Early Journal Content on JSTOR, Free to Anyone in the World

This article is one of nearly 500,000 scholarly works digitized and made freely available to everyone in the world by JSTOR.

Known as the Early Journal Content, this set of works include research articles, news, letters, and other writings published in more than 200 of the oldest leading academic journals. The works date from the mid-seventeenth to the early twentieth centuries.

We encourage people to read and share the Early Journal Content openly and to tell others that this resource exists. People may post this content online or redistribute in any way for non-commercial purposes.

Read more about Early Journal Content at http://about.jstor.org/participate-jstor/individuals/early-journal-content.

JSTOR is a digital library of academic journals, books, and primary source objects. JSTOR helps people discover, use, and build upon a wide range of content through a powerful research and teaching platform, and preserves this content for future generations. JSTOR is part of ITHAKA, a not-for-profit organization that also includes Ithaka S+R and Portico. For more information about JSTOR, please contact support@jstor.org.

THE INCOME TAX OF 1913

SUMMARY

The constitutional amendment of 1913 and the new income tax, 46. — I. The "normal" and "additional" taxes; the minimum exempt; the scale of progression, 47. — Dividends exempt from the normal tax, 49. — II. Limited application of stoppage at the source; its possible advantages and disadvantages, 50. — How applied as regards salaries and other single payments, 52. — As regards interest on bonds, 55. — "Fixed and determinable incomes," 56. — III. How minimum exemption is secured, 58. — IV. Return of income required; yet possible exceptions, 61. — V. The "additional" progressive tax, 65. — VI. Conclusion, 66.

Among the notable events of the year 1913, one of the most important in its influence upon the national finances and constitutional development of the United States is the adoption of an amendment to the Federal Constitution giving Congress the 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 mere fact that an amendment of any kind has been adopted is notable, this being the first occasion on which the Constitution had undergone any change since the period of the Civil War, and the first amendment adopted in peaceful and normal times since the early days of the Republic.

It is a little remarkable, altho perhaps not altogether accidental, that the adoption of this amendment should coincide with the return to power of the political party whose attempt to levy an income tax in 1894 was frustrated by the decision of the Supreme Court in that year. Then as now an income tax was a component part of the program of fiscal and commercial reform to which that

party was committed. This program included the reduction of protective tariff duties and the direct taxation of incomes. What the Democratic party failed to accomplish in 1894, it has had a free hand to do in 1913. Indeed, the national taxation of incomes might almost be regarded as a mandate of the people of the United States. At any rate, it was a foregone conclusion that the adoption of the constitutional amendment would be immediately followed by the enactment of an income tax law.

The law instituting the income tax was approved October 3, together with the law revising the tariff, both measures being included in one comprehensive statute entitled "An Act to reduce tariff duties and to provide revenue for Government, and for other purposes." It is the object of the present article to give a general description of the income tax. This seems to be especially well worth while because the tax cannot be readily understood from a mere perusal of the involved and sometimes obscure phraseology of the law itself. For the same reason, however, the task of interpretation is not easy or entirely safe. The law has certain novel features; and some of the questions of detail to which they give rise cannot be answered until we have the official construction placed upon the language of the act by the executive branch of the government and possibly by the courts. At the same time the main features of the tax become fairly evident to any one who makes a careful study of the provisions of the act, even tho its application to specific cases may remain doubtful.

I

The law provides that incomes shall be subject to a tax of one per cent on the amount by which they exceed

the prescribed minimum limit of exemption. This is designated as the "normal income tax." There is then an "additional tax" of one per cent on the amount by which any income exceeds $20,000. The rate is increased to two per cent on the amount above $50,000, to three per cent above $75,000, to four per cent above $100,000, to five per cent above $250,000, and to six per cent above $500,000. Therefore under the normal and additional tax combined, the first $20,000 of income, exclusive of the minimum exemption, will be taxed one per cent; the next $30,000, two per cent; the next $25,000, three per cent; the next $25,000, four per cent; the next $150,000, five per cent; the next $250,000, six per cent; and all income above that point seven per cent. This is a rigorous application of the progressive principle.

The minimum exemption, at the same time, is comparatively high, — $4,000 for a married person and $3,000 for everybody else. The higher exemption in case of the married is conditional upon husband and wife living together, and applies only to their aggregate income; that is to say, it cannot be deducted from the income of each. It may be noted, in this connection, that in England the exemption allowed under the income tax is £160 or $800; in Prussia it is 900 marks, or $225; and in the state of Wisconsin it is $800 for individuals and $1,200 for a husband and wife, with a further allowance for children or dependent members of the family.

The sharply progressive rates and the comparatively high exemption have given rise to the criticism that this is a rich man's income tax and disregards the principle that all persons should contribute to the expenses of the government in proportion to their several abilities. It is often said that an income tax ought to

reach all incomes with the exception of those which are close to or below the minimum necessary for subsistence, and that if people generally were called upon to contribute directly to the government they would take greater interest in public affairs and show more concern over any wasteful or unwise expenditure of public money. In reply it is contended that the limitation of the tax to the wealthy or well-to-do classes is justified because these classes do not pay their fair share of the indirect national taxes, or of local property taxes. These debatable questions lie outside the scope of the present article. It is evident, however, that the income tax should not be criticized as if it were a single tax or formed the only source of revenue for the Federal government. From the fiscal standpoint it occupies a subordinate position in the national finances, being expected to yield about $125,000,000 annually out of a total estimated tax revenue of $680,000,000.

The normal tax of one per cent is to be levied upon the income of corporations. In effect this provision of the law merely continues the corporation or " excise " tax which was already in existence. But that tax now becomes an integral part of the income tax, covering the income which accrues to the stockholder and is distributable in the form of dividends. On the theory that this income is reached at the source by the tax upon the net earnings of the corporation the dividends as such are exempt. They are not to be included, so far as concerns the normal tax, in the taxable incomes of the individual stockholders and the law does not provide that the tax paid by the corporation shall be deducted from the dividend.

It is perhaps a question whether under these conditions income which consists of dividends should be considered as subject to the normal tax or as exempt. It may be contended that a tax upon the net earnings

of corporations is virtually a tax on the stockholder's income, and in theory this is true. But so long as the tax is not actually withheld from the dividends, or the dividends are not reduced in consequence of the tax, the stockholder's current income is not affected. The imposition of the tax might indeed affect his prospective income and might depreciate the value of his stocks. It is hardly likely, however, that such effects will be perceptible, at least as regards the stocks of railroads and other large corporations. If, however, it be considered that income consisting of dividends pays the tax, it follows that the stockholder's income is taxed no matter how small it may be. No minimum is left exempt. On the other hand, if it be considered that all dividends are virtually exempt, the stockholder would seem to be unduly favored under this form of taxation in comparison with people whose incomes are derived from other sources. Doubtless in future the investor will look upon dividends as a form of income not subject to the normal income tax.

II

In the levy of the normal income tax there is to be a limited application of the method of assessment and collection at the source of the income. This method is applied very completely in the taxation of income in Great Britain. It may be well to recall summarily the essential features of the British system. The tax is levied upon the property or industrial enterprise which yields or produces the income. But the person occupying the property or conducting the enterprise, and paying the assessment in the first instance, is authorized and required to deduct the tax from the income as it is distributed among the persons entitled to share in it either as proprietors, landlords, creditors, or employees.

Under the English system, an industrial corporation, for instance, pays the income tax upon its gross earnings and then deducts it from the dividends, interest, salaries, and rents as these payments are made. The householder pays an assessment levied upon the annual value of his dwelling (less an allowance for repairs and insurance) and then if he occupies the premises as tenant deducts the tax from his rent. The income from agriculture is reached by a similar assessment upon the farmer, based upon the annual or rental value of the farm and with the same right of deduction from the rent if he is a tenant farmer.

From the standpoint of the government, the main advantage of this mode of assessment as compared with a tax levied directly upon the recipients of the income is the greater certainty with which it reaches the income subject to taxation. The opportunities for evasion by concealment of income are reduced to a minimum, partly because the sources of income are, in general, not easily concealed and partly because, to a considerable extent, the persons upon whom the tax is assessed are not interested in avoiding the tax. The advantages, however, are not all on the side of the government. The tax possesses certain advantages from the standpoint of the tax-payer also, assuming him to be an honest tax-payer who is not seeking opportunities to evade taxation. One advantage is that he is relieved in almost every case from the necessity of revealing to the tax officials the whole of his personal income. The tax does not pry into his personal affairs. Another advantage is that the tax is paid out of current income, being deducted from the income as it is received. It is therefore distributed over the year and adjusted to the flow of income as it comes in. A tax thus collected is less burdensome in its incidence than a tax paid in

one lump sum several months after the expiration of the year to which it relates and after the income on which it is levied has been all received and perhaps all expended.

The English system of assessing an income tax at the source, however, has its disadvantages. It is admirably suited for a tax levied at a uniform rate on all income or on all income above a small minimum. But it is not well suited for the application of progressive taxation or for the introduction of gradations or distinctions based upon the size or character of the individual incomes. Nevertheless the English income tax, besides exempting a minimum, provides for graded reductions or abatements in favor of the possessors of small incomes above the minimum, and for a reduced rate on "unearned" income within certain limits. All this, however, makes necessary a declaration or complete statement of income from the persons claiming the benefit of these provisions, and also necessitates refunding a large amount of the tax collected at the source. Moreover the progressive principle has recently been applied by imposing a "super-tax" on incomes in excess of £5,000, which also requires a declaration, the tax being necessarily assessed upon the possessor of the income and not at the source. The super-tax, it may be observed, occupies a position in the English system similar to that of the additional tax in the United States, serving to increase the tax upon the larger incomes in accordance with the principle of progression.

It has been stated above that the law which has just been enacted by Congress makes a limited application of this principle of assessment at the source, as regards the normal tax. The general rule of the law covering deduction at the source is of sufficient importance to be quoted in full. It reads as follows: —

All persons, firms, co-partnerships, companies, corporations, joint-stock companies or associations, and insurance companies, in whatever capacity acting, including lessees or mortgagors of real or personal property, trustees acting in any trust capacity, executors, administrators, agents, receivers, conservators, employers, and all officers and employees of the United States having the control, receipt, custody, disposal, or payment of interest, rent, salaries, wages, premiums, annuities, compensations, remuneration, emoluments or other fixed or determinable annual gains, profits, and income of another person, exceeding $3,000 for any taxable year, other than dividends on capital stock, or from the net earnings of corporations and joint-stock companies or associations subject to like tax, who are required to make and render a return in behalf of another,[1] as provided herein, to the collector of his, her or its district, are hereby authorized and required to deduct and withhold from such annual gains, profits, and income such sum as will be sufficient to pay the normal tax imposed thereon by this section, and shall pay to the officer of the United States Government authorized to receive the same; and they are each hereby made personally liable for such tax.

Under this paragraph of the act every person, corporation, etc., making payments of more than $3,000 in interest, rent, salary, etc., to any one person in any one year must in each instance deduct the normal tax and pay it to the tax collector. It should be noted, however, that the rule covers not only "payments" but also the "control, receipt, custody, or disposal" of such sums. It is impossible to say just what may be comprised under these terms. But the word "payment" doubtless represents the typical or usual case, and in the discussion which follows will be used in a generic sense to cover all cases.

The limitation of the operation of the above paragraph to payments in excess of $3,000 was presumably deemed necessary, or at least advisable, because income

[1] This restrictive clause appears to have very little significance, for the reason that the persons, firms, etc., "who are required to make and render a return in behalf of another" are apparently the persons, firms, etc., just enumerated, namely, those having the control, receipt, custody, etc., of the annual gains, profits, and income of another person, exceeding $3,000. The paragraph which defines the persons, firms, etc., who are to make returns in behalf of another person is cited on p. 64.

up to that limit is exempt. The intention seems to be, however, that when the normal tax is deducted it shall be computed on the total payment and not simply on the excess over $3,000. That being the case it is evident that the deduction of the tax under this rule, tho limited to sums of more than $3,000, will nevertheless reach a certain amount of income which is exempt. It will do this where the entire income of any person is derived from a single source or from several sources each of which yields more than $3,000. On the other hand, it is evident that a large proportion of the payments made in sums of less than $3,000 will represent taxable income, being received by persons whose incomes are above the limit of exemption. Many large incomes are derived wholly or in large part from sources which yield less than $3,000 each. The adoption of a $3,000 limit for the application of the method of deduction at the source therefore appears to be a compromise, a half-way measure. It comes far short of reaching at the source all income subject to taxation, and at the same time seems likely to reach some income that is exempt. This does not necessarily mean that any taxable income will escape assessment or that any tax-payer will lose the benefit of the exemption. Income not reached at the source is to be included in the taxable income of the person who receives it; and the taxpayer's right to exemption is safe-guarded by special provisions which are discussed below.

This $3,000 limit, however, and the general rule of the law as regards deducting the tax at the source are materially modified by the exceptions or provisos. It is to be noted, in the first place, that in the paragraph just cited, dividends are altogether excepted from the classes of payments which are subject to the deduction of the tax. The exception applies only to dividends

paid by corporations "subject to like tax," but these include practically all corporations either located or doing business in the United States. The source of this income is supposed to have been reached by the tax on the earnings of the corporations.

Again, the application of the method of collecting the tax by deduction is very materially affected, and in quite a different way, by a proviso which removes the $3,000 limit as regards interest payments made by corporations. The normal tax is to be deducted and withheld from the "interest upon bonds and mortgages, or deeds of trust or other similar obligations of corporations, joint-stock companies or associations, and insurance companies, whether payable annually or at shorter or longer periods, altho such interest does not amount to $3,000." A large proportion of the bonds issued by corporations, however, guarantee the payment of interest without deduction on account of taxes. In such cases the corporations will undoubtedly assume the burden of the tax, as the provisions of the law just cited are hardly likely to be construed as requiring the violation of contracts. At one stage in the preparation of the law, a clause was inserted providing that the interest in such cases as this should be included in the taxable income of the bondholder and assessed to him. This clause, however, was not retained in the act as passed. But a proviso was inserted that no "contract entered into after this act takes effect" shall be "valid in regard to any Federal income tax imposed upon a person liable to such payment"; it is intended to prohibit any future issue of bonds guaranteeing exemption from the income tax.

Considering the various provisos and exceptions in connection with the general rule of the act, the scope of the application of the method of collecting the tax

at the source may perhaps be safely stated thus: the normal tax is to be deducted (1) from all interest payments made by corporations on bonds and the like, without regard to the amount; (2) from all other interest payments when the amount is more than $3,000 in any one year; (3) from all payments of rents, salaries, or wages amounting in any one case to over $3,000 annually; (4) from all other payments of over $3,000 (excepting dividends) which may be comprised under the designations "premiums, compensations, remuneration, emoluments, or other fixed or determinable gains, profits, or income."

One general restriction upon the application of the method of deducting the tax at the source should perhaps be mentioned. It is indicated by the words "fixed and determinable." That these words are not unimportant would seem to be indicated by their recurrence in other connections, and particularly by a proviso in the paragraph defining the deductions which may be made in computing taxable income. This proviso reads:

> Provided that whenever the tax upon the income of a person is required to be withheld and paid at the source as hereinafter required, if such annual income does not exceed the sum of $3,000 or is not fixed or certain, or is indefinite, or irregular as to amount or time of accrual, the same shall not be deducted in the personal return of such person.

This proviso emphasizes the fact that there are at least two general conditions to be met before deduction at the source is required: first, as already explained, the amount of income paid out must (with exceptions already noted) exceed $3,000; and second, it must be fixed, certain, definite, and regular. Strictly speaking there would seem to be very little income which is fixed and certain in advance of its actual receipt and very little which is not fixed and certain after it has

been received. Doubtless, the terms here used are intended to cover periodical payments of income, such as salaries or interest, made in fixed or stipulated amounts. But even as regards such payments there is usually no certainty in any given instance that they will continue to be made to the same person throughout the year. Interest bearing notes and mortgages are usually transferable, and salaried positions are not always permanent. It will often not be possible to say in advance whether the aggregate payments will amount to $3,000. Instructions already issued by the Treasury Department provide that no tax shall be withheld until the accumulated payments of the current year pass the $3,000 limit, and that the person making these payments shall thereafter deduct the tax, the first deduction covering the tax on all payments up to date. But simple as such a procedure may be in theory, in the complicated and shifting relationships of the business world it will not always be easy to follow. The *payer* of income as well as the *payee* may change, and change more than once, during the same calendar year.

Income from investments in foreign countries is, of course, derived from sources which are inaccessible to this government. The law, however, undertakes to intercept the tax on certain classes of income of foreign origin by providing that the normal tax "shall be deducted and withheld from coupons, checks, or bills of exchange for or in payment of interest upon bonds of foreign countries and upon foreign mortgages or like obligations (not payable in the United States), and also from coupons, checks, or bills of exchange for or in payment of any dividends upon the stock or interest upon the obligations of foreign corporations, associations, and insurance companies engaged in

business in foreign countries." This deduction of the tax is to be made by " any banker or person who shall sell or otherwise realize coupons, checks, or bills of exchange drawn or made in payment of any such interest or dividends (not payable in the United States), and any person who shall obtain payment (not in the United States), in behalf of another of such dividends and interest by means of coupons, checks, or bills of exchange, and also any dealer in such coupons who shall purchase the same for any such dividends or interest (not payable in the United States), otherwise than from a banker or another dealer in such coupons."

III

In so far as the law requires the taxation of incomes at the source, some special provision must be made to ensure to the recipients of the incomes thus taxed the benefits of the minimum exemption and of any other deductions to which they may be lawfully entitled. The procedure to be followed is set forth in the following provisions of the law, the letters and numerals which mark subdivisions of the paragraph being inserted by the writer.

(1) In all cases where the income tax of a person is withheld and deducted and paid or to be paid at the source, as aforesaid, such person shall not receive the benefit of the deduction and exemption allowed in paragraph C of this section, except (*a*) by an application for refund of the tax unless he shall, (*b*) not less than thirty days prior to the day on which the return of his income is due, file with the person who is required to withhold and pay tax for him, a signed notice in writing claiming the benefit of such exemption and thereupon no tax shall be withheld upon the amount of such exemption; (2) nor shall any person under the foregoing conditions be allowed the benefit of any deduction provided for in subsection B of this section unless he shall, not less than thirty days prior to the day on which the return of his income is due, either (*a*) file with the person who is required to withhold and pay tax for him a true and correct

return of his annual gains, profits, and income from all other sources, and also the deductions asked for, and the showing thus made shall then become a part of the return to be made in his behalf by the person required to withhold and pay the tax, or (*b*) likewise make application for deductions to the collector of the district in which return is made or to be made for him.

The first part of this paragraph prescribes the steps which must be taken in order to secure the benefits of the general exemption of $3,000 or, in case of a married man, of $4,000. The second part relates to the deductions on account of business expenses, interest on indebtedness, taxes, losses, dividends and the like, which, as set forth in subsection B of the act, are permitted in computing the net income subject to taxation. The procedure to be followed does not seem to differ essentially in the two cases. The initiative rests with the tax-payer, or person from whose income the tax will, in absence of any action on his part, be deducted at the source. The law apparently gives the tax-payer the option of two alternatives — either to forestall the deduction of the tax or to secure a refund of the tax after it has been collected. The right to have the tax refunded in order to secure the benefits of the minimum exemption is clearly implied by the clause, "except by an application for the refund of the tax," appearing in the first part of the paragraph. That the deductions allowable on account of expenses and interest may likewise be obtained by a refund of the tax collected at the source is indicated by the clause at the end of the paragraph giving the tax-payer the option of making "application for deductions to the collector of the district in which return is made or to be made for him."

If the tax-payer prefers to forestall the deduction of the tax, the procedure prescribed by the law as applied to exemptions and as applied to deductions of income on account of expenses differs in one particular. As

regards the exemption all that he need do is "to file with the person who is required to withhold and pay the tax for him, a written notice claiming the benefit of such exemption." But if he wishes to forestall the retention of the tax on any income which is not taxable because it is offset by allowable deductions, he must file "a true and correct return of his annual gains, profits, and income from all other sources and also the deductions asked for." This return likewise is to be filed with the person "required to withhold and pay the tax." It would seem hardly possible, however, to make such a return prior to the completion of the calendar year for which the income is to be computed; and therefore it is difficult to see how the tax-payer can exercise this right in such a way as actually to forestall the retention of the tax at the source, unless the tax officials construe the law as permitting the acceptance of a statement of prospective income filed in advance of the actual receipt of the income. It may be noted in this connection, however, that the person retaining the tax at the source apparently is not required to pay it over to the government until the expiration of six months after the completion of the year for which the tax was assessed.[1] It is conceivable, therefore, that the tax-payer, instead of attempting to forestall the retention of the tax, might file his claim and return of income after the close of the tax year, not with the tax collector but with the person withholding the tax, so as to obtain a refund of it before it has been paid over to the tax collector. This possibility is suggested by the provision as to the period within which the claim

[1] As to time of payment there is no provision in the law except the general provision that all assessments shall be paid on or before the 30th of June. This would seem to cover assessments at the source, in view of the fact that the special provision requiring deduction of the tax simply states that the person withholding the tax shall pay it to officers of the government authorized to receive it, without specifying when it shall be paid.

may be filed, namely, " not less than thirty days before the day on which his return of income is due." The " return of income " is due on March 1st and therefore the claim may be filed at any time prior to the 29th or perhaps 30th of January following the year in which the income accrues.

No similar difficulty stands in the way of forestalling the retention of the tax when it concerns the exemption of a minimum. Here, as previously explained, the tax-payer's application need not be accompanied by a statement of income, presumably because this exemption is not dependent upon the amount of his income. He is entitled to the relief whatever his income may be. It would seem, therefore, entirely practicable in most cases to forestall the retention of the tax at the source where it affects the tax-payer's right to exemption.

The claim to exemption or deduction, with the accompanying return of income, when filed with the person who would otherwise retain the tax, is to be submitted by the latter, in making his own returns to the tax collector as his authorization for not having collected or retained the tax. This appears to be the meaning of the provision that "the showing thus made shall then become a part of the return to be made in his [the claimant's] behalf by the person required to withhold and pay the tax."

IV

The principle of assessing income at its source as applied in this act does not relieve the individual from the necessity of making a full revelation to the tax officials of his personal income from all sources. Tho this statement needs to be qualified in one or two particulars, the law provides in general that every person subject to the tax and having an income of

$3,000 or over shall make a true and accurate return under oath or affirmation " setting forth specifically the gross amount of income from all separate sources and from the total thereof deducting the aggregate items or expenses and allowance " authorized by the law. Altho income from which the tax has been withheld is not included in the net personal and taxable income of the tax-payer, it must, nevertheless, be accounted for and included in his declaration as a part of his gross income, forming one of the specified items which are to be deducted from the gross income in arriving at the income subject to taxation.

As already intimated, the general requirement of the full and complete statement of income is subject to certain exceptions. One relates to the income from dividends, the law providing that " persons liable to the normal tax only . . . shall not be required to make return of the income derived from dividends on the capital stock or from the net earnings of corporations, joint-stock companies or associations, and insurance companies taxable upon their net income." It will be noted that this proviso is restricted to persons who are " liable for the normal tax only," *i. e.*, persons having net incomes under $20,000. It would seem, therefore, that the tax-payer claiming and securing this privilege must in some way, without revealing the amount received from dividends, satisfy the tax assessors that his total net income including the dividends (amount not stated) does not exceed $20,000. Of course a form of statement can easily be devised to cover the situation. But whether the law will be administered in such a way that this provision affords some relief from the general obligation of making a detailed and complete statement of income remains to be seen.

Another exception to the general requirement of a complete declaration of income covers the case of the tax-payer whose entire income has been assessed and the tax on it deducted at the source. The law relieves such persons from the obligation of making any declaration of income; altho it is not certain that this privilege can be secured without foregoing or sacrificing the benefits of any abatements to which the individual tax-payer might be entitled on account of business expenses, interest payments, losses, etc. It seems probable that where the income is all assessed at the source the tax-payer may obtain the benefit of the minimum exemption without making a declaration of income.

It appears, therefore, that assessment at the source does not, under this law, operate in such a way as to afford the tax-payer any substantial relief from the necessity of making a revelation of his income to tax officials. Whatever basis there may be for the common criticism or complaint that an income tax is inquisitorial remains under the operation of this law to nearly the same extent that it would if the tax were levied wholly and directly upon the recipients of the income, with no resort to taxation at the source.

In addition to the returns which the individual is required to make covering his own income, every individual, firm, or corporation is required to make a return covering payments on which the tax has been deducted and giving the name and address, if known, of the persons to whom such payments were made. As regards the scope and application of this requirement, the law is not altogether clear or explicit. It seems best, therefore, to cite again the exact language of the statute:

All persons, firms, companies, co-partnerships, corporations, joint-stock companies or associations, and insurance companies, except as hereinafter provided, in whatever capacity acting, having the control, receipt, disposal, or payment of fixed or determinable annual or periodical gains, profits, and income of another person, subject to tax, shall in behalf of such person deduct and withhold from the payment an amount equivalent to the normal income tax upon the same and make and render a return, as aforesaid, but separate and distinct, of the portion of the income of each person from which the normal tax has been thus withheld, and containing also the name and address of such person or stating that the name and address or the address, as the case may be, are unknown: . . . *Provided*, That . . . no return of income not exceeding $3,000 shall be required.

The introduction of the last proviso (that no return should be made of payments of income not exceeding $3,000) was probably thought necessary in order to be consistent with the general rule that the tax shall be withheld and deducted only from payments exceeding that amount; but to that general rule there is one important exception, as already noted, covering interest payments made by corporations. The tax on such payments is to be deducted in all cases without regard to the amounts. There is no corresponding exception to the rule as to returns. The language of the statute, strictly interpreted, would seem to mean that the corporations, altho required to deduct the tax from all payments of interest, are not required to make a return of the names and addresses of persons to whom annual interest payments are made in amounts not exceeding $3,000.

It is, in fact, hardly possible in advance of the official interpretation and actual enforcement of the law to say how far this requirement of a return of payments of income taxed at the source extends or to whom it will apply. But as regards the deduction of the tax and the returns to be made in connection with the pay-

ment of the interest on corporation bonds, Treasury regulations have already been published, indicating the procedure to be followed. The case of registered bonds presents no especial difficulty, the officers of the corporation being in a position to make the required return giving the name of the bondholder and the amount of interest paid to him. But the procedure that would be followed in connection with the large amount of interest paid out on coupon bonds was not so obvious. In this case the corporation issuing the bonds and ultimately paying the interest has, as a rule, no knowledge who the bondholders are or how much interest they individually receive. The only person who can give this information is the person who cashes the coupons for the bondholder in the first instance. Usually coupons are redeemed through the banks; and the Treasury regulations above referred to provide that the coupons when presented to banks or other agencies for redemption or collection must be accompanied by a certificate of ownership signed by the owner of the bonds. In this case, presumably, the bank will collect from the corporation the interest less the tax and the corporation will pay the tax to the government. The failure to supply such a certificate places upon the bank accepting the coupons the obligation of retaining the tax and, at the same time, attaching to the coupons its own certificate giving the name and address of the owner of the coupons or of the person presenting them. Here the intention seems to be that the bank shall deduct and withhold the tax, collect the interest in full from the corporation, and ultimately pay the tax to the government. The corporations are to deliver all certificates to the tax collector on or before the 20th of the month following that in which they were received.

V

Regarding the assessment of the additional tax not much need be said in the way of explanation. It is, in theory at least, a comparatively simple matter. There is no attempt here to make any application of the principle of collection at the source. The tax is all levied directly upon the recipients of the individual incomes and the assessment is based upon the tax-payer's declaration, which for the purposes of this tax must cover the "entire net income from all sources, corporate or otherwise." The tax is thus largely distinct from the normal income tax as regards both the method of assessment and the rates. It is, however, to be administered through the same machinery, and no doubt to some extent the information obtained as to the sources of income in connection with the assessment of the normal tax will prove useful as a check upon the returns of income required for assessment of the additional tax. Every person whose income exceeds $20,000 will be subject to both taxes, the normal and the additional, but presumably will be required to make only one declaration. For the purposes of the additional tax he will be required to declare his income from all sources, and therefore any relief from the obligation of making a complete revelation of income which may be secured to him through the application of the principle of assessment at the source in connection with the normal tax will be entirely sacrificed.

VI

The administration of a direct personal income tax — using that term to describe a tax levied directly on individual incomes — is a comparatively simple matter, however ineffective it may prove to be in reaching the

income subject to it. Under this method of taxation it is easy to exempt a minimum, to apply progression in the rates, or to make any other adjustments that may be deemed equitable with reference either to the size or character of the income or to the circumstances of the tax-payer. But as soon as we depart from this simple method and resort to taxation at the source, we encounter difficulties in varying the rates, allowing exemptions, or making any similar adjustments. In the English income tax, these difficulties are squarely met and surmounted. As previously explained, that tax is in the first instance levied indiscriminately on all accessible sources of income and the adjustments are effected by refunding the tax collected at the source so far as may be necessary. No provision is made for forestalling the deduction of the tax, and no returns are required of the names and addresses of persons to whom payments of income are made. The exemption, however, is small ($800) and the abatements extend only to incomes below $3,500. Above that point the entire income is taxable.

A tax which provides for the exemption of $3,000 or $4,000 from every individual income places a formidable barrier in the way of a thoro-going application of assessment at the source. It is evident that with a universal exemption as high as this, a very large amount of tax withheld and collected at the source would ultimately have to be refunded. The law as enacted indicates an intention to secure in part the advantage of assessment at the source and at the same time avoid in part the attendant disadvantage of having to refund the tax. The measure might be characterized as one which as regards the "normal tax" applies the principle of assessment at the source to corporate income completely and to other income in spots. The "addi-

tional tax" is simply the direct personal tax. The normal tax will doubtless be successful in reaching the large amount of income earned or created by enterprises conducted under the corporate form of organization, much of which would probably escape assessment under a direct personal income tax. But beyond this it is questionable whether the method of assessment at the source as here applied will be of sufficient advantage to justify the administrative complications which it involves.

It seems useless, however, as well as unwise, to venture any predictions as to how successful the tax will be in reaching the income subject to it or how well it will work in actual practice. We can afford to wait and see. Much depends upon the way in which the law is administered. After it has been in operation for a year or two, after its novel features have been tested by actual experience and those provisions which are complicated or obscure have been interpreted by administrative rulings or possibly by court decisions, we shall have a better understanding of the merits or defects of the measure than is at present possible. The law will doubtless require amendment in many particulars even if it does not need to be radically revised. That the income tax in some form will be perpetuated as a permanent part of our system of national finance may safely be predicted. Properly adjusted and wisely administered it should greatly strengthen the financial resources of the government, make possible a closer adjustment of revenue to expenditure, and secure a more equitable distribution of the burden of taxation.

JOSEPH A. HILL.

WASHINGTON, D. C.