



A State Income Tax: Historically, Constitutionally, and Economically Wrong

Brent Connett

Politicians and interest groups alike are touting an individual income tax as a perfect repair mechanism for our school finance structure, especially in terms of property tax relief and ending recapture. Senator Eliot Shapleigh, Representative Eddie Rodriguez, and the Center for Public Policy Priorities have all pushed hard for a state income tax, and they all point to the many benefits an income tax carries.

However there was a time when individual income taxes, federal and state, were illegal and didn't exist in the United States. Today, the federal income tax is a part of life for Americans. Forty-three states have their own income taxes, and if some have their way, Texas would be the forty-fourth. An income tax is wrong for Texas however; if used as a tool, it *might* fix the initial problem at hand (property tax), but in the process it creates many more and much worse problems when implemented. Secondly (and more importantly), it contains inherent flaws that run questionably close to violating Constitutional protections.

The framers of the United States Constitution espoused a clear belief that taxes should be strictly linked to representation. Edmund Randolph, delegate to the Constitutional convention from New York, stated, "But in this new Constitution there is a more just and equitable rule fixed, a limitation beyond which we cannot go. Representatives and taxes go hand in hand. According to the one, the other will be regulated." Randolph's fellow delegates agreed, and the document emerged with

language that stated direct taxes were to be proportional to the census (via representation in the House of Representatives) and indirect taxes were to be equitable and uniform. The Federalist Papers also shed light on the framers' views on taxation. Alexander Hamilton stated in The Federalist #36¹ that “an actual census or enumeration of the people must furnish the rule [of taxation], a circumstance which effectively shuts the door to partiality or oppression.”

Taxation without representation was a major issue in the rift that grew between the colonies and Great Britain in the late 18th Century. The British levied numerous taxes against the colonies that were excessive in nature (such as the Stamp Act), and could do so because the colonists had no representative with any voice or vote in the decision-making process. The colonists wanted one of two things: either a repeal of the taxes or some representation in the British government. When taxes are assessed against an unrepresented or under-represented group, the taxes are likely to be severe, or as Hamilton alluded to, partial and/or oppressive. As the conservative cliché goes: it's easier to spend someone else's money than your own. Representatives apportioned according to population however will tax much more carefully than representatives not apportioned. In other words, an elected Representative who has a say in a group's taxation will protect that group, the colonists argued. Tax laws originating out of the Senate could have no apportionment according to the states' populations, because each state has two Senators, regardless of population, meaning that a tax law out of the Senate could be skewed by Senators from states with low populations to overwhelmingly tax the populations of more dense states. Therefore, the House of Representatives, in which representation is based upon a state's population (assessed by census), is the origin of all federal tax laws. Income taxes, however, counter these ideals.

In order to fund the Civil War, Congress passed an income tax with a low, flat rate (3 percent on annual incomes over \$800, which exempted most wage earners). Since the circumstances were extraordinary, and since the tax was repealed at the conclusion of the war, there was no Supreme Court intervention. However when Congress passed an

income tax towards the close of the 19th Century, the Supreme Court took action in the 1895 case, *Pollock v. Farmers' Loan & Trust Co.*.

There is some debate early in the opinion (authored by Chief Justice Melville Weston Fuller) on whether to classify the income tax as direct or indirect. After discussing the income tax's direct and indirect aspects, Chief Justice Fuller labels the income tax as direct, and not being apportioned according to any census, the income tax was in violation of the Constitution. Taken directly from the Constitution: "No direct tax shall be laid, unless in proportion to the census or enumeration herein before directed to be taken." Chief Justice Fuller noted that the direct characteristics of the income tax made it unconstitutional in that it was not subject to the rule of apportionment and not in proportion to the census: "such tax is direct, and void because imposed without regard to the rule of apportionment; and that by reason thereof the whole law is invalidated." In addition the indirect characteristics of the tax directly opposed the Constitutional guidelines for indirect taxes, namely the rules of equality, impartiality and uniformity of taxation. For example, Article 1, section 8, clause 1 of the Constitution reads: "...all duties, imposts, and excises shall be uniform throughout the United States". Although Chief Justice Fuller recognized the mostly direct nature of the tax but also noted that both of its direct and indirect mechanisms operated in violation of the Constitution; the law was subsequently struck down.

But Congress didn't give up on income taxes once the Supreme Court ruled them unconstitutional. In 1913, Congress passed the 16th Amendment to the Constitution, which amounts to a perversion of the original intent of the framers. Essentially a cop-out, the amendment reads: "the Congress shall have the power to lay and collect taxes on incomes... without apportionment among the several states, and without regard to any census or enumeration." The amendment makes the Constitution read in essence that all direct taxes *except the income tax* shall be apportioned among the several states. And thus are the true beginnings of the federal income tax, one that is both direct and not apportioned according to any census (read as: "exactly the kind of tax the framers' of the Constitution intended to prevent").

By 1957, 28 states had an income tax. From 1957 to 1997, that number increased to forty, with Texas, fortunately, not included. Economist Richard Vedder notes, in *The Worst Tax for Texans*, that states with income taxes prior to 1957 currently have large and growing tax burdens, but not nearly as severely as do the twelve states that have added an income tax since 1957. According to Vedder's research, those twelve states saw their average overall tax burden (calculated as taxes per \$1,000 of personal income) rise by 37.2%. In comparison, the 28 states that had an income tax in 1957 saw their tax burdens rise by 23.4%. Now, in sharp contrast to both of the previous figures, states with no income tax at all saw their tax burden rise by only 10.5%. Vedder explains the growth in tax burdens by pointing to a key feature of income taxes: "the income tax, which is progressive and thus taxes high wage earners at higher levels, typically takes in more revenue than other types of taxes". Vedder goes on to say that the states always spend the increased revenue, which equates to more government spending and thus bigger government. Vedder also notes that real personal income growth was more than twice as high in low- or no-income tax states². The numbers alone speak volumes against a state income tax in Texas.

This is just one of the inherent problems that come with a government taxing individual income. Another is an amazingly disproportionate burden, with income levels and location as key deciding factors in who bears a heavy or light burden. For example, data compiled by The Claremont Institute in 2002 shows that for 1999, the top 1% of taxpayers earned 19.5% of all adjusted gross income, but paid 36.2% of all federal income taxes. In stark contrast, the bottom 50% of taxpayers earned 13.2% of all adjusted gross income, but paid only 4% of income taxes³. It is unlikely that the rates set for a state income tax in Texas would produce a burden that corrects the flaws in the federal tax.

A second, equally inherent but less recognized flaw in the federal income tax is that the tax makes no adjustments for cost of living. According to *Special Report* released by the non-partisan Tax Foundation in November of 2003, Congress created a system in 1972 to account for differences in cost of living in government employees'

salaries. Therefore, according to the Tax Foundation's calculations, a government nurse in San Diego earns \$43,557 while the same nurse would earn \$36,781 in San Antonio. The pay cut doesn't truly affect the nurse's lifestyle, because the cost of living (rent, groceries, etc...) is lower in San Antonio than it is in San Diego. However as the *Special Report* points out, the amount the nurse owes the federal government is also lower in San Antonio: \$2,827 versus \$3,844 in San Diego. In other words, people who live in communities with low cost of living share less of an income tax burden than those who live in cities with high cost of living⁴. That means that people living in the most expensive cities in Texas will pay more than citizens of living in lower cost-of-living cities, regardless of level of income.

Having highlighted the disproportions under which the federal income tax operates, do both of these problems really apply to Texas, in the event that a state income passes? The answer to that question lies in one state income tax proposal, that of Representative Eddie Rodriguez. First, under the Rodriguez plan, the state income tax would have a progressive rate, which as discussed, taxes higher incomes at higher levels.

Secondly, Rodriguez states that his income tax will benefit the Texas economy. The truth however, can be gleaned from further analysis of the Tax Foundation's ranking of states' business climates⁵. Of the states ranking in the top ten business climates, six have no individual income tax, and Texas is the only state without an income tax that isn't ranked in the top ten. In addition, the CATO Institute points out that new taxes are inextricably linked to economic downswings. CATO notes that increased tax burdens, such as the one created by an individual income tax in Texas, historically match up with economic slowdowns and even recessions. On the other hand, reduced tax burdens historically are paired with positive economic growth, especially in the area of employment. CATO's economic analysis goes as far to say that "some kinds of taxes--such as income taxes--are clearly more damaging to the economy than others"⁶. Claims that income tax will benefit the Texas economy are especially suspect since most data on tax burdens and business climates speaks exactly the opposite. Income taxes hurt economies.

Delving deeper into the exactly how the burden of an income tax would fall on Texas families, the web site set up to push the Rodriguez income tax plan, www.texasrelief.com, features a calculator that produces how much each family can expect to save in the event the Rodriguez income tax plan passes. A family of four living in the Dallas Independent School District in a home valued at \$150,000 and with adjusted gross incomes of \$45,000 and \$65,000 would save \$1,473. However, in nearby Highland Park ISD, the story is much different. A family of four living in a home valued at \$300,000 and earning adjusted gross incomes of \$100,000 and \$150,000 would pay \$1,730 *more* in taxes, meaning that the Highland Park family subsidizes the Dallas family's tax break and then some⁷. When the principle behind the goal of ending recapture is fairness and ending subsidization, an income tax simply shifts the injustice and subsidization to another tax; property taxes are currently the culprit, and Representative Rodriguez's plan to remedy that creates a creature of far worse stature.

Chief Justice Fuller, in *Pollock v. Farmers'*, predicted some of these problems. "Nothing can be clearer than that what the Constitution intended to guard against was the exercise by the general government of the power of directly taxing persons and property within any state through a majority made up from the other states." Fuller also expresses strong desire "to prevent an attack upon accumulated property by mere force of numbers." When those fears are applied to Texas, an alarming question arises: why couldn't representatives of lower income areas of the state band together to force an income tax that would overwhelmingly apply to higher income areas? In the event that an income tax passes in Texas, its progressive rate and disproportions in terms of costs of living could create such problem. However thanks to a Constitutional amendment requiring voter approval of an income tax, the likelihood of that happening is low. In fact, according to a poll taken by TCCRI in January of 2004, Texas voters think education funding should come from government cuts, not new taxes; in addition to that, the voters prefer funding education via the sales tax over any other type⁸. The poll results hint at a voting population that would be highly unlikely to approve an income tax in the

event the proposal made it to the ballot. The point has been made: income taxes carry with them inherent flaws.

Using an income tax to end Robin Hood would simply shift the state's pattern of stealing from the rich from one tax (property), to another, (income). Robin Hood currently takes from the high wealth school districts and gives to low wealth districts. An income tax, which would be progressive, would tax higher incomes at much higher rates than low incomes, meaning a new arena for stealing from the rich.

Perhaps proponents of the income want exactly that, to disproportionately tax the rich over the poor. The Center for Public Policy Priorities, for example, strongly favors an individual income tax to fund education. The Center describes itself as “a non-partisan, non-profit policy research organization seeking sound solutions to the challenges faced by low- and moderate-income Texans.”⁹ Therefore they care not about higher income Texans and have no problem with taxing them excessively, so long as low- and middle-income Texans have a light tax burden to bear. Therein lies the true reason for the Center's support for a state individual income tax. In an op-ed titled “The Monster in the Closet – A State Income Tax”, the Center posits that an income tax is fairer than the sales tax¹⁰. However with its progressive rate and cost of living disparities, an income tax is not fair in the least.

In addition, the Center states that “an income tax would reflect our economic growth better than a sales tax...” What kind of economic growth is the Center talking about? When an economy grows, the citizens living under that economy prosper, and spend money. When that money is spent, it is taxed by the sales and use tax, making for a reflection of the economy. An income tax, on the other hand, has the very real potential to stall or reverse economic growth, as can be seen by the Tax Foundation's analysis of tax structures and business climates and CATO's study on taxes and the economy. Therefore the economic reflection that an income tax gives is one of a weaker, more fragmented economy.

In the same op-ed, as the title insinuates, the Center analogizes the state income tax to a monster in the closet: there is great fear of it, but the fears are baseless. Although

fears of a true monster in the closet are baseless, the worries surrounding a state income tax are very real. A weakened business climate, a disproportionate application, the continuation of recapture, and bigger government all go hand in hand with an income tax, and all of those belong in the closet and away from taxpayers.

Historically, constitutionally and economically, an income tax is bad for Texas. The framers of the U.S. Constitution put great care into their work, and wanted part of that work to include a strong link between taxes and representation. That desire is not one that has been met with the respect of subsequent generations of politicians. The nation's highest court struck down income taxes as invalid before an amendment was passed to make them Constitutional. Although representation isn't at all linked to an individual income tax, government growth and economic squalor are, as is a new form of recapture and subsidization that is bigger and badder than "Robin Hood". A state income tax should be avoided.

[About the Author: Brent Connett is currently a senior at the University of Texas at Austin, studying government. He has interned with the Texas Conservative Coalition Research Institute since January of 2003 and currently serves as a policy analyst for the organization. Brent can be reached at brent@txccri.org.]

¹ Alexander Hamilton; The Federalist #36, "Concerning the General Power of Taxation (continued)"; January 8th, 1788

² Richard Vedder, Ph.D.; Taxing Texans: A Six-Part Series Examining Taxes in the Lone Star State; "Part One: The Worst Tax for Texas?" <http://www.texaspolicy.com/pdf/2002-02-28-tax-taxingtexans1.pdf>

³ Scott W. Johnson and John H. Hinderaker; Regressive Thoughts on a Progressive Tax; April 15th, 2002 http://www.claremont.org/writings/precepts/20020415hinderaker_johnson.html

⁴ J. Scott Moody and David K. Hoffman; Special Report, "Federal Income Taxes and the Cost of Living"; November, 2003; <http://www.taxfoundation.org/sr125.pdf>

⁵ Background Paper, "State Business Tax Climate Index"; Scott A. Hodge, J. Scott Moody, M.A, Wendy P. Warcholik, Ph.D. May 2003 (p. 2) <http://www.taxfoundation.org/bp41.pdf>

⁶ William C. Dunkelberg and John Skorburg; How Rising Tax Burdens Can Produce Recession; February 21, 1991; <http://www.cato.org/pubs/pas/pa-148.html>

⁷ HB 3437, 78th Session, author: Rodriguez; <http://www.texastaxrelief.com/media/taxreform.pdf>; also, www.texastaxrelief.com

⁸ Texas Conservative Coalition Research Institute http://www.txccri.org/publications/TCCRI_School%20Finance%20Study_MQ_0401264.pdf

⁹ The Center for Public Policy Priorities, <http://www.cppp.org/who/index.html>

¹⁰ F. Scott McCown and Dick Lavine; "The Monster in the Closet – A State Income Tax" <http://www.cppp.org/products/media/op-eds/opdmonster.html>