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# The New REPUBLIC

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## Italy Lights the Fuse

*Will the Ethiopian Dispute  
Lead to a European Explosion?*

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## The Rich Get Richer

by ROBERT H. JACKSON

## Parenthood in Decline

by ENID CHARLES

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# The Rich Get Richer

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*The inequalities in the distribution of wealth and the burden of taxation in the United States are often described in general terms, but rarely does the public obtain a well documented analysis of the conditions actually existing. We present below such an analysis, prepared by Robert H. Jackson, Counsel to the Internal Revenue Bureau, and given by him in a hearing of the Senate Finance Committee. A few passages of subsidiary importance have been omitted.—THE EDITORS.*

**A**S THE figures of tax collections have become available, it has become apparent that the present administration inherited in 1933 a tax structure that, in terms of making that burden proportionate to ability to pay, had become out of balance even by the standards adopted during the preceding administration. . . . Miscellaneous internal revenue taxes and our entire structure of customs taxes, and now processing taxes, have an incidence that has little relation to ability to contribute to the cost of government. It is a commonplace that such taxes are proportioned to consumption, hit poorer classes hardest, and rest with greater weight upon large families with small incomes than they do upon small families with large incomes.

It may be assumed that collections in the year 1930, governed largely by the Revenue Act of 1928, represented a ratio of burden between these two types of taxes, fairly deliberately arrived at, without intent to penalize the more affluent unduly.

In that year we find that those taxes bearing most heavily on the well-to-do contributed \$2,475,000,000 to the national treasury, or 68.2 percent of its total internal revenue and customs receipts, while miscellaneous taxes and customs receipts, bearing most heavily upon the consumer, contributed only \$1,152,000,000, or 31.8 percent.

By 1933, however, this ratio had so changed that only \$781,000,000 was raised from the taxes based on ability to pay, and that sum constituted only 43.7 percent of the federal internal revenue and customs receipts, while taxes based on consumption produced \$1,090,000,000, or 58.3 percent of such federal receipts.

Since 1933 the trend has been in the same direction, but the percentage change is relatively small. In 1935 the taxes based on ability to pay contributed 38.7 percent of the internal revenue and customs receipts, or a decline since 1933 of only about 3 percent; and during the same period there has been an increase in the proportion of revenues contributed by taxes based on consumption from 58.3 to 61.3 percent, an increase of only about 3 percent. . . .

While the shift in the tax burden from those more able to those less able to pay has been small from 1933 to 1935, this shift, however small, is unsound. The trend should be reversed.

In weighing this shifting burden of taxation, allowance must also be made for declining incomes that make the relative weight of these consumer taxes greater than mere

yield would signify. These taxes are paid largely out of consumers' purchasing power, and are borne to a great extent by those whose incomes are barely adequate for maintenance and who lack other resources to fall back upon. . . .

The cost of the emergency measures to combat the depression has of necessity been met largely by borrowing. As we emerge from the depression, it is time to make such adjustments in the tax structure as will meet the postponed costs of protecting the social order with a tax structure in which the balance between taxes levied on the basis of ability to pay, and taxes based on consumption, is more equitable.

Added revenue to go toward balancing the budget and toward meeting the cost of overcoming a depression that threatened rights of property should be contributed by the propertied classes in proportion to their ability to pay.

## THE RISE OF MILLIONAIRES

It is well known that the per-capita income of the United States, particularly in the years 1928 and 1929, ranked among the highest in the world, and resulted in a high standard of living.

When the total income of the United States is averaged, the figures are impressive, but when it is viewed, not as it might be if it were equalized by averaging, but as it actually is distributed, the result must arouse concern.

Even informed observers were startled at the tendency to concentration, and the rate of concentration indicated by the 1935 returns. The number of persons filing income tax returns decreased from 1932 by 3.8 percent. Not all who file returns pay taxes, because of exemption, so that only 1,747,740 persons out of our entire population reported taxable incomes and the total amount of income reported fell by 5.5 percent.

Yet in the face of generally declining incomes, and in spite of the bank holiday and other events of that year, the number who reported net taxable incomes of \$1,000,000 or over more than doubled, having increased from twenty in 1932 to fifty such persons in 1933.

By general consent, our income tax laws, under all administrations, have provided exemptions, in amounts considered necessary to reasonable subsistence, so as to avoid depressing the standard of living within the lower income groups. The significant result is that when the groups that are considered to need all of their income for necessities are omitted, we have only a relatively small number left.

Applying the standard thus set by Congress as necessary to a reasonable way of life, we find the largest number who ever rose above that standard, as evidenced by the number of returns indicating taxable incomes, to be 5,518,310. This was in 1920 when exemptions allowed were at their lowest. In 1933 the returns filed that showed taxable incomes numbered 1,747,740.

The conclusion indicated by Treasury statistics is that

the base for our income tax is now seriously narrow and results in part from the fact that the number of people having incomes above a generally accepted subsistence level is seriously small.

Treasury statistics, on individual incomes, point to the same conclusions as a recent study of incomes by family groups. This basis is also important because the family is the usual unit of spending.

#### DISTRIBUTION OF NATIONAL INCOME

Recently the Brookings Institution, in connection with its study, "America's Capacity to Consume," presented figures on the distribution of our national income in the year 1929 by family units. The following estimates were disclosed:

Nearly 6,000,000 families, or more than 21 percent of the total, had incomes of less than \$1,000 annually, or less than \$25 a week.

About 12,000,000 families, or more than 42 percent, had incomes of less than \$1,500.

Nearly 20,000,000 families, or 71 percent, had incomes of less than \$2,500.

Only a little over 2,000,000 families, or 8 percent, had incomes in excess of \$5,000.

About 600,000 families, or 2.3 percent, had incomes in excess of \$10,000.

In the year 1929, 36,000 high-income families received as much of our national income as 11,000,000 families with the lowest incomes.

We have just studied the incomes of fifty-eight taxpayers who, in 1932, reported total taxable and non-taxable incomes exceeding \$1,000,000. Of the fifty-eight such taxpayers, thirty-eight, or over 70 percent, are accounted for by membership in fourteen families. This indicates that statistics may fail to reveal the true extent of concentration of opportunity and control, and hence of the benefit of organized government and of both ability and duty to pay.

Large incomes are derived in the main from invested capital, not from wages or salaries. The concentration of income among a small number of individuals results from, and at the same time furthers, wealth concentration. Unfortunately, information relating to the distribution of wealth is less definite than that relating to distribution of income, but the estate-tax returns filed in 1932, while not fully indicative, do give us some idea of the measure of wealth concentration. They are shown in the following table:

Net Estate Classes <sup>1</sup>	Number of Returns	Value of Gross Estate <sup>2</sup>		
		Percent	Estate <sup>2</sup>	Percent
Non-taxable	2,009	28.3	184	7.7
Under 100	2,762	28.8	442	18.4
100-400	1,600	22.5	564	23.5
400-1,000	500	7.0	429	17.8
1,000-5,000	215	3.0	507	21.0
5,000-10,000	21	.3	168	7.0
10,000 and over	6	.1	110	4.6
Total	7,113	100.0	2,404	100.0

<sup>1</sup> In thousands of dollars, after allowable deductions and a specific exemption of \$100,000 for each estate.

<sup>2</sup> Gross estate value as reported, in thousands of dollars, less indebtedness against the estates.

This table shows that nearly one-third of all the property reported as passing by death was concentrated in less than 4 percent of the estates, none of which were valued at less than one million net, and if we drop down a little and begin with net estates of \$400,000 we find that one-half of the property included in estate returns in the United States in 1932 was included in 10 percent of the estates. Rough as this measure is admitted to be, it none the less presents stubborn evidence that wealth is concentrated in a few hands.

It is often asserted that large wealth is dissipated in three generations and it has become a proverb that it is "three generations from shirt sleeves to shirt sleeves." It was doubtless once true that all a grandfather saved from the fruits of his labor could be spent by a grandson.

It is probably true today of very moderate fortunes. It is not true of large invested fortunes under present conditions. They not only perpetuate themselves, they grow.

This is because they are now so large. A riotous-living heir to one of our larger fortunes would exhaust himself before he could exhaust the income alone of the estate. Furthermore, such estates are largely perpetuated in trusts, and every legal and economic obstacle to their dissipation is employed.

They are invested in the enterprises of the country where the income and management are not dependent upon the judgment or industry of the heir, or are invested in tax-free government securities.

Most of the large estates as at present managed, we find, not only perpetuate themselves but are larger as they pass from generation to generation. With large incomes from inherited property remaining intact or actually increasing there results a diversion of a large proportion of the community's productive resources to the satisfaction of the wants of a few individuals, and a fastening of control in few hands.

As pointed out earlier, under the prevailing distribution of income, even in the most prosperous times a large proportion of the population lives at or even below the level recognized by Congress as necessary for adequate subsistence.

In a period of depression this same proportion of the population is pressed farther down the scale of living, while those in higher income groups, even though they suffer some reduction of income, are in a position to use their vast resources to maintain their accustomed very high standards of living.

In devising taxes on the basis of ability to pay those groups should have their tax burden readjusted to help meet the costs of protecting the social order in proportion to the advantages they enjoy.

#### GRADUATION SHOULD BE EXTENDED

The President in suggesting an extension of the principle of graduation to large incomes, used as an illustration of the defects of the present schedules the failure to apply the principle to incomes over \$1,000,000. The inconsistency of failing to apply the principle of graduation at all above the \$1,000,000 income is an illustrative, but not the only, inconsistency in the present schedule.

Before the \$1,000,000 income is reached our rates on

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very large incomes rise very slowly. Thus, while the top-bracket rate for a man with a \$5,000 income is double the rate for one with a \$4,000 income, and the top-bracket rates rise from 4 percent to 54 percent between taxable incomes of \$4,000 and \$100,000, the top-bracket rates thereafter increase very slowly.

From just over \$100,000 to anything in excess of \$1,000,000 of annual income, the top-bracket rate increases only from 56 to 63 percent; and thereafter it does not increase at all, being the same for an annual income of \$1,000,001, \$2,000,000 or \$5,000,000.

The progression of the effective rate on selected net incomes from \$3,000 to \$2,000,000 is shown in the following table<sup>1</sup>:

Net Income	Rate Percent	Difference Between Classes
\$ 3,000 .....	.3	....
5,000 .....	1.1	.8
10,000 .....	3.4	2.3
20,000 .....	6.9	3.5
50,000 .....	16.1	9.2
100,000 .....	28.7	12.6
500,000 .....	50.0	21.3
1,000,000 .....	54.6	4.6
2,000,000 .....	57.4	3.2

It must be emphasized, moreover, that our bracket rates are not the rates that are effective for the whole of an income. Each bracket rate applies only to a stated segment of the income; hence, a large part of all incomes are taxed at substantially lower rates than the rate applicable only to the last portion. On a \$50,000 income, for example, the highest bracket rate, plus the normal rate, is 31 percent, but the actual effective rate is only 16.1 percent.

It is obvious that needed additional revenue might be obtained by a more consistent application of the principle of graduating the tax rate according to ability to pay.

The numbers of taxpayers in high income brackets advantaged by the sudden slowing up of the rate of progression, for the last five years for which figures are available, have been as follows:

Year	Over \$50,000 Net Income	Over \$100,000 Net Income	Over \$500,000 Net Income	Over \$1,000,000 Net Income
1929 .....	38,889	14,816	1,459	513
1930 .....	19,847	6,202	408	150
1931 .....	11,014	3,184	226	77
1932 .....	7,738	1,816	106	20
1933 .....	8,072	2,047	100	50

#### TAX DODGERS IN THE UPPER BRACKETS

An illustrative, but by no means all-inclusive, list of means by which in actual experience the large tax rates are made less effective, is set forth in the several following paragraphs:

Investment in tax-exempt securities is an important tax shelter. The small taxpayer finds their yield small, and the supplemental yield to him through tax savings insignificant. The large taxpayer finds the nominal yield supplemented by a very valuable tax exemption, and the

<sup>1</sup> Based on 1934 rates, applied to incomes reported in "Statistics of Income" for 1933. Account has been taken of dividends, partially exempt interest and earned income credit, all of which are exempt from the normal tax. A deduction of \$2,500 (i.e., the personal exemption for a married person with no dependents) was made from each net income shown above.

result is a considerable concentration of holdings of tax-exempt securities among those having the larger incomes.

When Congress, therefore, writes rates such as apply to the wage-earners, salaried men, the small business men, or the professional men, it may be reasonably sure that most of them will pay the full legal rate upon their entire net income.

When considering the rates in the higher brackets, however, it must be remembered that they will apply to but a part of the taxpayer's actual income, for the taxpayers in the higher brackets, according to our studies, commonly have large tax-free incomes often equal to, or in excess of, taxable incomes. By reason of this fact, rates apparently severe are in fact moderated, and to some extent made ineffective.

#### SOURCES OF NON-TAXABLE INCOME

We have analyzed the 1932 returns of the fifty-eight taxpayers whose gross incomes for that year exceeded \$1,000,000. Twenty of them had net taxable incomes exceeding \$1,000,000. The information is incomplete. While the regulations require that tax-exempts shall be reported, although not taxed, a substantial number of taxpayers, including some of the largest, failed to return any information. The figures that we use, therefore, understate the extent of avoidance through tax-exempt securities.

The fifty-eight taxpayers reported the ownership of \$461,000,000 tax-exempt securities and a tax-free income therefrom in that year of \$21,000,487, as against a taxable income of the group amounting to \$57,015,000. The exemption of this group in 1932 cost the government \$11,866,000 in taxes.

This study indicates that our tax laws wholly fail to reach about 37 percent of the income actually enjoyed from all sources by those whose incomes are over a million dollars a year. . . .

Of the refuges from high taxes, the tax-free income is the most effective and least to be criticized so long as our laws allow it. But the effect that tax-exempt securities have by way of nullifying tax rates may well be considered in fixing rates upon that part of income which is taxable.

Big taxpayers also reduce their taxes by obtaining allowances, as business losses, of the expense of show farms, ranches, racing stables and hobbies, which are in fact amusements and recreations. This is done by asserting that the hobby is a business, entered into solely for profit, and the courts have generally sustained such claims when well sworn to. . . .

Taxpayers B, C and D are three such distinguished farmers, each of whom has regularly lost from \$150,000 to \$200,000 a year on his farm. In the last five years B has reduced his taxes \$221,000, C \$210,000 and D \$206,000 because of farm losses. Such "farm relief" is not available to smaller payers who cannot deduct for their hobbies or amusements. . . .

Our income tax law has been so devised and administered as to permit the forms of corporate reorganization to be used for the stepping up of wealth without the payment of a tax. The privilege of corporate reorganization

without the recognition of a gain or loss has been abused; and taxpayers, whose affairs are sufficiently large and so ordered that they can use it advantageously, have been able to convert their assets into essentially different values and often to hand on at death the securities representing the stepped-up value with no income tax ever having been paid upon the increase.

This, incidentally, is true of all capital gains that are not realized prior to death. Such gains escape income tax entirely.

Likewise, it has been mainly taxpayers in the high levels of income who have been able to have their cake and eat it too, through fictitious or shadow sales of assets by which they record a loss for tax purposes, but never actually part with the control or beneficial enjoyment of the asset claimed to have been sold.

Other avoidance or evasion devices to reduce the effective tax rate, of which there are many within or upon the borderline of the law, are available only to substantial taxpayers purely because of the cost of lawyers and machinery . . .

The foregoing are merely illustrative of some of the major methods by which the rates in higher levels are rendered partially ineffective and indicate that increased rates and revenues may properly be sought in those brackets to equalize the burdens of taxation and apply the principle of taxation according to benefits received and resultant ability to pay.

#### INHERITANCE VERSUS ESTATE TAXES

Taxation of inheritances and gifts is not, as many have assumed, a new field of taxation by the federal government . . .

The principles by which the taxation of inheritance is distinguished from the taxation of the estate as a whole are well understood. While the estate tax has simplicity of administration in its favor, the inheritance tax is more truly based on ability to pay and on benefits received, in that the tax is proportioned to the amount actually received by the legatee, while the estate tax makes no discrimination between an estate divided among, say, five heirs, and one passing to a single heir.

The principal questions that have been raised relate to administration, such as collection problems, hardship on going business and valuation. We see no serious difficulties in the way of administration of inheritance taxes. The estimated total number of inheritances of \$1,000 and over is only 161,755 per year at the present time, as compared with individual income tax returns filed for 1933 in excess of 3,700,000.

From the figures of income already given, one will see that the prospect of accumulating sizable estates is a hope to the many and a realization to but few. Furthermore, all inheritances of any substantial size are matters of court record.

The Treasury has made a rough estimate of the distribution of inheritance, based upon the United States 1935 estate values after deduction of federal estate taxes. The findings of the Treasury Department are shown in the following tabulation:

Average Inheritance (In thousands of dollars)	Number of Returns	Amount in Class (In thou- sands of dollars)
1.55	33,135	51,361
4.27	18,197	77,701
7.40	46,008	340,459
12.67	24,954	316,084
15.17	14,296	216,885
21.05	7,220	151,981
27.07	3,944	106,748
32.85	2,772	91,049
40.90	3,252	132,994
51.83	1,976	102,416
62.51	1,224	76,512
79.73	1,604	127,887
100.71	840	84,596
136.96	1,120	153,390
185.98	452	84,061
239.60	272	65,171
286.76	108	30,970
337.29	156	52,617
426.35	76	32,403
507.35	40	20,294
640.29	40	25,612
803.97	4	3,216
976.10	24	23,426
1,270.35	20	25,407
1,758.55	20	35,171

#### LIQUIDATION OF LARGE ESTATES

Much has been said of the difficulties involved in liquidating large estates in order to pay taxes imposed at high rates. Unquestionably some estates are so situated that liquidation is difficult, long delayed and accomplished only at sacrifice.

Where estates are frozen or embarked in hazardous enterprises, unquestionably difficulties will arise that will require sympathetic administration on the part of the bureau if hardship is to be avoided.

Legislation, however, must have regard for the general condition rather than for the exceptional. Examination of data as to the composition of estates filed under the Federal Estate-Tax Law during the calendar years 1932 and 1933, indicates that the difficulty of liquidation may be exaggerated. This is illustrated by the figures of the following table:

	1932		1933	
	Amount (in thousands of dollars)	Percent	Amount (in thousands of dollars)	Percent
Real estate .....	433,374	15.5	385,831	19.1
Securities .....	1,548,414	55.4	1,075,178	53.0
Mortgages, notes, cash, insurance, etc.	476,460	17.0	457,271	22.5
Miscellaneous ....	337,571	12.1	108,651	5.4
Total.....	2,795,819	100.0	2,026,931	100.0

The foregoing figures for 1932 relate mainly to the estates of persons who died in 1931. It is to be noted that 55.4 percent of the property comprising gross estates was left in the form of securities, with mortgages, notes, cash and insurance accounting for an additional 17 percent of the total.

Of course, the adequacy of these assets to meet tax claims in any individual case would be influenced greatly by the ratio of debts, pledges and liens existing. We find, however, that debts, unpaid mortgages, etc., were only 14 percent of total gross estate in 1932 and 17 percent in 1933.

Perhaps the best measure of the actual difficulty that estates now experience is the number of estates that are granted extensions of time for the payment of tax. For the fiscal years 1929 to 1935 the average number of estates obtaining extensions has been under 2 percent. . . .

The National Industrial Conference Board in a study of inheritance-tax proposals asks: "If a well-to-do business man with a net estate of \$100,000,000, over and above the exemption of \$50,000 for the estate tax, should desire to leave his estate to an only son, what net amount would the son receive?" Under certain assumptions it answers that he would receive \$13,157,850, and that death taxes of all kinds would take about 87 percent of the estate. One involuntarily asks if an estate of \$100,000,000 represents that of a "well-to-do business man," what size estate does a man need to be considered really rich?

The example so offered is over-simplified, and other elements will be present in actual practice that enter into the consideration of the policy of the tax. It is not usual for a well-to-do business man with an estate of \$100,000,000 in fact to follow the simple procedure specified. If the experience of the Bureau of Internal Revenue is to guide, one may safely assume that the son, during the father's lifetime, has had many direct and indirect advantages from his father's surplus of resources. In a great majority of cases one will find that he has already been given money and property, which represent a fortune as compared to the resources of most men.

#### WEALTH PASSES TO WEALTH

The father has probably set up trusts for the support of his children and grandchildren. Some of America's richest families have carried the setting up of trusts for future generations to the very limit permitted by law, and even provide for those yet unborn.

A very recent and tentative study of the tax methods pursued by one large family indicates the existence of 197 separate trusts, resulting in great tax advantages from the split-up of the income to separate tax entities. You will also find that the son has been given shares of stock in some of the leading companies in which his father's estate has been invested; that he has been elected to boards of directors, and probably placed in a position to receive a substantial salary. He has likely been taken in on profitable transactions and has accumulated a substantial estate of his own. It is a rare thing, in actual practice, that a big estate descends to a person in poverty. Most of the big estates descend to persons already advantaged by wealth far beyond the hopes of the average person. . . . Therefore, we may safely assume that the \$13,000,000 net inheritance is a small part of the real advantages from the accident of being born son to a well-to-do business man.

Of course, even taking the National Industrial Conference Board's naked example, the \$100,000,000 estate will leave for the heir \$13,000,000. At interest rates of 4 to 5 percent this will produce a regular annual income for the heir ranging from a half million to \$700,000.

*An analysis prepared by Mr. Jackson showing the present concentration of corporate wealth will be published in next week's issue.—THE EDITORS.*

## Washington Notes

*Republicans on the Make—Out Pops  
MacIntyre—Some Results  
of the Session*

AS THE session moves to its long delayed close, the air is noisy with partisan fireworks. There has been no such display since Charles Michelson used to make the nights hideous for Mr. Hoover with his giant torpedoes and Roman candles. Now, however, it is the Republicans who are delightedly heaving lighted cannon-crackers in the White House windows. Although the display means nothing so far as the future welfare of the country is concerned, it has great importance for the Republican professionals. They have bright hopes that the showing made by their party during the last few weeks will enable them to blast loose a few preliminary contributions from big business.

For weary months, the problem of the Republican National Committee has been to bring about a revival of business confidence in the party. Reputedly a number of rich men have been prepared to spend money to defeat Roosevelt, but have not regarded the future of the Republican Party as sufficiently promising to warrant donations. The Democratic defeat in Rhode Island has helped dissipate this skepticism. So, too, has the evident wish of the Democratic high command to dodge an election in Ohio, where the seat made vacant by the death of Representative Charles V. Truax must be filled by a statewide election. After a hurried trip to the White House, Governor Davy refused to set the election for November, the normal date, postponing it, instead, until May. The Republicans rightly consider this an unsolicited testimonial to their new strength.

Once they can start contributions flowing their way, the professionals look forward to a rush business. They feel that they now have an attractive line of goods to offer. They regard the party's opposition to Mr. Roosevelt's present tax program as a particularly hot number. Despite its final innocuousness, the tax bill alarmed many rich people. The professionals will argue that it is better to contribute five or ten thousand dollars to the Republican fund than to pay the same amount to a future tax collector.

The chief aid to the Republicans in their contribution collecting, especially from great corporations, is likely to be the resentment among the rich caused by Mr. Morgenthau's quiet tightening up of the Treasury's tax machinery. It may not be literally true that the wealthy do not care who makes the nation's laws if they can dictate the tax rebates handed down by the Bureau of Internal Revenue, but this approximates the case. The vigor with which the Treasury has prosecuted Andrew Mellon before the Board of Tax Appeals, and the Board's recent decision in the Charles E. Mitchell case, have aroused much apprehension. Mr. Morgenthau's reformation of the Treasury, while still incomplete, has been a remarkable job, considering that he had to rescue it from the dominance of Mr. Farley and a little group of Democratic professionals.

No one beyond the fairy-tale age doubts that the death-sentence vote in the House was influenced by money spent by the utility companies. The revelation that one of the