The Federal credit might be impaired substantially by the continuation of such a trend of increased borrowing and reduced powers of taxation. Ultimately, tax limitation would work to the disadvantage of bondholders, insurance policyholders, bank depositors, and other groups of thrifty Americans.

8. The allegation that the proposed amendment would stimulate higher levels of economic activity rests largely on the argument that work and investment incentives of high-income persons would be increased. Opinions of objective observers regarding the effect of taxes on incentives differ. Some argue that high tax rates impair incentives by reducing the amount of additional income which can be retained after tax. Others point out that if taxes are high some people work harder and assume greater risks in order to maintain a given standard of living. Also, high-income individuals frequently are motivated by nonpecuniary considerations, such as pride of achievement, prestige, and economic power. The fact that the Nation's output has doubled over the past decade suggests that individuals and corporations carry on economic activities at high levels of efficiency even if taxes must be heavy. Moreover, the large budget deficits which are likely to result from the adoption of the proposed amendment would lead to inflation with disruptive effects on the economy.

9. The stabilizing effect of the tax system would be jeopardized if the tax limitation amendment were adopted. Present taxes account for a greater percentage of national income when business conditions are prosperous than when business conditions are depressed. The result is that the tax system tends to dampen inflationary booms and to cushion depressions. If the amendment were adopted, collections from the individual and corporate income taxes would not rise as

high in prosperous years and would not fall as much in depression years as under present law. The situation would be aggravated if heavier consumption taxes were imposed to replace the loss of revenue under the amendment, since these taxes as a group are less sensitive than income taxes to changes in the national income. In the long run, after inflationary pressures have subsided, the shift from progressive income taxes to less progressive methods of taxation would curtail the broad purchasing power base which is necessary to sustain a growing and dynamic economy.

10. The tax limitation amendment would not benefit State and local governments and might prove detrimental to them.

First, it would force the Federal Government further into taxation areas now also employed by State Governments.

Second, the retrenchments necessitated by the loss of revenue would be likely to result in the curtailment of grants-in-aid to the States and localities, which are expected to total about $3 billion in fiscal year 1953.

Third, the States could not appreciably increase their revenue from income, estate, and gift taxes as the result of Federal tax reductions in these areas. Under present law, State income taxes may be deducted from income for Federal tax purposes and State death taxes are allowed as credits against the Federal estate tax. These Federal tax allowances divert much of the impact of the State taxes from the taxpayer to the Federal Government. They enable the States to impose or increase income taxes without imposing an equal net additional burden on the taxpayer.

11. Since the adoption of the income tax amendment in 1913, the Federal Government has possessed complete freedom of action in determining tax rates. Other countries have similar power over tax rates and are not limited by constitutional provisions. During the 1930's, several States adopted constitutional limitations on property tax rates but experience with these limitations was generally unsatisfactory. States and localities were forced to curtail essential government services and to borrow to meet current operating expenses. Their debt increased and their credit standing deteriorated.

This experience underscores the need for keeping tax rates continually under legislative review to enable the Government to meet its revenue needs under changing conditions.

12. The initiation of an amendment to the Constitution by the States petitioning Congress to call a convention for proposing amendments has never been used. As a matter of political science, provision for this alternative method was doubtless desirable and foresighted on the part of the framers of the Constitution. Its use now, however, is fraught with so many uncertainties that its procedures should not be rushed into or accepted lightly. If a Constitutional Convention is called, its agenda can not be limited to the specific matters covered by the call. The calling, procedures, and operations of such a convention would almost certainly be subjected to protracted court attack.

CHAPTER I

INTRODUCTION—WHAT THE PROPOSAL WOULD AND WOULD NOT DO[1]

A number of State legislatures have in the past decade adopted resolutions calling upon the Congress to initiate an amendment to the Federal Constitution designed to limit Federal tax powers, or to call a constitutional convention to initiate such an amendment. As a matter of form, the proposal in most cases calls first for the repeal of the sixteenth (income tax) amendment incorporated into the Constitution in 1913. Additional clauses in the proposal would simultaneously reinstate the power to levy and collect taxes on incomes without apportionment among the States but with the proviso that in no case may peacetime rates of income or death taxes exceed 25 percent. The wording of the resolutions adopted by the State legislatures has varied but in essentials are quite similar.

Over the years refinements have been introduced taking care of some of the more obviously unacceptable features of the original proposal. In the earlier resolutions, the limitation was ambiguously worded as applying to the "maximum rate of tax." This, it was feared, might be interpreted either as a limitation on the marginal or on the effective rate. More recent forms of the resolution specify that the "maximum aggregate rate of taxes" shall not exceed 25 percent, indicating specifically that the proposed limitation is intended to apply to effective rates.

Some, but not all, of the resolutions include a qualification that

> in the event of war in which the United States is engaged creating a great national emergency requiring such action to avoid national disaster, the Congress by a vote of three-fourths of the total membership of each House, while the United States is so engaged, may suspend, for periods not exceeding one year each, such limitation * * *

At the end of the "active" stage of a war, the limitation on rates would automatically come back into force. None of the resolutions or proposals examined make any similar provision for suspending the limitation in the event of national emergencies other than war.

The 25-percent limitation proposed would apply only to certain taxes, that is, to income taxes on individuals and corporations and to estate and gift taxes. It would not apply to or establish maximum rates of tariff levies, excise or sales taxes, or any other tax which might be devised apart from income, death and gift taxes. At least one of the proposals recently introduced in Congress would go still further and provide that no tax whatever could be laid or collected by the Federal Government with respect to the transfer of property to take effect at or after death or by way of gift.[2]

Within the limitations placed upon the maximum top rate, "including the aggregate of all top rates" of taxes, duties, and excises on

[1] Prepared by staff, Joint Committee on the Economic Report.
[2] H. J. Res. 323, 82d Cong., 1st sess., introduced September 13, 1951. See appendix D.

income, estates, or gifts, the proposals place no limitations on the structure or progression to be applied. While some of the proponents of the limitation apparently envision the possibilities of a significantly progressive tax structure remaining in the area below the ceiling, there is nothing in the proposal itself which would require any progressive schedule of rates. With the marginal rates of combined normal and surtax now beginning at 22 percent for individuals, the corporate normal tax now at 30 percent with a 52-percent rate on all net income over $25,000 and the difficulty of finding any compensatory forms of taxes if these rates were cut back by law, the result might well be that the proposed "maximum" would become also a minimum rate with progressivity gone entirely.

What the proposal calls for is a peacetime limitation upon certain specified forms of taxation. It proposes neither a direct or indirect limitation on the rate or magnitude of Government expenditures. Even if adopted as part of the Constitution, there is no necessary reason why the limitation of income, estate and gift tax revenues should have any substantial limiting effect upon expenditures. To the extent that supporters of the limitation movement feel that it offers a device for controlling or limiting Government expenditures, they are placing reliance on a method remotely indirect and one which is not likely to be successful.

A sovereign government with world leadership responsibilities and with the power to go into debt and to levy some forms of taxes without limit may not be limited in the level of its expenditures by inadequate collections from a specific source of revenue. In a number of States where real or personal property tax limitation provisions have been adopted, the State or local government has, in certain cases, been driven into, or perhaps one should say found escapes through, debt and deficit financing. Taxation to service debt must be brought under the ceiling limitation at the risk of seriously impairing the "full faith" and general credit of the State. If tax levies needed to provide funds for the payment of interest and repayment of debt are not included under the limitations, the door is left open for regular operating deficits and substantial debt financing.[3]

There are doubtless some who would argue the desirability of limiting Federal expenditures by one device or another. But, supporters of the proposed limitation upon income and estate taxes cannot claim that as one of its major merits.

The proposal is quite unrelated and should be distinguished from discussions and opinions regarding the maximum or proper share of the gross national product or national income which may safely be taken by Government in taxes. Though great differences of opinion exist relative to the precise point beyond which taxation cannot go without causing economic trouble, most economists would concede that some such practical limit does exist. Heavy defense expenditures together with the prospect that such may continue high for many years has made the understanding and recognition of this critical level, if such indeed there be, extremely important.

[3] For a recent study see Effects of Property Tax Limitation in West Virginia, James H. Thompson' National Tax Journal, June 1951, p. 129. Mr. Thompson concludes his article with the statement: "On the whole, the experience with tax limitation in West Virginia bears out an opinion once expressed by Simeon Leland, who described this form of control as 'an unintelligent and ineffective method of accomplishing desirable results' (Property Tax Limitation Laws, publication 36; Chicago: Public Administration Service, 1936, p. 89)."

Mr. Colin Clark, the Australian economist, has suggested that a critical point, beyond which taxation may not go without generating inflationary forces, comes into play at around 25 percent of the national income. The coincidence between this 25 percent (with which incidentally most economists disagree) [4] and the proposal for a 25 percent constitutional limitation on certain taxes should not be interpreted as lending support to either proposition. Whatever the merits of the precise figure which he has suggested, Mr. Clark is quite specific in saying that the figure he is talking about includes total revenue from all forms of taxation—direct, indirect, Federal, State, and local.

> The figure on the critical economic maximum does not tell what proportion of an individual's income or a corporation's income or of an estate can legitimately be taken in taxation—

he points out—

> it simply indicates how large a proportion of the national income can safely be taken without serious economic disturbance.[5]

One further point about the proposed constitutional limitation deals with the procedure which its proponents have chosen to urge in seeking amendment to the Constitution. The proposal is generally that the amendment be initiated by two-thirds of the States petitioning Congress to call a Constitutional Convention which would then draft an amendment to be submitted to the States for ratification. Although on a number of occasions States have requested Congress to call a Constitutional Convention, there has never been a sufficient number of States making the request to have resulted in the calling of a convention. The procedure proposed is thus unfamiliar in comparison to the process used in connection with the previous 22 amendments to the Constitution. The problems of precedents and procedure in this unusual method are so great that their discussion is taken up as a constitutional matter in a separate chapter.

[4] See e. g., appendix E, panel discussion Joint Committee on the Economic Report, January 31, 1952.
[5] The Danger Point in Taxes, Colin Clark, Harper's Magazine. December 1950, p. 69.

CHAPTER II

LEGISLATIVE ACTION BY THE VARIOUS STATES [1]

The movement for a tax limitation amendment began in 1938. Sponsors first sought congressional approval of a joint resolution submitting a constitutional amendment to the States for ratification.[2] This method by congressional initiation is the way that all previous amendments have been added to the Constitution.

The advocates, unable to elicit any substantial enthusiasm in Congress for tax limitation of this kind, changed their strategy and launched a drive to invoke the hitherto unused alternate procedure authorized by article V of the Constitution. This provision states that the Congress shall call a Constitutional Convention on the application of the legislatures of two-thirds (32) of the several States.[3] Since 1939 the advocates of the amendment have devoted their efforts to persuading State legislatures to petition Congress to call a Constitutional Convention for the purpose of proposing the 25-percent limitation on income, estate, and gift taxes.

The first result of this strategy appeared in Wyoming in 1939. It was followed in 1940 by Mississippi and Rhode Island and in 1941 by Iowa, Maine, Massachusetts, and Michigan. In 1943 the legislatures of eight States endorsed the proposed amendment namely Alabama, Arkansas, Delaware, Illinois, Indiana, New Hampshire, Pennsylvania, and Wisconsin. In 1944 two States, Kentucky and New Jersey, approved similar resolutions.[4]

By 1944 the movement reached such proportions that individual Members of Congress became concerned. Led by Representative Wright Patman, the implications of the movement were brought to the attention of the States. Seven States proceeded to rescind their previous resolutions. These seven States and the year of rescinding were: Alabama, Arkansas, Illinois and Iowa, 1945, Kentucky, 1946, Rhode Island, 1949, and Wisconsin, 1945.

While the advocates' major efforts since 1939 have been directed toward the State legislatures, resolutions seeking the 25-percent limitation have also been introduced in Congress.[5] It is interesting to note how the demand for a 25-percent limitation on income, estate, and gift taxes has alternated between the Congress and the States. As has been stated the resolution was first placed before the Congress in 1938 and again in 1939. Then the resolution was taken up in the States. Between 1939 and 1945, action was confined to the States. In 1945 rescinding resolutions began passing the State legislatures. The amendment was again introduced in the Congress in 1945 and 1947. Then followed a period of declining taxes and for the next 3 years, 1948, 1949, and 1950, the proposal seemingly lay dormant.

[1] Prepared by staff of Select Committee on Small Business, House of Representatives.
[2] H. J. Res. 722, 75th Cong., 3d sess., introduced on June 15, 1938 by Representative Celler (by request). The resolution was reintroduced Jan. 3, 1939 (H. J. Res. 1).
[3] See chapter VI, infra.
[4] For table of State actions to date see appendix A.
[5] Appendix D; other resolutions have been introduced by Mr. Mason, of Illinois.

With the outbreak of the Korean conflict and the entry of the United Nations into that troubled area, the necessity of rearming the United States brought about the need for higher taxes. The immediate reaction to a prospect of higher taxes was readily apparent; the tax limitation amendment was again vigorously proposed to the State legislatures. In 1951 the legislatures of five States approved the proposal, namely Florida, Kansas, Montana, Nevada, and Utah. Also, in 1951 the Congress has had two resolutions introduced seeking the limitation.

The record as it stands on February 21, 1952 shows the following 17 State legislatures as having been in favor of the proposed amendment: Delaware, Florida, Georgia, Indiana, Kansas, Louisiana, Maine, Massachusetts, Michigan, Mississippi, Montana, Nevada, New Hampshire, New Jersey, Pennsylvania, Utah, and Wyoming.[6]

There are questions as to effectiveness of many of these memorials as received by the Congress. These questions will be discussed in greater length in a following chapter (ch. VI).

The question arises as to whether a governor has the power of veto over such a resolution. For example, two States have had their resolutions vetoed by the Governors—Pennsylvania and Montana. In Montana the house of representatives upheld the Governor's veto by a majority vote which seems to indicate that, in Montana, the Governor does have the veto power. And Nevada's resolution is unique in that it asks the Congress to submit the amendment to the several States for ratification, rather than to call a constitutional convention.

The facts listed above record the actions as taken by the States. As received by the Congress, these actions present a somewhat different picture. With the exception of Nevada, each of the endorsing resolutions, as enacted by the States, instruct the Secretaries of State to forward duly certified copies of the resolutions to the Senate of the United States and to the House of Representatives in the Congress. If the recording of the endorsing and rescinding resolutions in the Congressional Record can be taken as an official count, then 19 States may be said to be in favor of the amendment. These 19 States include those of Montana and Pennsylvania whose memorials were vetoed by the Governors.

Two States are known to have passed endorsing resolutions calling for a constitutional convention to ratify this proposal but no record of their filing has been found. They are Louisiana and Nevada.

Four States are known to have passed rescinding resolutions calling for repudiation and retraction of their former endorsing resolution, although no record of filing with Congress has been found. These are: Alabama, Iowa, Rhode Island, and Wisconsin.

When viewed in this light one may consider that 19 States—Alabama, Delaware, Florida, Georgia, Indiana, Iowa, Kansas, Maine, Massachusetts, Michigan, Mississippi, Montana (vetoed by the Governor), New Hampshire, New Jersey, Pennsylvania (vetoed by the Governor), Rhode Island, Utah, Wisconsin, and Wyoming—are on record as favoring a constitutional convention for the purpose of considering and ratifying the proposed tax limitation.[7]

[6] See appendix A.
[7] See appendix A, item 2, for tabulation of State action as received by the Congress.

In summary:

Number of States enacting endorsing resolutions	24
Number of States enacting rescinding resolutions	7
Number of endorsing resolutions recorded by the Congress	22
Number of rescinding resolutions recorded by the Congress	3

There is another type of resolution being circulated among the several States for adoption similar to the resolution requesting the Congress to call a constitutional convention for the purpose of adopting the 25-percent limitation on income, estate, and gift-tax rates. While this resolution also requests the Congress to call a convention, the article it proposed to make a part of the Constitution provides for a strict distribution of tax moneys received by the Government. It does not call for any limitation on the congressional power to tax.

This proposed amendment has been recommended to Congress by five States: Iowa, Maine, Nebraska, New Hampshire and New Mexico—and has been included by the advocates of the 25-percent-limitation amendment in their widely advertised totals of the number of States that are in favor of the tax-limitation amendment. This is true despite the fact that all amendments of this type submitted to the Congress include the following:

> *Resolved*, That the Legislature of the State of ——— does not, by this exercise of its power under article V, authorize the Congress to call a convention for any other purpose other than the proposing of the specific amendment which is a part hereof; nor does it authorize any representative of the State of ——— who may participate in such convention to consider or to agree to the proposing of any amendment other than the one made a part thereof; * * *

The 25-percent tax-limitation proposal has aroused much opposition on grounds other than the drastic restriction of the Congress' power of taxation. Many congressional leaders object to the way that it has been placed before the legislatures of the States for consideration. In a number of cases the resolutions were introduced in the legislatures near the end of the sessions when little or no debate could be held. Furthermore, there has been an apparent lack of factual information available to enable opponents in the State legislatures to make a case, and for the legislative bodies to reach an informed judgment. This has led many opponents to believe that the will of the majority of citizens was not being accurately expressed in the memorials.

The fact that seven legislatures have rescinded the earlier action indicates that in at least some of the States the proposal was originally adopted without full appreciation of its implications. Kentucky's rescinding resolution stated that its original action was "the result of a misapprehension as to its true meaning." Alabama's rescinding resolution described the limitation as—

> an arbitrary and unwise restriction of the rights which the Congress requires to perform its constitutional duty of providing for the general welfare of the United States.

In his veto of the resolution, the Governor of Montana stated that the amendment—

> would apply only to the wealthy and would be of no benefit to the average man or woman. The proposed amendment would favor large corporations, giving no relief to the small-business man or the small corporations. Income taxes are generally devised upon the principle of requiring those to pay who have ability to pay. The proposed amendment would be repugnant to this principle.

CHAPTER III

ECONOMIC AND FISCAL IMPLICATIONS [1]

REVENUE LOSS

The proposed amendment would, other things being equal, reduce Federal tax revenue by an estimated $16.2 billion, at calendar year 1951 income levels. This is equivalent to a reduction of over 30 percent in the yield of the individual income and corporate taxes and the estate and gift taxes.

Effect of 25-percent tax-rate limitation on revenues [1]

[Dollar amounts in millions]

	Present law [2]	25 percent limit	Revenue loss	
			Amount	Percent reduction
Corporate taxes, total	$24,720	$10,750	$13,970	57
Income tax	21,190	10,750	10,440	49
Excess-profits tax	3,530		3,530	100
Individual income tax	26,190	[3] 24,125	2,065	8
Estate and gift taxes	750	630	120	16
Total	51,660	35,505	16,155	31

[1] Estimates are based on calendar year 1951 income levels for the individual income and corporate taxes and on fiscal year 1952 levels for estate and gift taxes.

[2] Revenue Act of 1951 rates applicable to 1952.

[3] The individual income-tax yield on incomes as currently reported for tax purposes would be reduced to $22.6 billion. The above estimate takes into account the effect of increased dividends resulting from lower corporate taxes on the total income reported for individual income-tax purposes.

Corporation taxes would be cut $14 billion, including $3.5 billion from the excess-profits tax which would be wiped out completely. The reduction in corporation-tax liabilities would increase corporate net income after taxes by about 75 percent.

The individual income-tax yield would be cut initially from $26.2 billion to $22.6 billion. However, after taking account of the effect of increased dividends on the total income reported for tax purposes, it is estimated that the income tax would produce $24.1 billion, or $2.1 billion below the present yield. This assumes that it would be possible to maintain the tax liabilities of low-income taxpayers at present levels, while those at the highest income levels were reduced substantially.

The estate and gift taxes would decline by about $120 million from $750 million to $630 million.

The revenue loss would be difficult, if not impossible, to recover. To recover $16 billion by a general consumption tax would require a sales tax of almost 10 percent on all retail sales including food. To recover it through the individual income tax would require more than an increase in all bracket rates to 25 percent and a reduction in the per capita personal exemption from $600 to $200. Even if every existing excise tax were doubled, the revenue gained would fall about $7 billion short of the revenue lost by the amendment.

[1] Prepared by Tax Advisory Staff of the Secretary of the Treasury.

DISTRIBUTION OF BENEFITS

The four taxes directly affected by the proposed amendment—the individual income tax, the corporate taxes, the estate tax, and the gift tax—are the most progressive elements in the Federal tax structure. A limitation on the rates of these taxes would reduce the extent to which Federal taxes could be distributed in accordance with taxpaying ability.

The chief beneficiaries would be persons with large amounts of income or property who are subject to effective rates in excess of 25 percent under present law. The principal direct benefits of the reduced corporate income and excess-profits taxes would go to the largest and most profitable corporations. Insofar as the reduction in corporate taxes would be reflected in increased dividends and higher stock prices, high-income taxpayers would also be principal beneficiaries. Low- and moderate-income persons would not share in the tax reductions under the amendment. Moreover, as already indicated, there is a strong likelihood that they would be called upon to make up the loss of revenue through increased consumption taxes, lower personal exemptions, or higher income-tax rates.[2]

The shift in relative tax burdens of high- and low-income groups under the tax limitation amendment should be viewed against the background of the combined structure of Federal, State, and local tax systems. In the fiscal year 1951, individual and corporation income

TABLE 1.—*Federal, State, and local tax revenue, by sources, fiscal year 1951* [1]

[Dollar amounts in millions]

Source	Total	Federal [2]	State	Local [3]
Income:				
Individual	$21,814	[4] $20,940	[5] $810	$64
Corporation	14,790	14,101	682	7
Death and gift	908	708	196	4
Sales, gross receipts, and customs	14,890	9,137	5,269	484
Property	7,402		346	7,056
Licenses, permits, and others	2,142	130	1,629	383
Total	61,947	45,016	8,932	7,998
PERCENT OF TOTAL				
Income:				
Individual	35.2	46.5	9.1	0.8
Corporation	23.9	31.3	7.6	.1
Death and gift	1.5	1.6	2.2	.1
Sales, gross receipts, and customs	24.0	20.3	59.0	6.1
Property	11.9		3.9	88.2
Licenses, permits, and others	3.5	.3	18.2	4.8
Total	100.0	100.0	100.0	100.0

Treasury Department, Tax Advisory Staff of the Secretary, Jan. 15, 1952.

[1] Excluding old-age and unemployment insurance contributions.

[2] Internal-revenue collections minus refunds, net of interest allowed on refunds. Federal figures are on a collection basis, except customs which are on a Daily Treasury Statement basis.

[3] Local tax revenue for fiscal year 1950.

[4] Beginning Jan. 1, 1951, amounts withheld for Federal income tax and for old-age insurance are not reported separately. Withheld individual income-tax collections are estimated by deducting appropriations to Federal old-age insurance trust fund from total withheld taxes.

[5] Combined corporation and individual income taxes as reported by 4 States are included in individual income taxes.

NOTE.—Figures are rounded and will not necessarily add to totals.

Sources: Federal taxes (except customs): Bureau of Internal Revenue, Summary of Internal Revenue Collections, Aug. 27, 1951. Customs: Daily Treasury Statement, June 29, 1951. State taxes: Bureau of Census, State Tax Collections in 1951. Local taxes: Bureau of Census, Governmental Revenue in 1950.

[2] Such a movement away from progressive taxation is expressly intended and desired by the sponsors of the proposed limitation. See Wilford I. King, Setting a 25 Percent Maximum on Income Tax Rates Would Benefit All Classes, Committee on Constitutional Government, Spotlight, No. 52 (1950).

taxes together accounted for more than 75 percent of tax collections of the Federal Government (other than social-insurance payments) compared with less than 17 percent for the States (table 1). Sales and excise taxes produced almost 60 percent of total State tax collections as against 20 percent of Federal tax collections. Almost 90 percent of local tax revenues are derived from the property tax. Thus, the redistribution of Federal taxes which would be brought about by the tax-limitation amendment would reduce progression in a setting in which the combined Federal, State, and local tax structures are already less progressive than the Federal tax structure alone.

1. Individual income tax

The individual income tax, the largest revenue producer in the Federal tax system, is now paid by about 42,000,000 single persons and married couples. Tax rates, which apply after allowance for deductions and an exemption of $600 for the taxpayer and each dependent, range from 22.2 percent on surtax net income under $2,000 to 92 percent on surtax net income over $200,000, but cannot exceed 88 percent of net income.

The proposed amendment would not reduce the taxes of most taxpayers. As shown in table 2 single persons with no dependents

TABLE 2.—*Comparison of income-tax liabilities under present law [1] and under the 25-percent maximum effective rate limitation proposal*

Net income before exemptions	Amounts of tax		Tax reduction		
	Present law	25 percent maximum effective rate	Amount	As a percent of—	
				Present tax	Net income after present tax
				Percent	*Percent*
SINGLE PERSON—NO DEPENDENTS					
$8,089 [2]	$2,022	$2,022			
$10,000	2,728	2,500	$228	8.4	3.1
$15,000	4,968	3,750	1,218	24.5	12.1
$20,000	7,762	5,000	2,762	35.6	22.6
$25,000	10,940	6,250	4,690	42.9	33.4
$50,000	28,466	12,500	15,966	56.1	74.1
$100,000	69,688	25,000	44,688	64.1	147.4
$500,000	436,164	125,000	311,164	71.3	487.4
$1,000,000	[3] 880,000	250,000	630,000	71.6	525.0
MARRIED COUPLE—NO DEPENDENTS					
$16,178 [2]	$4,044	$4,044			
$20,000	5,456	5,000	$456	8.4	3.1
$25,000	7,508	6,250	1,258	16.8	7.2
$50,000	21,880	12,500	9,380	42.9	33.4
$100,000	56,932	25,000	31,932	56.1	74.1
$500,000	412,328	125,000	287,328	69.7	327.7
$1,000,000	872,328	250,000	622,328	71.3	487.4
$2,000,000	[3] 1,760,000	500,000	1,260,000	71.6	525.0
MARRIED COUPLE—TWO DEPENDENTS					
$20,000 [2]	$5,000	$5,000			
$25,000	7,004	6,250	$754	10.8	4.2
$50,000	21,088	12,500	8,588	40.7	29.7
$100,000	56,032	25,000	31,032	55.4	70.6
$500,000	411,224	125,000	286,224	69.6	322.4
$1,000,000	871,224	250,000	621,224	71.3	482.4
$2,000,000	[3] 1,760,000	500,000	1,260,000	71.6	525.0

[1] Revenue Act of 1951, rates applicable to 1952 income.
[2] Level above which the 25-percent rate limitation is effective in reducing tax liability.
[3] Taking into account maximum effective rate limitation of 88 percent.

Treasury Department, Tax Advisory Staff of the Secretary. Jan. 15, 1952.

and with less than about $8,000 of net income and married persons with two dependents and with less than about $20,000 of income would receive no relief since their taxes already are less than 25 percent under present law. In total, only about 450,000 out of the 42,000,000 taxpayers, or about 1 percent, would benefit from the amendment.

For those individuals whose taxes would be reduced, the tax savings would increase directly with the size of income. The tax reduction for a married person with two dependents would amount to $754 or 11 percent at the $25,000 net income level, $8,588 or 41 percent at $50,000, $31,032 or 55 percent at $100,000, and $621,224 or 71 percent at $1,000,000.

2. Corporation taxes

Corporation income taxes consist of a normal tax of 30 percent applicable to total taxable income, and a surtax of 22 percent which applies to incomes above $25,000. In addition, a 30-percent tax is levied on excess profits, subject to a limitation of 18 percent of total income.

The proposed amendment would reduce the 30-percent normal tax to 25 percent and, therefore, would reduce to some extent the taxes of all corporations. However, since the amendment would completely eliminate the 22-percent surtax, the greatest benefit would go to corporations with profits of more than $25,000. The excess-profits tax would presumably also be eliminated, unless this tax were construed to be not an income tax and hence outside the scope of the limitation.

Because all corporations regardless of size would be subject to the same 25-percent tax rate, the preferential treatment granted to small corporations would be eliminated. As shown in table 3, corporations with incomes of $25,000 or less, which are now subject only to the

TABLE 3.—*Comparison of combined corporate normal tax and surtax under present law*[1] *and under 25-percent maximum effective rate limitation proposal*

Net income	Amounts of tax		Tax reduction	
	Present law	25 percent maximum effective rate	Amount	Percent of present tax
$25,000	$7,500	$6,250	$1,250	16.67
$30,000	10,100	7,500	2,600	25.74
$50,000	20,500	12,500	8,000	39.02
$75,000	33,500	18,750	14,750	44.03
$100,000	46,500	25,000	21,500	46.24
$150,000	72,500	37,500	35,000	48.28
$200,000	98,500	50,000	48,500	49.24
$300,000	150,500	75,000	75,500	50.17
$500,000	254,500	125,000	129,500	50.88
$750,000	384,500	187,500	197,000	51.24
$1,000,000	514,500	250,000	264,500	51.41
$1,500,000	774,500	375,000	399,500	51.58
$2,000,000	1,034,500	500,000	534,500	51.67
$5,000,000	2,594,500	1,250,000	1,344,500	51.82
$10,000,000	5,194,500	2,500,000	2,694,500	51.87
$100,000,000	51,994,500	25,000,000	26,994,500	51.92

[1] Revenue Act of 1951, rates applicable to 1952 income.

Treasury Department, Tax Advisory Staff of the Secretary. Jan. 15, 1952.

30-percent normal tax rate, would receive a tax reduction of about 17 percent. However, at $100,000 of income, where the corporation normal tax and surtax together now reach an effective rate of 47 percent, the tax savings, exclusive of excess-profits tax, would amount to over 46 percent. At $1,000,000, where the effective rate is almost 52 percent, the tax savings would amount to about 52 percent. If the limitation were to apply not only to normal tax and surtax but also to excess-profits tax, the tax savings of large corporations would be even greater. For a corporation with sufficient ordinary income and excess profits to be taxed at an effective rate of 70 percent—the maximum combined income and excess-profits-tax rate under present law—the tax saving would be 64 percent.

To the extent that the $14 billion reduction in corporate income and excess-profits taxes would not be reflected in lower prices of corporate products, dividends, and stock-market prices would increase and the principal beneficiaries would be those who hold corporate securities. In 1948, the most recent year for which data are available, persons with incomes of $5,000 and over received 84 percent of all dividends reported on tax returns while over 50 percent of such dividends went to persons with incomes of $25,000 and over. In the same year, dividends constituted 44 percent of incomes of $1,000,000 or more and less than 1 percent for those with less than $5,000 of income.

3. Estate and gift taxes

The estate and gift taxes were largely bypassed in the wartime expansion of the Federal revenue system and, because of major structural changes in the postwar period, are now at lower levels than in 1939. After a $60,000 exemption, present estate tax rates range from 3 percent of the first $5,000 to 77 percent on that portion of the estate in excess of $10 million. However, these rates rise slowly. In addition, since the 1948 Revenue Act, a decedent can leave up to one-half his estate to his spouse without incurring tax. As a result of these provisions, the estates of only about 1 percent of the adult decedents in the United States are taxable under the Federal estate tax.

An estate which takes full advantage of the marital exclusions would have to be over $20 million before becoming subject to a 25 percent effective rate. Even without the marital deduction, a decedent could leave as much as $670,000 before being subject to a 25 percent rate. Consequently, a 25 percent effective rate limitation on estate and gift taxes would affect only a small number of extremely large property transfers. In the few instances where the limitation would apply, the tax savings would be very substantial. For example, the tax on a $10 million estate left by a single person would be cut almost $2.4 million, or about 50 percent.

Gift tax rates are now set at 75 percent of estate tax rates. In addition to a lifetime gift tax exemption of $30,000, a taxpayer may exclude the first $3,000 given to each donee annually. Since the 1948 revenue act, only one-half of gifts made by one spouse to another is taxable. In case of a gift to a third person, the spouses may elect to treat the gift for tax purposes as though made one-half by each spouse. As a result of all these factors, the proposed 25-percent effective rate limitation would take effect at an even higher level of property transfers under the gift tax than under the estate tax.

IMPACT ON FEDERAL EXPENDITURES AND THE NATIONAL DEBT

The proposed amendment placing a ceiling on Federal tax rates would seriously impair the ability of the Government to meet essential and emergency expenditures. Under the proposed language, it would be possible to suspend the constitutional limitation only during a war. However, this would require a vote of three-fourths of each house of Congress and the suspension would be effective for only 1 year. Since the Congress, with the concurrence of the President, now has the power to declare war by a simple majority vote of each house, it would be more difficult to raise taxes to finance the war than to declare war. Moreover, the amendment would make it difficult to finance increased expenditures in situations such as the present, when war is not actually declared.

In permitting the tax limitation to be suspended only during wartime the amendment would also give inadequate recognition to the fact that part of the costs of war ordinarily is carried over to the postwar period in such costs as debt service charges and veterans' programs. These costs must be borne at the same time as the defense program.

Federal expenditures for fiscal year 1952 will approximate $71 billion. Expenditures attributable to past wars or present defense needs account for about $61 billion of total budget expenditures. National security programs, both domestic and international, alone require $50 billion. Interest on the national debt, most of which stems from World War II, absorbs nearly $6 billion. Veterans' services and benefits cost another $5 billion. Federal expenditures for carrying on the remaining functions of Government account for $9 to $10 billion.

The $16.2 billion revenue loss under the proposed amendment would be almost twice as large as total expenditures which are not the result of war and defense needs. Accordingly, if this revenue loss were to be completely offset by a reduction in Federal spending, it would be necessary to reduce expenditures related to war and defense. Some of these expenditures, such as interest on the national debt and veterans' pensions, are contractual obligations.

Because large current expenditures on the defense program and fixed charges place a practical floor below which Federal spending might not go, it seems unlikely that the loss involved under the amendment could be offset fully by a reduction in Federal expenditures. Part of this revenue loss could be recovered through the type of tax adjustments which have already been discussed. In all probability, however, the Federal Government would be forced to make up a substantial part of the revenue loss by borrowing. It would be most difficult to balance the Federal budget, and when defense expenditures fall off, to secure a budgetary surplus to reduce the debt.

The experience of municipal governments with property tax limitations suggests that the amendment might affect the Government's credit. When municipal governments operate under tax limits, these restrictions are frequently reflected in the credit rating of their bonds. Because they do not have sufficient tax powers in reserve, such municipalities have little ability to meet unforeseen contingencies, with the result that emergencies bring sharp declines in their credit standing. The tax limitation amendment might have a similar effect on the credit of the Federal Government.

ECONOMIC EFFECTS

According to its sponsors, the tax limitation amendment would increase the incentives of high-income persons to work and to invest by allowing them to keep a larger portion of their income after taxes. This claim is based on the presumption that the present tax burden on high-income groups and corporations has passed economically feasible limits and is now restricting production and investment.

Opinions of objective observers regarding the effect of taxes on incentives differ. Some argue that high tax rates impair incentives by reducing the amount of additional income which can be retained after tax. Others point out that if taxes are high, some people work harder and assume greater risks in order to maintain a given standard of living. Moreover, to the extent that individuals engage in economic activities because of nonpecuniary motives, such as pride of achievement, prestige and economic power, they would not respond to tax cuts.

The fact that we have made substantial, if not unprecedented, economic progress in the past decade, with taxes at relatively high levels suggests that these levels of taxes have not deterred most individuals from putting forth their best efforts. The gross national product (measured in first half of 1951 prices) almost doubled between 1939 and the first half of 1951, rising from $179 billion to $324 billion. Civilian employment rose from 46 million to 62 million. Weekly wages in manufacturing increased from $24 per week to $65 per week at the end of 1951, or about 50 percent in real terms after allowance for the increases in prices since 1939. Over the same period, corporate profits rose from about $6 billion to $45 billion before taxes and from $5 billion to $18 billion after taxes.[3] Corporate expenditures on new plant and equipment in the past 5 years aggregated about $100 billion.

Since the economy is already operating at or near capacity, it is hardly likely that under present circumstances tax reductions alone could increase output and real incomes substantially. To the contrary, the large budget deficits resulting from the adoption of the proposed amendment would lead to inflation, which could distort management incentives and disrupt production.

The effect on incentives cannot be measured in terms of the level of tax rates alone. The Federal tax law contains numerous provisions which are designed to protect incentives and to encourage the development of new and small businesses. For example, deductions for business losses are allowed for tax purposes not only against income in the year losses are incurred but also against income in the preceding year and the five succeeding years. As a result, the taxpayer is allowed as long as 7 years to average losses and profits in order to assure taxation only on income and to prevent impairment of capital. The exemption of corporations with profits of less than $25,000 from both the corporation surtax and excess profits tax was adopted specifically to foster and safeguard small business. The preferential treatment of capital gains and special depreciation and

[3] These data on corporate profits and plant and equipment are in current dollars and do not take account of the price rise since 1939. However, a substantial portion of the increases cited above represents increases in real terms.

amortization provisions have also been enacted by Congress to stimulate investment generally.

Another important consideration involved in assessing the merits of the tax limitation amendment from an economic standpoint is whether it leaves the Federal Government enough flexibility to contribute to economic stability and growth. In the long run, after inflationary pressures have subsided, the shift in tax burden from high- to low-income groups would curtail the broad purchasing power base which is necessary to sustain a growing and dynamic economy. Experience during the early thirties demonstrated that without adequate markets, investment and employment can fall to relatively low levels even when taxes on large incomes, estates, and gifts are moderate.

The income taxes now make an important contribution to economic stability. The yields of both the individual income and corporation taxes account for a greater percentage of national income when business conditions are prosperous than when business conditions are depressed. Thus, when business is prosperous, the tax system tends to absorb inflationary pressures by taking a relatively large percentage of private income; when business is poor, the tax system encourages consumption and stimulates business expenditures by taking a relatively small percentage of private incomes. These effects can be strengthened by changes in rates and exemptions.

The same stabilizing effect could not be achieved if the tax limitation amendment were adopted. Tax collections would not rise as high in prosperous years and would not fall as much in depressed years as under present law. This result would be reinforced if heavier consumption taxes were imposed to replace the loss of revenue under the amendment, since consumption taxes are generally less sensitive than income taxes to changes in national income.

Finally, the reduction in the effective rates of the individual income tax and the corporate income tax would make it more difficult in periods like the present to combat inflation. It would also be harder, especially if the excess profits tax were eliminated, to tax extraordinary incomes attributable to the rearmament program.

FEDERAL, STATE, AND LOCAL FISCAL RELATIONS

The proposed tax limitation amendment would be harmful also to State and local governments.

Restriction of high Federal tax rates is often justified on the ground that it would permit the States to increase their own revenues from income, estate, and gift taxes. This claim ignores the fact that the Federal tax structure narrows interstate tax differentials in these areas and, therefore, does not interfere with more intensive use of high taxes by the States. If the amendment compelled the Federal Government to rely more heavily on consumption taxes, it might well reduce rather than increase the revenue sources available to the States. Confronted by a large revenue loss, the Federal Government might also find it difficult to continue on the present scale grants-in-aid to the States and localities for such purposes as education and highways.

The failure of the States to develop income tax revenues further does not appear to be a result of high Federal income taxes. Only 29 States impose individual income taxes and 32 States impose corpora-

tion income taxes. Several States have constitutional barriers to a graduated income tax. For new revenue sources in recent years, the States have exhibited a preference for general sales taxes over income taxes. The number of States employing individual income taxes has not changed since 1937. In contrast, 8 of the 31 States which now impose general sales taxes have enacted them since the end of World War II.

Federal income tax rates do not prevent the States from imposing income taxes.[4] State individual and corporate income taxes may be deducted in computing net income for Federal income tax purposes.[5] A substantial portion of the burden of State income taxes is therefore borne by the Federal Government, thus reducing the taxpayer's combined tax liability. Where the taxpayer's income reaches into the highest tax brackets, the Federal Government actually bears the major portion of the additional burden of the State income tax. For example, for a married person with two dependents, at the $200,000 level, the effective rate of Federal tax is 69.2 percent and the New York State tax is 6.1 percent, before taking account of the deductibility of the State tax for Federal tax purposes. However, the deductibility feature of the Federal law limits the combined Federal-State liability at this level to 69.9 percent. The burden of the State tax is, therefore, reduced from the nominal 6.1 percent rate to 0.7 percent (table 4).

Frequent assertions are made that the combined Federal and State marginal tax rates (i. e., the rates applicable to an additional dollar

TABLE 4.—*Effect of deductibility on combined Federal and State income tax for a married man with two dependents, at selected net income levels* [1]

Net income before personal exemption [2]	Effective rates of tax				
	Federal (assuming no State tax)	State		Combined Federal and State	
		New York	Minnesota (assuming no Federal tax)	New York	Minnesota [3]
	Percent	*Percent*	*Percent*	*Percent*	*Percent*
$20,000	25.0	4.1	6.9	27.6	27.9
$50,000	42.2	5.4	9.1	44.0	43.9
$100,000	56.0	5.9	9.8	57.5	57.1
$200,000	69.2	6.1	10.1	69.9	69.5
$1,500,000	[4] 88.0	6.3	10.5	89.3	88.9

[1] Federal rates under Revenue Act of 1951, applicable to taxable year 1952; New York and Minnesota rates under income tax laws applicable to taxes paid in 1952.

[2] Prior to allowable deductions for income taxes. The Federal Government allows taxpayers to deduct State income taxes in computing net taxable income for Federal purposes, and, similarly, Minnesota allows deduction of Federal tax in computing the State tax. New York does not allow deduction of the Federal income tax in computing the State tax.

[3] Taking into account reciprocal deductibility under Federal and Minnesota taxes.

[4] Taking into account Federal maximum effective rate limitation of 88 percent.

NOTE.—The effect of deductibility is illustrated only for net incomes beginning at $20,000, since most low-income taxpayers do not itemize deductions, but use the standard deduction for both Federal and State income tax purposes.

Treasury Department, Tax Advisory Staff of the Secretary. Jan. 15, 1952.

[4] Where States allow Federal individual and corporate income taxes to be deducted in computing tax liability, State revenue from these taxes is sharply reduced.

[5] Individuals with small and moderate incomes generally do not itemize their deductions under the Federal income tax but, instead, take the standard deduction. The deduction has been set at a level which allows, among other deductions, for State income tax payments.

of income) are confiscatory in the higher brackets. Table 5 illustrates that this is never the case. For example, in a State which permits deduction of the Federal tax, a 10-percent State income tax adds only 1.5 percentage points to the Federal marginal tax rate at the $20,000 surtax net income level and less than one percentage point at the $200,000 surtax level. Whether or not the State permits the deduction of Federal tax, the taxpayer is protected against confiscatory rates because the State income tax is deductible from the top income bracket under the Federal tax.[6]

TABLE 5.—*Effect of deductibility* [1] *on combined Federal and State marginal rates,* [2] *at selected surtax net-income levels*

Surtax net income	Federal marginal rate	State marginal rate [3]	State does not allow deduction for Federal tax		State allows deduction for Federal tax	
			Combined Federal and State marginal rate	Percentage points added by State tax	Combined Federal and State marginal rate	Percentage points added by State tax
	Percent	*Percent*	*Percent*		*Percent*	
$20,000	62	10	65.80	3.80	63.54	1.54
$30,000	67	10	70.30	3.30	68.17	1.17
$50,000	77	10	79.30	2.30	77.57	.57
$100,000	90	10	91.00	1.00	90.11	.11
$200,000	92	10	92.80	.80	92.07	.07

[1] The Federal Government allows taxpayers to deduct State income taxes in computing net taxable income for Federal purposes. Approximately two-thirds of the income-tax States allow deduction of Federal tax in computing the State tax.

[2] The marginal rate is the rate applicable to an additional dollar of income. Federal rates under the Revenue Act of 1951, applicable to taxable year 1952.

[3] The top rate is as high as 10 percent in only 3 States (in one of these it is 15 percent); in 2 States the top rate is 8 percent; in 24 States it is no higher than 7 percent.

NOTE.—The effect of deductibility is illustrated only for net incomes beginning at $20,000, since most low-income taxpayers do not itemize deductions, but use the standard deduction for both Federal and State income-tax purposes.

Treasury Department, Tax Advisory Staff of the Secretary, Jan. 15, 1952.

The deductibility of State income taxes under the Federal income tax assists States which have income taxes by protecting them against competition from States which do not have such taxes. Because the deduction reduces the taxpayer's liability and diverts much of the impact of the State tax from the taxpayer to the Federal Government, States may at present impose or increase income taxes without imposing an equivalent net additional burden on the taxpayer and with less fear of driving out wealthy taxpayers. State governors are aware of the effect of the deductibility feature and recently have called attention to it in connection with proposed rate increases.[7]

To a limited extent, a similar situation exists under the Federal estate tax, which allows taxpayers to claim taxes paid to States as a partial credit against Federal tax liability. States are able to impose taxes on estates up to 80 percent of the Federal liability under the 1926 law without increasing the taxpayer's total tax burden.

[6] In the case of extreme fluctuations of income from year to year, a taxpayer on a cash basis may not obtain full advantage of the deductibility feature if, for State tax purposes, he is on a cash basis and the deducttion from Federal tax does not relate to the same income year as the tax. The use of an accrual basis, however, would give the taxpayer full advantage of the deduction since in his Federal return he would report his State income tax due and payable at the time of reporting rather than the cash outlay for income tax purposes during the previous year.

[7] One governor, in recommending a 100 percent increase in the State income tax in 1951, pointed out that such an increase would result in an actual increased cost to the taxpayer of only a little over 50 percent of his present State tax because of the Federal deductibility feature. Another governor in asking for enactment of a 4-percent corporate income tax estimated that because of the Federal deduction, the State corporation income-tax burden would be increased by only 1½ percent. The remaining portion of these increases in State revenues would be absorbed by deductions under the Federal income tax.

The original purpose of the crediting device was to eliminate interstate competition for wealthy residents. Prior to its adoption, States competed with each other to attract such residents. One State went so far as to adopt a constitutional amendment prohibiting all inheritance taxes, with the avowed purposes of attracting the wealthy aged. Every State, except one, now has some form of death tax and most take full advantage of the Federal credit.

If the Federal Government were forced to increase its revenue from sources not affected by the limitations, namely, general and selective excises, competition with State and local governments would be increased. Overlapping State, local, and Federal excise taxes already constitute an important problem. Practically all the postwar discussions regarding coördination of Federal-State tax systems have been primarily concerned with the relinquishment of certain excise taxes by the Federal Government so that State and local governments can more fully exploit these fields.

The proposed limitation of the Federal tax powers might also affect the grants-in-aid which the Federal Government could afford to extend to the States. These grants, which constitute a vital link in the Federal-State system of government, are expected to total about $3 billion in fiscal year 1952. In the fiscal year 1950 (the latest year for which State data are available), Federal aid constituted 17 percent of total State general revenue.

EXPERIENCE WITH CONSTITUTIONAL LIMITATIONS ON TAX RATES

Since the adoption of the income-tax amendment in 1913 and the inauguration of Federal estate and gift taxation, the Federal Government has possessed complete freedom of action in determining tax rates. Other countries have similar power over the tax rates and are not limited by constitutional provisions.

However, there has been considerable State and local experience with tax limitations. During the 1930's, several States adopted constitutional limitations on the maximum over-all property tax rate which could be levied by the State and its political subdivisions. These limitations generally had the dual purpose of limiting expenditures and reforming the tax system by replacing the property tax with other sources of revenue.

These constitutional limitations on property taxes have been subject to much criticism. They have tended to deprive the localities of fiscal flexibility to meet changing conditions. Their immediate effect was the restriction of municipal spending to the extent that essential services were seriously curtailed. In the States with most drastic limitations, considerable reduction in educational services resulted in the form of reduced staffs, teachers' salary cuts, and shorter school years. Some cities discontinued street lighting and fire protection temporarily. Others were unable to pay salaries of teachers, firemen, and policemen for long periods.

The source of revenue most widely adopted by the tax-limitation States to provide replacement revenues was the sales tax. The property-tax limitation had been represented as a means of relieving the small home owner and the low-income classes. It is generally agreed, however, that these groups have gained little and probably lost by the substitution of consumption taxes for some property taxes.

The reaction of investors to tax limitations closed certain markets to bonds issued by communities subject to over-all tax limits. Savings banks and insurance companies under some State laws were not permitted to invest in bonds payable from limited tax levies. Some regard the disastrous effects upon municipal credit as one of the most serious consequences of the tax-rate limitations.[8]

Most State tax-limitation provisions permitted levies in excess of the specified limit when authorized by popular referendum. Special authorizations, however, were not easy to obtain since approval usually required more than a simple majority of the electorate voting on the provision, sometimes as much as two-thirds of the qualified electorate.

A realization of the disadvantages of property tax limitations has compelled the States to come to the aid of local governments by assuming responsibility for functions formerly performed at the local level (such as highway maintenance, education, and relief), by sharing State revenues with the localities, and by extending municipal taxing powers. Although most of the property-tax limitations are still in effect, the pressure of revenue needs obliged local governments to develop means for circumventing the intent of these limitations.

The experience with property-tax limitations illustrates the dangers inherent in a constitutional limitation on Federal taxes. Tax rates, by their very nature, should be determined currently by a majority of the elected and responsible representatives of the people. They must be revised frequently to enable Government to meet its revenue needs as they develop under continually changing conditions.

[8] See, for example, Frederick I. Bird, Director of Municipal Research, Dun & Bradstreet, The Effect of Tax Rate Limits on Municipal Credit, National Municipal Review, November 1935, p. 607.

CHAPTER IV

RELATION OF THE PROPOSAL TO MAXIMUM EMPLOYMENT POLICIES [1]

Whatever other considerations may be urged either for or against the proposed constitutional limitation on rates of income, estate and gift taxes, the proposal does have broad implications from the standpoint of governmental efforts to foster a stable and growing economy. First of all, the limitation would have an important bearing upon the flexibility and, therefore, upon the usefulness of Government fiscal policy as a device to be relied on in the quest for stabilization, at maximum employment and production levels. Secondly, by restricting the operation of progressive income, estate, and gift taxes the limitation principle would move away from taxation based on ability to pay and force increased reliance of the Federal Government on more regressive forms of taxation, or drive it into persistent deficit financing with resulting inflation.

Under the Employment Act of 1946, the Federal Government has undertaken to use its influence and resources to promote an expanding and productive economy. The act declares:

> It is the continuing policy and responsibility of the Federal Government to use all practicable means consistent with its needs and obligations and other essential considerations of national policy, with the assistance and cooperation of industry, agriculture, labor, and State and local governments, to coordinate and utilize all its plans, functions, and resources for the purpose of creating and maintaining, in a manner calculated to foster and promote free competitive enterprise and the general welfare, conditions under which there will be afforded useful employment opportunities, including self-employment, for those able, willing, and seeking to work; and to promote maximum employment, production, and purchasing power.

The act of 1946 declaring this policy, after careful consideration by the Congressional committees, passed the Senate without an opposing vote and passed the House by a vote of 320 to 84. Seldom has a major declaration of policy been received with such unanimity. Seldom has the acceptance of responsibility on the part of the Government presented such a challenge.

In recognition of the fact that changing economic conditions rarely follow a predictible pattern, framers of the act deliberately provided the utmost flexibility in policy formulation and administration. The act as a consequence does not list or specify the precise tools to be employed in the furtherance of the purpose of the act. Indeed, no exhaustive catalog of the tools available to the Government for implementing the policy has ever been made.[2] Major methods by which the Government can exert its influence positively toward the maintenance of economic stability include:

1. Adjustment of the Government's expenditure and revenue programs to produce a surplus of revenue in periods of high

[1] Prepared by staff, Joint Committee on the Economic Report.

[2] For a list of Federal Government activities having special impact on employment, see hearings, subcommittee of Committee on Banking and Currency, United States Senate, 79th Cong., 1st sess. on S. 380, Full Employment Act of 1945, p. 691.

employment, and an excess of expenditures in periods of unemployment or deflation. Control of the structure and type of taxes and expenditures are equally effective tools.

2. Flexible and vigorous monetary policy directed toward an appropriate easing or restriction of credit as employment and business conditions vary.

3. Specific programs aimed at expanding or stabilizing strategic segments of the economy, examples of which may be cited in the farm price-support program, the insurance of bank deposits, provision of adequate capital facilities, etc.

4. Regulatory programs to promote competition, and in periods of emergency to control prices and allocate materials.

5. Exhortation of individuals and businesses to save or dissave, to invest or to spend, as economic conditions display tendencies to excesses in one direction or another.

The mere listing of these major tools is sufficient to suggest that high importance must be assigned to flexible fiscal policy if the purposes of the Employment Act are to be fostered or attained. Certainly the hope of achieving the objectives of the act demands careful husbanding and improvement of all of the tools which can make an important or positive contribution toward assuring a dynamic economy within the framework of a free competitive enterprise system.

Flexibility of fiscal policy cannot be obtained, of course, without flexibility in taxation policy since Government revenues are one blade of the fiscal scissors. Not only is flexibility in income-tax collection a necessary and useful device for furthering the objectives of the Employment Act but it is a tool already available and in use.

With the Federal budget grown to $70 billion or more each year, representing 20 percent or more of total national production, the considerable influence of Federal fiscal policy on the behavior of the economy can hardly be questioned. Since tax collections and Government surplus tend to shrink the market for private business while Government expenditures and deficits tend to raise prices and stimulate employment, their economic effects cannot be ignored. A subcommittee of the Joint Committee on the Economic Report, after exhaustive hearings and study, concluded that—

> Federal expenditure and revenue policies now constitute one of the most important determinants of production and employment * * *[2]

Even when the present need for huge defense budgets has passed, the impact of Federal tax collections and expenditures on persons and business firms will remain large. Since this impact cannot be avoided, its influence should, so far as possible, be exerted for good rather than for evil, that is, toward stability and growth, rather than instability and depression. In periods of actual or imminent inflation, a surplus of tax collections over Government spendings can contribute greatly to stabilization.

When the withdrawal of cash from the private economy is necessary to meet the needs of Government, income taxes, both individual and corporate, are the most useful devices. Taxes based upon individual incomes withdraw purchasing power from individuals, while taxes levied upon corporate incomes work to the same end, by removing funds which might otherwise enter the markets for scarce goods and services.

[2] Report of the Subcommittee on Monetary, Credit and Fiscal Policies, Document 129, 81st Cong., 2d sess., p. 12.

Thus, in periods of inflationary pressures as prices, profits, and incomes rise, the progressive income tax is an important tool which automatically reduces the amounts of this pressure. On the other hand, in depressed times, the burden exacted by the income tax declines much more rapidly than does the income on which the tax is based, and thus additional sums remain with individuals and corporations for consumption and investment. This operation is in striking contrast to the operation of excises—on which the Federal Government would have to rely with the removal of important parts of the income tax. Further imposition of additional excises—such as a general sales tax—would most certainly mean a transfer to the low-income groups of a substantial part of the burden currently borne by the middle and higher-income groups, and thus result in a reduction of the available consumer market.

Since the Employment Act calls upon the Federal Government to use all practical resources available to it, the obligation to maintain the effectiveness of its own fiscal tools goes without saying. The proposed constitutional limitation on rates of taxation at levels below those necessary to meet recognized needs for revenue could easily become a minimum rate. Designed to establish a ceiling on rates, the proposed limitation might well become a floor or going rate as well. As an effective maximum and minimum adhered to through good times and bad, all flexibility in income-tax rates would be lost and the possibility of varying income-tax collections with the various phases of changing business conditions and Government need would be gone. With normal fiscal needs of Government calling for tax collections substantially in excess of those which might reasonably be anticipated under the limited rates, income tax flexibility as a counterinflationary device would have been completely abandoned. Not only would the automatic flexibility inherent in the system of progressive rates be lost but the freedom to adjust the rate schedule would be so restricted as to be useless. Instead of governmental income-tax programs providing a balance wheel which might be used compensating so far as practicable for ups and downs in the private economy, tax programs would become a rigid lodestone exerting at all times the same—if not an inverse—force on business, agriculture, and consumers.

But this compensatory budget aspect of the income tax is not the only area in which the proposed constitutional limitation on rates would affect the stabilizing efforts of the Federal Government. Indeed, so far as over-all fiscal policy is concerned, any discussion of the proposed limitation on income taxes may seem unimpressive or irrelevant. While the proposed constitutional amendment might be effective in bringing about a substantial reduction in marginal rates of income taxes, it undertakes nothing by way of limiting tax collections from other sources. It is not a limitation upon aggregate tax collections as a whole. Furthermore, deficits would still be possible even though certain important forms of taxation were rigidly limited. Expenditures could still be varied and other substituted taxes modified as economic conditions warranted.

The question presented by the proposal thus is not whether taxes in general should be limited but whether progression in income, estate, and gift tax rates is undesirable or wrong. Given the background of the Government's sizable peacetime needs for revenue, the proposed

limitation on tax rates can only be viewed (1) as a blow at income and estate taxation as compared to sales taxes or other forms of taxation, and (2) as a blow at progressive taxation as compared to proportional or regressive systems.

The tax structure has important effects upon incentives. At times it may be desired to add to the incentives to invest or to save while at other times it may be equally desirable to encourage precisely opposite tendencies in order to offset unstabilizing influences. When the Government is called upon to raise a given sum in peacetimes as well as in wartimes, the decision as to how it is best raised and from whom it can be taken in taxes is in itself an important tool in stabilization efforts. The progressive income tax is by far the most flexible of all taxes.

Closely allied with the problem of economic growth are the claims advanced by proponents of the amendment to the effect that a 25 percent ceiling on income tax rates would increase investment incentives and permit businesses to accumulate capital necessary to finance job-giving investments. But students of the subject of corporate taxation discount this claim to the extent that corporate income taxes can be and are passed on to consumers. Competent authorities, including most business executives, argue that corporate income taxes are passed along or shifted and are not paid out of or reduce stockholders' profits.[1]

As far as the second part of the claim is concerned—the needs for capital accumulation and investment—it is generally recognized that the problem of financing relates principally to the smaller enterprises as will be pointed out in the following chapter. Large corporations which are now paying highest bracket rates are precisely the class that have been least deterred from investment or accumulating funds.

The proposal to place a 25-percent ceiling on tax rates applicable to individual and corporate incomes, estates, and gifts would go far toward frustrating the Government's efforts in behalf of economic stability and growth. The resources available to Government for carrying out its challenging responsibility are limited enough. Flexibility in revenues and expenditures rather than rigid constitutional rules should be the goal. Mitigation of extremes in the unequal distribution of income and wealth rather than measures calculated to preserve and increase inequality is the all but universally accepted need. The fact is that adoption of the proposal would work its greatest hardship on the very people it is intended to benefit most. By driving the Federal Government into continuing deficits and persistent inflation, it would go far to undermine the value of the dollar from which all taxpayers would suffer.

[1] In a recent statement of this view Crawford H. Greenewalt, president, E. I. du Pont de Nemours & Co. (Bulwark of Progress, p. 10), says: "It has been said also that the corporate income tax is a tax on stock holders, that it comes out of profits, and that its impact is limited to a relatively small group. Anyone who has been concerned with practical business operations knows that this is not so. The corporate income tax is no more than an element of cost in the production of goods and services. In normal times, it is treated no differently than the cost of materials or the cost of labor. Corporate taxes are simply transferred to the price of the goods offered for sale, and in the last analysis are paid by the consumer at retail."

CHAPTER V

EFFECT OF THE PROPOSED AMENDMENT ON SMALL-BUSINESS ENTERPRISE [1]

The goal of a balanced and productive, free-enterprise system is not to be achieved without healthy and vigorous small business. A tax system that exerts the minimum repressive effect on the smaller firms is essential to the well-being of the entire business economy. The impact of the proposed constitutional amendment on the small-business enterprises of this country thus provides an important criterion of its social and economic expediency.

From the standpoint of its effects on small manufacturing, mercantile, and service corporations, the proposal to establish a constitutional maximum of 25 percent to Federal income and inheritance taxes must be viewed with grave misgivings. Instead of granting relief to small firms, the proposal would most certainly impose additional and very onerous burdens. Just as it would shift the individual tax burden from the rich to the poor, so it would shift the corporate tax burden from the large to the small. At the same time, it would aggravate the impact of economic fluctuations on small firms and would make more difficult the task of survival in an ever-changing economic world.

The evil in the proposed amendment arises primarily from the fact that the preferential treatment now given in the corporate income tax to small concerns would be withdrawn. A basic difficulty with taxes on corporate incomes lies in their general lack of progressivity. The *burden* of the tax as distinct from the tax *rate* tends to rest too heavily on firms with small incomes. This has been recognized in the present Federal tax and measures to lighten the burden on small firms have been adopted. Thus the surtax applies only to firms with incomes in excess of $25,000. In spite of this concession, the corporate income tax is still only mildly progressive. The quarterly financial reports of the Federal Trade Commission indicate, for instance, that in the fiscal year ending June 30, 1951, corporations with assets of less than $250,000 paid on an average about three-eighths of their income (including income and excess profits taxes) to the Federal Government, whereas the largest corporations (those with assets of $5,000,000 or more) paid about one-half.

Small as it is, the concession now granted to small firms would disappear if a flat 25 percent tax rate were imposed. It is true that under the proposed amendment taxes on all corporations would be reduced somewhat. The 22 percent surtax would presumably be dropped and the 30 percent normal tax would be reduced. The significant fact is, however, that large corporations would gain much more than small. Corporations with incomes of $25,000 or less would receive a tax reduction from the 1951 level of only about 17 percent. Larger corporations, on the other hand, would receive reductions of

[1] Prepared by staff, Select Committee on Small Business, House of Representatives.

over 50 percent. For large corporations subject to the excess profits tax, the tax savings might run as high as 64 percent.

The share of profits remaining after taxes is a matter of the utmost concern to the small enterpriser. In the competitive struggle for survival the small firm frequently finds itself at a serious disadvantage because of the inability to obtain the capital necessary to a normal and healthy growth. Rarely can it rely on external sources for its risk capital. The business is generally founded on the savings of its owners. Subsequent needs are met largely from earnings. To retain control likewise may require the owner to base his expansion on earnings rather than on outside capital.

By depriving small businesses of the present tax differential, the proposed amendment would seriously weaken their competitive position. It would force the smaller corporations to assume an inordinate share of the corporate tax burden. It would provide a strong stimulant to industrial concentration, and by jeopardizing the small-business segment of our economy, jeopardize the entire economic system.

The proposed limitation on income, excess profits, and inheritance taxes will impose additional burdens on small business because of increased reliance on indirect taxation. It is highly important that a tax structure be devised that places as light a burden as possible on business activities that involve direct dealing with the consumer. It is here that small firms find their greatest strength. Retailing and service trades, residential construction, and the apparel, food, and similar industries provide the stronghold of small business. As we have seen, the proposed limitation on income and inheritance taxes would undoubtedly lead to a sharp increase in sales and other excise taxes, taxes which bear heavily on the small firms engaged in selling directly to the consumer. Sales taxes already impose a heavy burden on small business. In addition to the direct burden, there is the heavy cost of bookkeeping and clerical labor involved in making collections.

But this is not all. The proposed amendment would impose an additional threat to small concerns through its tendency to nullify the Government's program of stabilizing economic conditions and maintaining maximum employment. Basic economic stability is important to the small firm. This is the result of the simple fact that profits of small firms normally experience wider swings with the ebb and flow of economic prosperity than do the profits of larger firms. A typical example is afforded by the period from the second quarter of 1947 to the third quarter of 1949. According to the quarterly financial reports of the Federal Trade Commission, profits of manufacturing concerns were generally declining at that time. The profits before taxes of small firms (those with less than $250,000 of assets) declined 19.5 points (from 26.5 percent of owners' equity to 7 percent) whereas the profits of large companies (those with $5,000,000 or more of assets) declined less than 6 points. Any fiscal policy that accentuates economic fluctuations thus works grave hardship on small enterprises. This is particularly true of periods of business recession when the profits of the smaller firms soon reach the vanishing point.

As appeared in the preceding chapter, a uniform corporate tax of 25 percent would materially reduce the flexibility of the Federal tax system and lessen the ability of the Government to use taxes as a tool

to maintain a steady and high level of employment. The opportunity to adjust income tax rates and hence collections to changing economic conditions would be lost. Small business would thus find itself subjected to increasing pressures in times of declining business activity. The difficulties of making adjustments to changing conditions would be enhanced, failures would increase, and the entire economy would be weakened.

Finally, it should be borne in mind that the income received from small corporations is much more closely akin to individual income than is the income received from large corporations. In fact, for the really small corporation, the distinction between corporate income and individual income is negligible. The relation between income receiver and the source of the income is both close and personal Individual initiative, energy and willingness to assume risks are important determinants of the magnitude of the taxable income. It makes little difference whether the form of organization is an individual proprietorship, a partnership or a corporation; if it is small, the return to its owners is a personal, individualized income. To lump this income in the same category as the impersonal, strictly investment returns obtained from large companies is to confuse the name with the reality. It is essential that our tax policy continue to distinguish between large and small corporations. Income from the latter must be treated as the personal income it inherently is.

CHAPTER VI

CONSTITUTIONAL AMENDMENT BY CONVENTION [1]

The Constitution of the United States, Article V, providing an amending process reads as follows:

> The Congress, whenever two thirds of both Houses shall deem it necessary, shall propose Amendments to this Constitution, or, on the Application of the Legislatures of two thirds of the several States, shall call a Convention for proposing Amendments, which, in either Case, shall be valid to all Intents and Purposes, as Part of this Constitution, when ratified by the Legislatures of three fourths of the several States, or by Conventions in three fourths thereof, as the one or the other Mode of Ratification may be proposed by the Congress; Provided that no Amendment which may be made prior to the Year One thousand eight hundred and eight shall in any Manner affect the first and fourth Clauses in the Ninth Section of the first Article; and that no State, without its Consent, shall be deprived of its equal Suffrage in the Senate.

Of the four possible ways of amending the Constitution, only two have been used. All amendments except the twenty-first were initiated by two-thirds vote of both Houses of Congress and ratified by the legislatures of three-fourths of the States. The twenty-first amendment was initiated in the same manner as the others but was ratified by conventions in three-fourths of the States. So far the Congress has never called a convention to propose amendments.

Consideration of the provision for initiation of amendments by a convention called by Congress at the petition of two-thirds of the State legislatures raises a number of questions. How did the provision come to be included in the Constitution? How frequently, and on what subjects, have State legislatures petitioned Congress for a convention? To what extent does it lie within the discretion of Congress to determine when a convention shall be called? How close together in time and in subject matter must petitions be to count toward the requisite two-thirds? What is the effect of a resolution rescinding a petition? If Congress should decide to call a convention, how would it be organized? Could its powers be limited?

It is hoped that the discussion which follows will throw some light on the above and related questions, although it does not purport to answer them definitively. An attempt has been made to summarize the more significant historical information, to outline the major constitutional issues, and to analyze the various possible lines of argument with respect to each of these issues.

ARTICLE V IN THE CONSTITUTIONAL CONVENTION OF 1787

On May 29, 1787, shortly after the Constitutional Convention had met and organized, Edmund Randolph of Virginia and Charles Pinckney of South Carolina presented general plans for a new Constitution. In both plans the States were given a voice in the initiation of con-

[1] Prepared by Legislative Reference Service, Library of Congress.

stitutional amendments. Article 13 of the so-called Virginia plan, presented by Randolph, stated simply—

> that provision ought to be made for the amendment of the Articles of Union whensoever it shall seem necessary; and that the assent of the National Legislature ought not to be required thereto. [2]

Article 16 of the Pinckney plan, which closely resembled the amending procedure finally adopted, read as follows:

> If two-thirds of the legislatures of the States apply for the same, the legislature of the United States shall call a convention for the purpose of amending the Constitution—or should Congress with the consent of two-thirds of each House propose to the States amendments to the same—the agreement of two-thirds of the legislatures of the States shall be sufficient to make the said amendments parts of the Constitution.
>
> The ratifications of the conventions of — States shall be sufficient for organizing this Constitution.[3]

When article 13 of the Randolph plan was discussed in Committee of the Whole House on June 11, Madison reported that—

> Several Members did not see the necessity of the resolution at all, nor the propriety of making the consent of the National Legislature unnecessary.

Colonel Mason and Randolph supported the resolution, Colonel Mason arguing that—

> It would be improper to require the consent of the National Legislature, because they may abuse their power, and refuse their consent on that very account. The opportunity for such an abuse may be the fault of the Constitution calling for amendment.

The Convention (in committee) then voted to postpone consideration of the words "without requiring the consent of the National Legislature," and passed the other provision in the clause. This vote was ratified by the Convention on July 23.[4]

When the Committee on detail reported on August 6, the amending provision (article XIX) was worded as follows:

> On the application of the legislatures of two-thirds of the States in the Union, for an amendment of this Constitution, the Legislature of the United States shall call a convention for that purpose.[5]

On August 30, article XIX was agreed to, with no opposition, although Gouverneur Morris suggested that the National Legislature should be left at liberty to call a convention whenever it pleased.[6]

Then, on September 10, only a week before the Convention adjourned, Elbridge Gerry moved to reconsider article XIX. "This Constitution" he said "is to be paramount to the State constitutions. It follows, hence, from this article that two-thirds of the States may obtain a convention, a majority of which can bind the Union to innovations that may subvert the State constitutions altogether." Hamilton seconded the motion, but on the grounds that "the State legislatures will not apply for alterations, but with a view to increase their own powers"; he wanted the National Legislature to be given power to call a convention, on the vote of two-thirds of each branch. Madison made an interesting observation on the vagueness of the

[2] Max Farrand (ed.), The Records of the Federal Convention (New Haven, 1937), vol. I, p. 22. The account of the convention proceedings contained in this section is taken from Farrand's four-volume work. For a detailed discussion of the history of article V in the convention, see Paul J. Scheips, The Significance and Adoption of Article V of the Constitution, Notre Dame Lawyer, vol. 26, pp. 46–67 (Fall, 1950).
[3] Farrand, III, p. 601.
[4] Farrand, I, pp. 202-3; II, p. 84.
[5] Farrand, II, p. 188.
[6] Ibid., pp. 467-8.

wording of article XIX: "How was a convention to be formed? By what rule decide? What the force of its acts"? Following this discussion the Convention voted to reconsider, nine States to one, New Hampshire being divided.[7]

Sherman then moved to add the words: "or the legislature may propose amendments to the several States for their approbation; but no amendments shall be binding until consented to by the several States."[8] After this motion had been amended by inserting "three-fourths of" before "the several States" (in the proviso), Madison moved to postpone consideration of the amended proposition to take up the following:

> The Legislature of the United States whenever two-thirds of both Houses shall deem necessary, or on the application of two-thirds of the legislatures of the several States, shall propose amendments to this Constitution, which shall be valid to all intents and purposes as part thereof, when the same shall have been ratified by three-fourths at least of the legislatures of the several States, or by conventions in three-fourths thereof, as one or the other mode of ratification may be proposed by the Legislature of the United States.[9]

With the slavery proviso added, Madison's proposition passed, nine States to one, with New Hampshire's vote again divided.

When the committee of style reported on September 12 the amending article was worded as follows:

> The Congress, whenever two-thirds of both Houses shall deem necessary, or on the application of two-thirds of the legislatures of the several States, shall propose amendments to this Constitution, which shall be valid to all intents and purposes, as part thereof, when the same shall have been ratified by three-fourths at least of the legislatures of the several States, or by conventions in three-fourths thereof, as the one or the other mode of ratification may be proposed by the Congress: *Provided*, that no amendment which may be made prior to the year 1808 shall in any manner affect the — and — sections of article —.[10]

This article was not taken up until September 15, when the Constitution was ordered to be engrossed. Sherman wanted more protection of the rights of the States. Mason thought the proposed amendment procedures "exceptionable and dangerous. As the proposing of amendments is in both the modes to depend, in the first immediately, and in the second ultimately, on Congress, no amendments of the proper kind would ever be obtained by the people, if the Government should become oppressive, as he verily believed would be the case."[11]

Morris and Gerry moved to amend, to require a convention on application of two-thirds of the States.

Madison "did not see why Congress would not be as much bound to propose amendments applied for by two-thirds of the States, as to call a convention on the like application. He saw no objection, however, against providing for a convention for the purpose of amendments, except only that difficulties might arise as to the form, the quorum, etc., which in constitutional regulations ought to be as much as possible avoided."[12]

The motion of Morris and Gerry was then unanimously agreed to.

On this same day, after being further amended to safeguard the equal representation of the States in the Senate, article V, along with the other provisions of the Constitution, was ordered to be engrossed.[13]

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[7] Ibid., pp. 557–8.
[8] Ibid., p. 558.
[9] Ibid., p. 559.
[10] Ibid., p. 602.
[11] Ibid., p. 629.
[12] Ibid., pp. 629–30.
[13] Ibid, pp. 630, 633.

The history of article V is an erratic one, and the recorded debate concerning its provisions is scanty. It is interesting to note, however, that the participation of the States in the process of initiating amendments appears to have been taken for granted. There were differences of opinion as to the desirability of having any provision for amendment, and, if there was to be one, of excluding the National Legislature from having a voice in it. With regard to State participation in the proposal of amendments, however, the only real point at issue was what form it should take.

PREVIOUS USAGE OF THE STATE PETITION PROCEDURE [14]

The contrast between the apparent expectation of the framers as to the importance of State initiation of amendments and the actual use made of the procedure is startling. General petitions were presented to Congress in 1789 by New York and Virginia.
The next petition, also general in nature, was by Georgia in 1833. Later in the same year Alabama petitioned with respect to an amendment against the protective tariff. Shortly before the Civil War six State legislatures petitioned for the calling of a drafting convention.[15] These 10 petitions appear to have constituted the entire output for over 100 years.

In the past 50 years petitions have been much more numerous. The largest number of petitions so far recorded on a single subject called for a convention to initiate an amendment providing for the popular election of Senators. A total of 55 petitions were adopted, representing 29 State legislatures. This movement took place chiefly between 1901 and 1911. In second place comes the current income-tax limitation proposal, on which 24 States have petitioned. Beginning with New York in 1906, 18 States petitioned for a convention on the subject of prohibiting polygamy. These are the only three subjects on which a substantial number of petitions have been recorded. One to half a dozen petitions have been adopted on a wide range of subjects, including antitrust control, repeal of the eighteenth amendment, taxation of tax-exempt securities, regulation of hours of labor and minimum wages by Congress, method of apportionment and presidential tenure. In addition, several legislatures have adopted petitions calling for a convention without specifying any object. Altogether there appear to have been over 100 petitions in the last half century, but many of these represent second and third petitions from several of the State legislatures on the subject of popular election of Senators.

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[14] Information in this section concerning petitions adopted up to 1930 is based chiefly on Federal Constitutional Convention, Senate Document No. 78, 71st Cong., 2d sess. (1930) and Wayne B. Wheeler, "Is A Constitutional Convention Impending?", Illinois Law Review, Vol. 21, pp. 782 ff. (Apr. 1927). Petitions on the income tax proposal are listed in Appendix A of this report. The following list of additional petitions is not intended to be complete: Taxation of securities, previously tax-exempt, by federal government: Idaho 1928, C. R. 69:455; California, 1935, C. R. 79:10814. General constitutional convention: Wisconsin, 1929, C. R. 71:2590, 3369. Repeal of Eighteenth Amendment: Massachusetts, 1931, C. R. 74:45; New York, 1931, C. R. 75:48; Wisconsin, 1931, C. R. 75:57; Rhode Island, 1931, C. R. 75:495-6; New Jersey, 1932, C. R. 75:3299. Regulation of wages and hours by Congress in intrastate commerce: California, 1935, C. R. 79:10814. Change of method of apportionment of congressmen: Iowa, 1941, C. R. 87:2494. Limitation of presidential tenure (either action by Congress or by convention requested): Iowa, 1943, C. R. 89:2516, 2728; Illinois, 1943, C. R. 89:2516-7. Distribution of Federal revenues (see ch. II, this report): Nebraska, 1949, C. R. 95:7893-4; Iowa, 1951, C. R. (daily), Apr. 17, pp. 4045-6; Maine, 1951, C. R. (daily), June 4, pp. 6186-7; New Hampshire, 1951, C. R. (daily), Aug. 28, pp. 10929-31; New Mexico, 1952, C. R. (daily), Feb. 11, 1962. In view of the difficulties in tabulating petitions—one of which is that petitions are not always presented to Congress—most of the figures in this section must be regarded as approximate.

[15] Herman V. Ames, The Proposed Amendments to the Constitution of the United States During the First Century of Its History (Washington, U. S. Government Printing Office, 1897), p. 283. (H. Doc. No. 353, pt. 2, 54th Cong.)

Only in the case of the provision for popular election of Senators has the petition procedure proved influential in amending the Constitution. The seventeenth amendment was, of course, initiated by Congress, but between 1894 and 1902 the Senate four times blocked passage of resolutions adopted by the House.[16] Following the flood of State petitions for the calling of a convention the Senate finally concurred in the resolution initiating the amendment.

The history of the State petition procedure suggests that from a political standpoint it is nearly always simpler for the advocates of an amendment to concentrate their efforts on persuading Congress to initiate it by a two-thirds vote of both Houses than to secure the adoption of petitions by the legislatures of two-thirds of the States. The exception in the case of the seventeenth amendment is easily explained by the Senate's direct involvement in the proposal. At the same time, the sharp rise in the number of petitions in the past 50 years—some 10 times the number in the first 100 years—makes one hesitate to predict that it will continue to be a vehicle for lost causes.

WHEN IS A CONVENTION TO BE CALLED?

In providing that—

> The Congress * * * on the application of the legislatures of two-thirds of the several States, shall call a convention for proposing amendments * * *.

Article V leaves unanswered many important questions. How closely must petitions be related in time to be counted toward the necessary two-thirds? In subject matter? Should a petition be counted if it is later rescinded by the legislature? If it is vetoed by the governor? Is the role of Congress simply the ministerial one of issuing a call for a convention when two-thirds of the States have applied, or can it determine for itself the desirability of calling a convention? To what extent will the courts review the action of Congress in calling or in failing to call a convention?

1. The nature and extent of Congress' responsibilities

In the light of the history of the amending article in the Constitutional Convention, it is reasonably clear that when two-thirds of the States have made application Congress is to call a convention, not consider whether one should be called. Our constitutional history makes it equally clear that the duty to call a convention is one to be enforced by the Congress itself. It is unlikely that the courts would attempt to compel the Congress to perform a positive act in furtherance of a constitutional obligation. Failure to call a convention would be comparable to the failure after the census of 1920 to make a reapportionment of seats in the House of Representatives, contrary to the requirement of article I, section 2.

When it comes to judicial review of action taken by Congress in calling a convention, the answer is not so clear. Specific rulings of the courts are referred to below, in connection with particular problems of interpretation. In general, it may be said that the Supreme Court has been increasingly inclined to leave to the political branches of the Government the decision of questions arising out of the amending process. In *Coleman* v. *Miller*, which presented several issues concerning the ratification of the twenty-first amendment, Mr. Justice

[16] Wheeler, op. cit., p. 786.

Black in a concurring opinion, speaking for himself and Justices Roberts, Frankfurter, and Douglas, said that article V—

> grants power over the amending of the Constitution to Congress alone. Undivided control of that process has been given by the article exclusively and completely to Congress. The process itself is "political" in its entirety, from submission until an amendment becomes part of the Constitution, and is not subject to judicial guidance, control, or interference at any point. [17]

The above four members of the Court, in an opinion written by Mr. Justice Frankfurter, contended that the courts had no jurisdiction over the issues there in question. The decision in the case did not go so far. The Court took jurisdiction, but held that two of the questions involved (see below) were "political" and not "justiciable." On a third question it was evenly divided on this point.

Whether decision-making authority is ultimately held to vest in the Congress or in the courts, it is to be presumed that it will not be exercised on the basis of sheer whim. It will be useful, therefore, in discussing the various questions enumerated at the beginning of this section, to review whatever precedents may appear relevant and to indicate alternative solutions which have been or might be advanced.

2. The time element

An extremely rigid and no doubt unreasonable interpretation would be that Congress is required to call a convention only if the legislatures of two-thirds of the States petition during the life of that Congress. At the other extreme is the view that the time of making application for a convention is irrelevant. The position most commonly held, however, is that petitions ought to be "reasonably contemporaneous," so that they reflect the state of public opinion at a given time.[18] A comparable issue has arisen in connection with the ratification of amendments. In *Dillon* v. *Gloss* the Supreme Court not only upheld the 7-year time limit provided by Congress for the ratification of the eighteenth amendment, but stated that even in the absence of such express limitation:

> there is a fair implication that it [i. e., ratification] must be sufficiently contemporaneous in that number of States to reflect the will of the people in all sections at relatively the same period.[19]

In *Coleman* v. *Miller* one of the points at issue was whether the proposal by Congress of the Child Labor Amendment had lost its validity through lapse of time. In that case nearly 13 years had elapsed between the proposal and the Kansas ratification, which was in question. The Court refused, however, in the absence of a limitation set by Congress, to take upon itself the responsibility of setting a limit. The Court's view was that:

> * * * the question of a reasonable time in many cases would involve, as in this case it does involve, an appraisal of a great variety of relevant conditions, political, social, and economic, which can hardly be said to be within the appropriate range of evidence receivable in a court of justice and as to which it would be an extravagant extension of judicial authority to assert judicial notice as the basis of deciding a controversy with respect to the validity of an amendment actually ratified. On the other hand, these conditions are appropriate for the consideration of the political departments of the Government. The questions they involve are essentially political and not justiciable. They can be decided by the Congress

[17] *Coleman* v. *Miller*, (307 U. S. 433, 459 (1938)).
[18] Wheeler, op. cit., pp. 792–794; Lester Bernhardt Orfield, The Amending of the Federal Constitution (Ann Arbor, 1942), pp. 41–42; and Edward S. Corwin and Mary Louise Ramsey, The Constitutional Law of Constitutional Amendment, Notre Dame Lawyer, vol. 26, pp. 194–196 (Winter, 1951).
[19] *Dillon* v. *Gloss* (256 U. S. 368, 375 (1921)).

with the full knowledge and appreciation ascribed to the national legislature of the political, social, and economic conditions which have prevailed during the period since the submission of the amendment.[20]

On the basis of this decision it would appear that Congress, while it need not require that petitions be "reasonably contemporaneous," would have ample authority and justification to so require.

3. Subject matter of petitions

Does article V mean that Congress is to call a convention whenever two-thirds of the States apply, regardless of the subject matter of the petitions? Some writers have contended that it does. Wheeler comments as follows:

* * * Even where 32 State legislatures made application for a convention, each requesting a different amendment it might be considered sufficient to call a convention on the ground that they conclusively showed a widespread demand for changes in Government, provided, of course, the resolutions of the State legislatures were sufficiently concurrent in point of time.

The nature of the right conferred upon the State legislatures in requesting Congress to call a constitutional convention is nothing more or less than the right of petition. The statements of the purposes and objects underlying the petition would have no legal effect except as they indicated to any convention assembled the wishes of the people in regard to proposed changes. It would therefore appear that under article V, whenever two-thirds of the State legislatures apply to Congress, it becomes the duty of Congress to call a convention if the petitions were passed within a reasonable time.[21]

Corwin and Ramsey express a contrary view:

* * * To be obligatory upon Congress, the applications of the States should be reasonably contemporaneous with one another, for only then would they be persuasive of a real consensus of opinion throughout the nation for holding a convention, and *by the same token, they ought also to be expressive of similar views respecting the nature of the amendments to be sought.*[22]

This question would seem to be eminently political in nature, as much or more so than the question of relation in time. Congress would appear to have ample justification for requiring general similarity of purpose, should it so desire, but whatever decision it might make would in all probability be sustained.

4. The effect of rescinding action

A number of the State legislatures which petitioned for a convention on the tax-limitation proposal later rescinded their petitions.[23] Do these States count toward the required two-thirds?

In *Coleman* v. *Miller* the Supreme Court dealt at some length with the effect both of previous rejection and of attempted withdrawal of ratifications by State legislatures. The Court found that in practice the political departments of the Government had "determined that both were ineffectual in the presence of an actual ratification."[24] The Court's actual holding in this case, however, was that—

the question of the efficacy of ratifications by State legislatures, in the light of previous rejection or attempted withdrawal, should be regarded as a political question pertaining to the political departments, with the ultimate authority in the Congress in the exercise of its control over the promulgation of the adoption of the amendment."[25]

[20] *Coleman* v. *Miller* (307 U. S. 433, 453–4 (1938)).
[21] Wheeler, *op., cit.* p. 795. In 1929 Wisconsin presented a resolution to Congress, asking that Congress, having received petitions for a convention from 35 different States, proceed with the call for a convention. The petitions referred to covered a variety of subjects and a period of approximately 100 years.
[22] Corwin *and* Ramsey, *op. cit.*, pp. 195–196. [Italics added.]
[23] See appendix A.
[24] *Coleman* v. *Miller* (307 U. S. 433, 449 (1938)).
[25] Ibid., 450.

Corwin and Ramsey find the legislative precedent less certain than the above opinion indicates.[26] Apart from this, it may be questioned whether the attempted withdrawal of a ratification is strictly comparable to the withdrawal of a petition requesting Congress to call a convention. Ratification of a proposed constitutional amendment might be considered a more formal and irrevocable action than the adoption of a petition.

5. Procedure in petitioning

In two instances petitions relating to the proposed tax limitation were vetoed by the Governor of the State. This raises the question, What is meant by the term "legislature" as used in article V?

It has been held by the Supreme Court that the term "legislature" means the representative body which makes the laws, and that the holding of a popular referendum on ratification of an amendment is inconsistent with article V.[27] Approval of the governor has been regarded as unnecessary,[28] although there has been no clear-cut decision to that effect. Many other procedural issues, such as applicability of State constitutional provisions relative to a quorum, and the right of the lieutenant governor to cast a vote in case of a tie, remain unsettled, even as regards ratification. In *Coleman* v. *Miller* the Supreme Court was equally divided as to whether or not the latter question was "political." The effect in this instance was to uphold the decision of the lower court, which had sustained the lieutenant governor's participation in the vote.[29]

ORGANIZATION AND POWERS OF CONVENTION

Neither the wording of article V nor the debates in the Constitutional Convention shed any light on the numerous problems that would arise should Congress decide to call a convention. It seems to be the view that Congress would possess the implied power to regulate all matters concerning the composition of the Convention, should it choose to do so. This would include the determination as to whether the delegates should represent the States, or the Nation at large.[30] It has been suggested that Congress would probably prefer to address the call to the States and leave to them the method of selecting delegates.[31] This, of course, was the method followed in calling the Convention of 1787, in which voting was by States.

Doubt has been expressed that either the petitioning States or the Congress could restrict the powers of a constitutional convention. Orfield's view is as follows:

> * * * Where the States apply for a convention for general purposes, it would seem that the convention would be free to draft a new document. But even though the application were for a limited purpose, it would seem that the State legislatures would have no authority to limit an instrumentality set up under the Federal Constitution. In reality, the right of legislatures is confined to applying for a convention, and any statement of purposes in their petitions would be irrevelant as to the scope of powers of the convention. Inasmuch as Congress issued the call simply on the basis of the application of the State legis-

[26] Corwin and Ramsey, op. cit., pp. 202 ff.
[27] *Hawke* v. *Smith* (253 U. S. 221 (1920)).
[28] Corwin and Ramsey, op. cit., p. 207.
[29] *Coleman* v. *Miller* (307 U. S. 433, 446–447).
[30] Orfield, op. cit., pp. 43–44, and Wheeler, op. cit., p. 798.
[31] Wheeler, op. cit., pp. 798–799.

latures, there would seem to be no warrant for an attempt by Congress to limit the changes proposed. The primary and in fact the sole business of the convention would be to propose changes in the Constitution. In this sphere the only limitation on it would seem to be article V.[32]

[32] Orfield, op. cit., pp. 44–55. Wheeler is of the same opinion: op. cit., p. 795 ff., especially pp. 96.
See, however, this report, ch. II, for a provision in the proposed amendment controlling the distribution of tax moneys which attempts to limit the power of the convention to the purpose specified. In justification of this limitation, the proposed amendment uses the following language:
"That since this method of proposing amendments to the Constitution has never been completed to the point of calling a convention and no interpretation of the power of the States in the exercise of this right has ever been made by any court or any qualified tribunal, if there be such, and since the exercise of the power is a matter of basic sovereign rights and the interpretation thereof is primarily in the sovereign government making such exercise and since the power to use such right in full also carries the power to use such right in part the legislature of the State of Nebraska interprets article V to mean that if two-thirds of the States make application for a convention to propose an identical amendment to the Constitution for ratification with a limitation that such amendment be the only matter before it, that such convention would have power only to propose the specified amendment and would be limited to such proposal and would not have power to vary the text thereof nor would it have power to propose other amendments on the same or different propositions" (Congressional Record, June 20, 1949, vol. 95, pp. 7893–7894).

APPENDIXES

APPENDIX A

ITEM 1.—*State legislative action on the proposed 25-percent limitation amendment*

Year of adoption	States	Status of resolution		
		Rescinded	Vetoed by Governor	In effect
1939	Wyoming			Wyoming.
1940	Mississippi			Mississippi.
	Rhode Island	Rhode Island (1949).		
1941	Iowa	Iowa (1945)		
	Maine			Maine.
	Massachusetts			Massachusetts.
	Michigan			Michigan.
1943	Alabama	Alabama (1945)		
	Arkansas	Arkansas (1945)		
	Delaware			Delaware.
	Illinois	Illinois (1945)		
	Indiana			Indiana.
	New Hampshire			New Hampshire.
	Pennsylvania		Pennsylvania (1943).	
	Wisconsin	Wisconsin (1945)		
1944	Kentucky	Kentucky (1946)		
	New Jersey			New Jersey.
1950	Louisiana			Louisiana.
1951	Florida			Florida.
	Kansas			Kansas.
	Montana		Montana (1951)	
	Nevada			Nevada.
	Utah			Utah.
1952	Georgia			Georgia.
Total	24	7	2	15.

Source: Legislative Reference Service, Library of Congress, Feb. 21, 1952.

ITEM 2.—*Status of State actions to place a 25 percent maximum rate on incomes, estates, and gifts* [1]

States	Endorsing	Rescinding	Congressional Record	
			Endorsing	Rescinding
Alabama	July 8, 1943 (H. J. Res. 66).	June 13, 1945 (H. J. Res. 10).	Vol. 89, pp. 7523-7524.	None.
Arkansas	April 1943 (H. J. Res. 10).	Jan. 18, 1945 (H. Con. Res. 4).	Daily, Feb. 4, 1952, p. 752.	Vol. 91, p. 11209.
Delaware	Apr. 22, 1943 (S. Con. Res. 6).		Vol. 89, p. 4017	
Florida	May 5, 1951 (S. Con. Res. 206).		Daily, May 10, 1951, p. 5273.	
Georgia	Feb. 6, 1952		Daily, Feb. 18, 1952, p. 1076.	
Illinois	May 26, 1943 (H. J. Res. 32).	1945 (H. J. Res. 7).	Daily, Feb. 4, 1952, p. 752.	Daily, Feb. 4, 1952, p. 752.
Indiana	Mar. 2, 1943 (H. Con. Res. 10).		Daily, Feb. 18, 1952, p. 1075.	
Iowa	Feb. 14, 1941 (H. Con. Res. 15).	Mar. 14, 1945 (H. Con. Res. 9).	Vol. 87, p. 3172	None.
Kansas	Mar. 21, 1951 (S. Con. Res. 4).		Daily, Mar. 28, 1951, p. 3026.	
Kentucky	Mar. 20, 1944 (H. R. 79).	Apr. 12, 1946 (S. Res. 43).	Vol. 90, p. 4040	Daily, Sept. 6, 1951, p. 11195.
Louisiana	June 12, 1950 (H. Con. Res. 24).		None	
Maine	Apr. 17, 1941		Vol. 87, pp. 3370-3371.	
Massachusetts	Apr. 29, 1941 (S. 658).		Vol. 87, pp. 3812-3813.	
Michigan	May 16, 1941 (S. Con. Res. 20).		Vol. 87, p. 8904	
Mississippi	Apr. 29, 1940 (S. Con. Res. 14).		Vol. 86, p. 6025	
Montana	Feb. 1951 (H. J. Res. 4).		Daily, Mar. 16, 1951 p. 2613 vetoed). [2]	
Nevada	Mar. 1951 (S. J. Res. 5).		None	
New Hampshire	Apr. 24, 1943		Vol. 89, p. 3761	
New Jersey	Feb. 25, 1944 (S. J. Res. 3).		Vol. 90, p. 6141	
Pennsylvania	June 7, 1943 (H. R. 50).		Vol. 89, p. 8220 (vetoed).	
Rhode Island	Mar. 15, 1940 (S. 80).	May 3, 1949 (H. 548).	Vol. 86, p. 3407	None.
Utah	1951 (H. J. Res. 3).		Daily, Feb. 11, 1952, p. 962.	
Wisconsin	Apr. 1943 (J. Res. 75).	Jan. 1945 (J. Res. 114).	Vol. 89, p. 7525	None.
Wyoming	Feb. 23, 1939 (H. J. Memorial 6).		Vol. 84, p. 2509	

[1] As of Feb. 21, 1952.

APPENDIX B

FORMS OF RESOLUTIONS ACTED ON BY VARIOUS STATES

Petition adopted by *Arkansas*, 1943; Delaware, 1943; Indiana, 1943; *Iowa*, 1941; Mississippi, 1940; New Hampshire, 1943; Pennsylvania, 1943; [1] and Wyoming, 1939. [States italicized have rescinded their petitions.]

SECTION 1. The sixteenth amendment to the Constitution of the United States is hereby repealed.

SECTION 2. The Congress shall have power to lay and collect taxes on income, from whatever source derived, without apportionment among the several States and without regard to any census or enumeration; provided that in no case shall the maximum rate of tax exceed 25 percent.

SECTION 3. The maximum rate of any tax, duty, or excise which Congress may lay and collect with respect to the devolution or transfer of property, or any

[1] Vetoed by the governor.

interest therein; upon or in contemplation of death, or by way of gift, shall in no case exceed 25 percent.

SECTION 4. Sections 1 and 2 shall take effect at midnight on the 31st day of December, following the ratification of this article. Nothing contained in this article shall affect the power of the United States to collect any tax on any devolution or transfer occurring prior to the taking effect of section 3, laid in accordance with the terms of any law then in effect.

Petition Adopted by *Alabama*, 1943; Florida, 1951; Georgia, 1952; *Illinois*, 1943; Kansas, 1951, Kentucky, 1944; Louisiana, 1950; Maine, 1941; Massachusetts, 1941; Michigan, 1941; *Rhode Island*, 1940; Utah, 1951; and, Wisconsin, 1943. [States italicized have rescinded their petitions.]

SECTION 1. The sixteenth article of amendment to the Constitution of the United States is hereby repealed.

SECTION 2. The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration: *Provided*, that in no case shall the maximum rate of tax exceed 25 percent.

SECTION 3. The maximum rate of any tax, duty, or excise which Congress may lay and collect with respect to the devolution or transfer of property, or any interest therein, upon or in contemplation of or intended to take effect in possession or enjoyment at or after death, or by way of gift, shall in no case exceed 25 percent.

SECTION 4. The limitations upon the rates of said taxes contained in sections 2 and 3 shall, however, be subject to the qualification that in the event of a war in which the United States is engaged creating a grave national emergency requiring such action to avoid national disaster, the Congress by a vote of three-fourths of each House may for a period not exceeding 1 year increase beyond the limits above prescribed the maximum rate of any such tax upon income subsequently accruing or received or with respect to subsequent devolutions or transfers of property, with like power, while the United States is actively engaged in such way, to repeat such action as often as such emergency may require.

SECTION 5. Sections 1 and 2 shall take effect at midnight on the 31st day of December following the ratification of this article. Nothing contained in this article shall affect the power of the United States after said date to collect any tax on incomes for any period ending on or prior to said 31st day of December laid in accordance with the terms of any law then in effect.

SECTION 6. Section 3 shall take effect at midnight on the last day of the sixth month following the ratification of this article. Nothing contained in this article shall affect the power of the United States to collect any tax on any devolution or transfer occurring prior to the taking effect of section 3, laid in accordance with the terms of any law then in effect.

Petition adopted by Montana,[1] 1951; Nevada,[2] 1951; and New Jersey, 1944.

SECTION 1. The sixteenth article of amendment to the Constitution of the United States is hereby repealed.

SECTION 2. The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration. The maximum aggregate rate of all taxes, duties, and excises which the Congress may lay or collect on, with respect to, or measured by, income, however, shall not exceed 25 percent. In the event that the United States shall be engaged in a war which creates a national emergency so grave as to necessitate such action to avoid national disaster, the Congress by a vote of three-fourths of each House, may while the United States is so engaged, suspend, for periods not exceeding one year each, such limitation with respect to income subsequently accruing or received.

SECTION 3. The maximum aggregate rate of all taxes, duties, and excises which the Congress may lay or collect with respect to the devolution or transfer of property, or any interest therein, upon or in contemplation of or intended to take effect in possession or enjoyment at or after death, or by way of gift, shall not exceed 25 percent.

[1] Vetoed by the Governor.

[2] Nevada's petition asks that the Congress submit the amendment to the States for ratification. Also, the petition contains only the first three sections.

SECTION 4. Sections 1 and 2 shall take effect at midnight on the 31st day of December following the ratification of the article. Nothing contained in the article shall affect the power of the United States after said date to collect any tax on, with respect to, or measured by, income for any period ending on or prior to said 31st day of December laid in accordance with the terms of any law then in effect.

SECTION 5. Section 3 shall take effect at midnight on the last day of the sixth month following the ratification of this article. Nothing contained in this article shall affect the power of the United States after said date to collect any tax with respect to any devolution or transfer occurring prior to the taking effect of section 3, laid in accordance with the terms of any law then in effect.

APPENDIX C

FORMS OF RESOLUTIONS USED IN RESCINDING PREVIOUS ACTION

KENTUCKY

(S. R. 43)

A JOINT RESOLUTION repudiating, retracting, and withdrawing House Resolution No. 79 of the Regular Session of the 1944 General Assembly

Whereas, by House Resolution No. 79 of the Regular Session of the 1944 General Assembly, application was made to the Congress of the United States to call a convention for the purpose of proposing an amendment to the Constitution of the United States relating to taxes on income, inheritance, and gifts; and

Whereas, such resolution was adopted by the General Assembly under a misapprehension as to its true meaning, intent, and purpose, and without a full consideration of the results that might obtain from such action, and

Whereas, the amendment proposed in such resolution establishes a policy with regard to taxation that is contrary to the established public policy of Kentucky, and will impose the burden of taxation upon those least able to bear it: Now, therefore, be it

Resolved by the General Assembly of the Commonwealth of Kentucky, That House Resolution No. 79 of the Regular Session of the 1944 General Assembly of Kentucky is hereby repudiated and retracted, and the General Assembly hereby withdraws the same.

The Secretary of State is directed to send a duly certified copy of this resolution to the Senate of the United States and to the House of Representatives in Congress of the United States.

Passed and enrolled March 21, 1946.

ILLINOIS

OPPOSITION OF MAXIMUM INCOME TAX RATE

(H. J. Res. No. 7)

Whereas the Sixty-third General Assembly adopted House Joint Resolution No. 32 thereby making application to the Congress of the United States to call a convention for the purpose of proposing a suggested amendment to the Federal constitution, the effect of which would be to fix the maximum income tax rate at 25 percent; and

Whereas the Sixty-fourth General Assembly considers the proposal made by such resolution inadvisable and is opposed thereto: Therefore be it

Resolved by the House of Representatives of the Sixty-fourth General Assembly of the State of Illinois, the Senate concurring herein, That it express its opposition to the application and intent of the resolution set forth in the preamble hereof; and, be it further

Resolved, That the Secretary of State be directed to forward a copy of this resolution to the Senate and House of Representatives of the Congress of the United States.

Adopted by the House, March 13, 1945.

Concurred in by the Senate, March 28, 1945.

APPENDIX D

LIMITATION RESOLUTION AS INTRODUCED IN CONGRESS

82D CONGRESS
1ST SESSION

H. J. RES. 323

IN THE HOUSE OF REPRESENTATIVES

SEPTEMBER 13, 1951

Mr. REED of Illinois introduced the following joint resolution; which was referred to the Committee on the Judiciary

JOINT RESOLUTION Proposing an amendment to the Constitution of the United States relative to taxes, on incomes, inheritances, and gifts

Resolved by the Senate and House of Representatives of the United States of America in Congress assembled (two-thirds of each House concurring therein), That the following article is hereby proposed as an amendment to the Constitution of the United States, which shall be valid to all intents and purposes as part of the Constitution when ratified by the legislators of three-fourths of the several States.

"ARTICLE—

"SECTION 1. The sixteenth article of amendment to the Constitution of the United States is hereby repealed.

"SEC. 2. The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration. The maximum top rate (including the aggregate of all top rates) of all taxes, duties, and excises which the Congress may lay or collect on, with respect to, or measured by, income shall not exceed 25 per centum: *Provided, however*, That Congress by a vote of three-fourths of all the Members of each House may fix a rate in excess of 25 per centum, but not in excess of 40 per centum, for periods, either successive or otherwise, not exceeding one year each. In the event that the United States shall be engaged in a war which creates a national emergency so grave as to necessitate such action to avoid national disaster, the Congress by a vote of three-fourths of all the Members of each House may, while the United States is so engaged, suspend, for periods, either successive or otherwise, not exceeding one year each, such limitation with respect to income subsequently accruing or received.

"SEC. 3. The Congress shall have no power to lay or collect any tax, duty, or excise with respect to the devolution or transfer of property, or any interest therein, upon or in contemplation of or intended to take effect in possession or enjoyment at or after death, or by way of gift.

"SEC. 4. Sections 1 and 2 shall take effect at midnight on the 31st day of December following the ratification of this article. Nothing contained in this article shall affect the power of the United States after said date to collect any tax on, with respect to, or measured by, income for any period ending on or prior to said 31st day of December laid in accordance with the terms of any law then in effect.

"SEC. 5. Section 3 shall take effect at midnight of the day of ratification of this article. Nothing contained in this article shall affect the power of the United States after said date to collect any tax with respect to any devolution or transfer occurring prior to the taking effect of section 3, laid in accordance with the terms of any law then in effect."

APPENDIX E

EXCERPT FROM TESTIMONY, PANEL HEARINGS, JOINT COMMITTEE ON THE ECONOMIC REPORT: JANUARY 31, 1952 [1]

Representative PATMAN. I understand, Mr. Chairman, that the Colin Clark proposition, which has been mentioned by Mr. Heller, is not the same thing as the proposal that has been adopted by many State legislatures, commencing prior

[1] Hearings, January 1952, Economic Report of the President, Joint Committee on the Economic Report, pp. 344-347. Participants at the panel were the following: Arthur Smithies, Harvard; H. van Buren Cleveland, Committee for Economic Development; Walter W. Heller, University of Minnesota; Carl S. Shoup, Graduate School of Business, Columbia University, John P. Miller, Yale; Richard Musgrave, University of Michigan; Alfred G. Buehler, University of Pennsylvania; and Milton Friedman, University of Chicago.

to 1940, calling for a limitation of personal and corporate income taxes to not more than 25 percent in any one year. The Clark contention is that in the aggregate not more than 25 percent of the national income may safely be taken in taxes; is that right?

Mr. HELLER. That is correct, sir.

Representative PATMAN. I want to ask about this proposal that has been sponsored by different organizations, one in particular, before various legislatures. Now that proposal, of course, appeals to a lot of people. I have personal knowledge of a meeting in a certain city in the Southwest. They got people at this meeting who were in the high income brackets, and asked them to take a card and determine for themselves how much money they would save if there were a constitutional limitation against the collection of more than 25 percent in taxes.

Naturally, they found that they would save a lot of money if such a limitation were in effect. The person holding the meeting didn't have any trouble getting a lot of money for his fund to campaign for this limitation before the legislatures. You can see why. That is a selfish reason. We expect people to be selfish up to a point but it shouldn't interfere with the public interest.

There are other reasons, I think, why they are pushing that, but that is not so important as what effect it would have on the country. Personally, I am in favor of a balanced budget. I have always advocated that.

I would be in favor of joining with the majority of the Members of the House in staying in session and we will not adjourn this Congress until the budget is balanced. But we cannot always get done what we want done, because legislation in a democracy is a matter of give and take; compromise and adjustment.

But it occurs to me that it would be a very bad thing fof the sovereign power to have a restriction like that of 25 percent. All the States, counties and cities, the political subdivisions, are restricted by State constitutions. In the event of serious trouble, the only government that heretofore has been able to bail us out and do what is necessary would, if the limitation were adopted, be restricted in its operations. For that reason I think it would be very bad. What do you think about that, Mr. Heller?

Mr. HELLER. As you spoke, I did not find myself disagreeing with anything you said. In fact, I would go beyond it. If we actually were to cut back to 25 percent today on our existing corporate and individual income and estate taxes, we would lose—according to a rough calculation I made a year ago—around $15 billion of revenue. It would certainly be more today. Needless to say, this has to be made up somewhere.

If we follow the tax path, it leads pretty straight to a broad-based consumption tax of some kind, presumably a sales tax. This may very well be exactly what some of the backers of the 25-percent limitation amendment would have in mind. From that standpoint it runs counter to our whole tradition of progressivity in taxation and to the whole democratic structure of income distribution. Moreover, in peacetime such heavy reliance on consumption taxes would make serious inroads on the mass-consumer markets which provide the ultimate base for a full-employment economy.

Representative PATMAN. It is true that these amendments vary somewhat in form. I have read every one of them. In most of them there is a provision that in the event of war a three-fourths majority of Congress may suspend the limitation.

The CHAIRMAN. That is, that the Congress could.

Representative PATMAN. That is setting a bad example. That is endorsing minority control. In a democracy I think the majority should rule. Why should we set up any standards whereby a minority would have absolute control of the House or Senate?

For instance, we are now at war with Korea. That war, I think, was accepted by unanimous consent. I don't think a single Member of the House or Senate said a word of opposition to it until later on; when it became a little unpopular in some quarters, some began to criticize.

But now I don't know but what we would have trouble making the appropriations to carry on operations if it required three-fourths of the Members of the House and Senate.

I think that it is equally as bad in a democracy to have minority control as to have the limitation.

Mr. HELLER. As I recall, it is three-fourths of both Houses of Congress.

Representative PATMAN. That is right.

Mr. HELLER. It is not only of those present but of all Members.

Representative PATMAN. That makes it doubly bad, because it is so seldom we have all Members present in either House. Under that proposal, it has to be a constitutional three-fourths of the Members elected to that body, which wouldn't require many to obstruct absolutely.

The CHAIRMAN. And also unless the amendment established a new cloture rule for the Senate, you would never get it through.

Mr. HELLER. Mr. Patman, may I make one comment about the illusions under which I think some States are operating that have supported this amendment. I understand, by the way, the actual number whose memorials to Congress are firm and solid is only about 15 instead of the 26 claimed by the groups pushing for this amendment.

Representative PATMAN. But even those 15—I wonder if they realize this would be driving the Federal Government into the very areas of taxation that they now occupy. It really would not open up the income tax to them because they can't impose high rates of income taxation.

As I understand, some additional ones may rescind. At one time there were more States approving. I took it upon myself, just as a poor humble Member of the House, to make a few speeches and send those speeches to the 7,500 members of the legislatures of the 48 States, and some of these States that had passed this amendment actually passed an amendment stating they were opposed to it; in other words, to cancel it or wipe it off the books. They didn't want to be certified as being in favor of that type of amendment. I think it was seven States that did that.

Investigation will disclose that not a single one of those amendments has passed the legislature of a State after full, free, and fair discussion. Every one of them has passed right at the end of a session, when the opportunity for public consideration was limited.

In one legislature they were ready to pass it; maybe they were foolish in inviting me, but I went over to that legislature and answered questions. One plea I made was, like you did just now, about the taxing power. That legislature, although they were ready to pass it, decided not to pass it. If a Member as ineffective as I am can persuade them against it, I know that when the legislatures and people get the truth and logic and reason against it, very few States will pass or insist upon it. But unanswered, it has an awful appeal. It wouldn't surprise me, if the Congress submitted that amendment to the States, they would probably adopt it right off without sufficient consideration and debate on the theory that the big bureaucracy in Washington ought to be stopped, and if we stop them from taxing, we can tax in our State. It has a tremendous appeal, but when you analyze it like you have, I think the good arguments are all against it, but it is an issue that has to be met in a forthright manner right away, right now.

This committee, realizing that, has been making a study, which I hope will be available very soon, and that we can begin to circulate this information and place it where it is needed.

The CHAIRMAN. Now let me say for the record that that pamphlet is wholly objective in its purpose. It does not attempt to take sides on this issue, but does attempt to gather together in one compendium, so to speak, all of the facts which seem to have been developed so far.

Representative PATMAN. Since Senator Flanders is interested in this as well as other Members, I would like to ask if any of the other members of the panel would like to express an opinion on this proposal.

Mr. BUEHLER. Could I say a word?

The CHAIRMAN. Mr. Buehler.

Mr. BUEHLER. Pennsylvania is one of the States that passed the resolution, and Senator Martin, who was then Governor, vetoed the resolution.

Representative PATMAN. That is right.

Mr. BUEHLER. I think our Attorney General has given out the opinion unofficially that the veto would have no legal effect.

Representative PATMAN. That would be up to Congress to decide.

Mr. BUEHLER. I presume so. I thought that was a curious twist. But I think that underneath the agitation for a constitutional tax limit is not only a resistance to the higher taxes on incomes, but also a resistance to the growing Federal budget. I have had the proposed amendment explained to me as a way by which Congress would be forced into reducing the budget, keeping expenditures down. You would have available only the revenues that could be raised under

the 25 percent limitation, and therefore you would have to cut the budget. Actually, the total taxes which would be available might support a much larger budget than we now have.

The CHAIRMAN. May I interrupt to say I think from what I have seen that there is a very widespread misapprehension among at least some of those who are supporting this movement, that when the requisite number of States have passed a resolution, it will be mandatory that Congress submit such an amendment for ratification; whereas, that isn't the fact at all.

Congress would be required only to call a Constitutional Convention, and that Convention could at the same time consider and perhaps report and recommend the amendment which was suggested here this morning, that the Federal Government be given the power to tax real property within the boundaries of the several States.

Representative PATMAN. That is under article V of the Constitution, and you are exactly right about it.

Senator FLANDERS. Mr. Chairman.

The CHAIRMAN. Senator Flanders.

Senator FLANDERS. I think this thing might be resolved by a show of hands on the part of the economists. All those in favor of this constitutional amendment, you might ask them to raise their right hands, and those opposed afterwards. I can guess very clearly just how the vote would come out.

Representative PATMAN. Suppose you do that.

The CHAIRMAN. At the suggestion of the distinguished and able Senator from Vermont, the chairman invites those who are in favor of the constitutional amendment to limit to 25 percent for every individual the tax burden which may be levied in a single year upon an individual to raise their hands.

There are no hands showing.

Those who are opposed please raise their hands.

The voting is unanimously against.

APPENDIX F

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