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High Rates and Low Taxes

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<https://escholarship.org/uc/item/57v1j2pm>

Journal

UCLA School of Law Law & Economics, 28(2)

Author

Bank, Steven

Publication Date

2026-04-01

HIGH RATES AND LOW TAXES

BY

STEVEN A. BANK

PAUL HASTINGS PROFESSOR OF BUSINESS LAW

Introduction: *High Rates and Low Taxes: Tax Dodging in Mid-Century America* (Cambridge University Press 2026)

High Rates and Low Taxes

Tax Dodging in Mid-Century America

(Cambridge University Press 2026)

Steven A. Bank

Paul Hastings Professor of Business Law
University of California, Los Angeles School of Law

INTRODUCTION

“TAX DODGING” AND ITS EVOLUTION

In their book, *The Triumph of Injustice: How the Rich Dodge Taxes and How to Make Them Pay*, economists Emmanuel Saez and Gabriel Zucman lamented the retreat of the United States’ tax system from its heyday between the 1930s and 1970s when it was, in their words, “perhaps the most progressive in world history.”¹ As seen in Figure 1.1, the top rate shot up from 25 percent after World War I to more than 60 percent in the early 1930s and settled at the astronomically high rate of 91 percent for over a decade between 1951 and 1963. That turned out to be the high point for the top marginal rate. Over the next several decades it dropped to 70 percent, then 50 percent, and finally a low of 28 percent rate in the late 1980s. Although it has crept up since then, the top rate has never approached anything close to what it was at midcentury, remaining below 40 percent for the last four decades. Saez and Zucman and many others have called for a return to something approaching those high mid-century tax rates,² while others reject this nostalgia for a so-called “Golden Age” of taxation.³

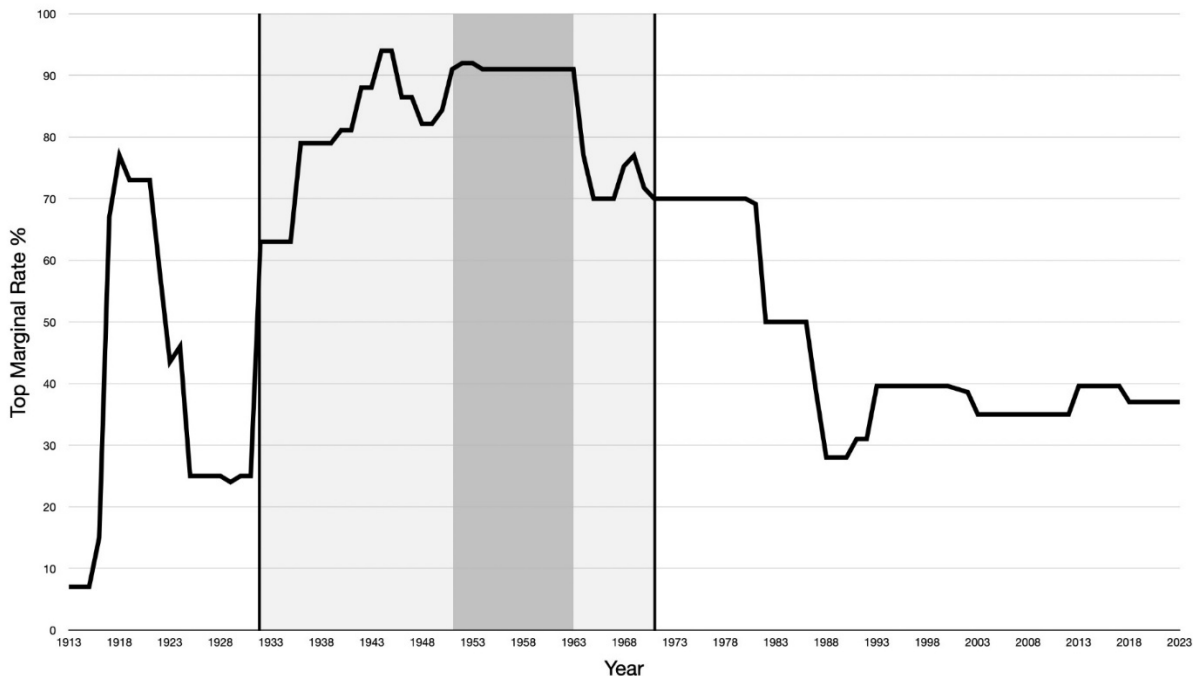
¹ EMMANUEL SAEZ AND GABRIEL ZUCMAN, *THE TRIUMPH OF INJUSTICE: HOW THE RICH DODGE TAXES AND HOW TO MAKE THEM PAY* 48 (2019).

² Most proponents of higher marginal rates do not call for a return to the 91 percent rate. Saez and Zucman suggest a top marginal rate “in the vicinity of 75%” that would amount to an effective rate of 60 percent on average for the top 1 percent. *Id.* at 134. See Thomas Piketty, Emmanuel Saez, and Stefanie Stantcheva, *Optimal Taxation of Labor Incomes: A Tale of Three Elasticities*, 6 AM. ECON. J. ECON POL’Y 230, 232 (2014) (recommending a top rate of over 80 percent); THOMAS PIKETTY, *CAPITAL IN THE TWENTY-FIRST CENTURY* 512 (2014) (same); Veronica Stracqualursi, *Ocasio-Cortez Suggests 70% Tax for Wealthy to Fund Climate Change Plan*, CNN, Jan. 4, 2019 (proposing a top rate as high as 60 to 70 percent on earnings over \$10 million). This call for a return to 1950’s era taxation is not new either. See, e.g., Ezra Klein, *A Rich Guy’s Case for Higher Taxes*, WASH. POST, April 16, 2012; Marc Linder, *I like Ike: Bringing Back Eisenhower-Era Progressive Taxation*, 67 TAX NOTES 833 (1995).

³ Arpit Gupta, *Revisiting the High Tax Rates of the 1950s*, 19 MANHATTAN INST. FOR POL’Y RESEARCH ISSUE BRIEF 1 (April 2013). See Lawrence Mone, *There’s No Going Back to the 1950s Tax System*, WALL ST. J., April 16, 2013; James Pethokoukis, *Why We Can’t Go Back to Sky-High, 1950s Tax Rates*, AEIdeas, April 18, 2012.

Figure 1.1⁴

Top Marginal Income Tax Rates, 1913-2023



Both proponents and critics of the mid-century rates acknowledge that taxpayers did not actually pay taxes at those high rates on all their income. Under our graduated rate income tax system, the marginal tax rates only apply to the dollars earned “at the margin,” or above the threshold at which that stated rate begins. A more important indicator of the tax burden is what is called the “effective rate.”⁵ This is the percentage of an individual’s annual income paid in taxes.⁶ It is essentially an average of all the graduated rates applied to the marginal increments of income earned from first to last dollar, after taking into account the effect of deductions, credits,

⁴ All rates are from Tax Policy Center, Historical Individual Income Tax Parameters, 1913-2023 (May 11, 2023). The top rate rose to 31 percent as part of George W. Bush’s infamous “Read My Lips” tax hike in 1990 and to 39.6 percent in 1993 before it was reduced to 35 percent in 2003. That rate cut expired in 2013, returning it to 39.6 percent, before it was dropped slightly to 37 percent under the Tax Cuts and Jobs Act in 2017. Id.

⁵ Reuven S. Avi-Yonah, *Book Review, Why Tax the Rich? Efficiency, Equity, and Progressive Taxation*, 111 YALE L. J. 1391, 1394 (2002) (reviewing DOES ATLAS SHRUG? THE ECONOMIC CONSEQUENCES OF TAXING THE RICH (Joel B. Slemrod, ed. 2000)).

⁶ Joseph J. Thorndike, *Soak-the-Rich Republicans? The Persistence of High Tax Rates in the 1950’s*, 66 TAX L. REV. 761, 762 (2013).

preferential capital gains tax rates and other methods of reducing, avoiding, or evading income taxes.⁷ It is no surprise, therefore, that the effective rates at midcentury were lower than the statutory rates.

Saez and Zucman argue that while “few people paid the 80%-90% top marginal income tax rates that prevailed from the 1930s through to the 1970s,” the “effective rates for the very affluent exceeded 50 percent.”⁸ Although it would be natural to assume that the gap between the statutory rate and the effective rate was at least in part because “tax dodging was out of control,” they claim that this was not the case.⁹ According to Saez and Zucman, “[President Franklin Delano] Roosevelt had pioneered, in the 1930s, the enforcement strategy that would keep tax evasion and avoidance under control for the decades that followed.”¹⁰ They conceded that “schemes to avoid taxes did regularly pop up,” such as to convert ordinary income to capital gains, but they maintained that such schemes “were quickly prohibited.”¹¹

Where it was not as easy to shut down avoidance maneuvers or evasion was more difficult to detect, Saez and Zucman believed that strong social norms prevented abusive tax transactions. They contend, for example, that “there is no evidence, in any contemporary chronicles of how company executives lived in the 1940s, 1950s, and 1960s,” that perks “such as company jets, lavish offices, gargantuan meals, ‘company’ seminars in Cape Cod or Aspen and so on . . . were particularly common or large.”¹² From this, they surmised that “spending lavishly using corporate money was simply not the socially accepted way for company executives to behave before the

⁷ Avi-Yonah, *supra* note 5, at 1394.

⁸ SAEZ AND ZUCMAN, *supra* note 1, at 48.

⁹ *Id.* at 49.

¹⁰ *Id.* at 48.

¹¹ *Id.* at 50.

¹² *Id.*

1980s.”¹³ Consequently, Saez and Zucman concluded that “tax dodging was kept in check” in mid-century America.¹⁴

This conclusion is controversial. Others have reported an effective rate that ranged between 20 and 30 percent, rather than 50 percent, by the end of the 1950s,¹⁵ although some of these studies are themselves contested.¹⁶ As Yale law professor Boris Bittker long ago pointed out, “there are . . . many different ways to compute effective tax rates, generating – despite occasional references to the ‘true’ or ‘actual’ rate – as many computations as there are commentators.”¹⁷ Nevertheless, at least one aspect of the differences in effective rate calculations in this case is readily apparent. Saez and Zucman took into account all taxes, including federal, state, and local income taxes, payroll taxes, estate taxes, corporate profits, property taxes, and sales taxes,¹⁸ while other studies have focused exclusively on income taxes.¹⁹ Moreover, some of these lower estimates of the effective rate include state and local income taxes, rather than just federal income taxes, and some include or omit capital gains, which means they over or understate the effective federal income tax burden.

¹³ Id.

¹⁴ Id. at 48.

¹⁵ W. Elliot Brownlee, *Historical Perspective on U.S. Tax Policy Toward the Rich*, in DOES ATLAS SHRUG? THE ECONOMIC CONSEQUENCES OF TAXING THE RICH 60, tbl. 2.5 (Joel B. Slemrod, ed. 2000) (while the effective rate on the top 1 percent was 58.6 percent in 1944, when the top marginal rate was 94 percent, it was between 25 and 32 percent throughout the 1950s and 1960s); William V. Williams, *The Changing Progressivity of the Federal Income Tax*, 17 NAT’L TAX J. 425 (1964) (effective rate on the top earners declined from 49.3 percent in 1954 to 27.2 percent by 1961); Erika York, *Income Taxes on the Top 0.1 Percent Weren’t Much Higher in the 1950s*, Tax Foundation, January 23, 2019 (effective income tax rate on the top .1 percent was 21 percent in the 1950s); Amity Shlaes, *1950s Tax Fantasy is a Republican Nightmare*, BLOOMBERG, Jan. 12, 2013 (studies show the effective rate for millionaires dropped from 49 percent in 1953 to 31 percent in 1960).

¹⁶ See Marc Linder, *Eisenhower-Era Marxist Confiscatory Taxation: Requiem for the Rhetoric of Rate Reduction for the Rich*, 70 TUL. L. REV. 905, 931 (1996) (critiquing Williams’ methodology).

¹⁷ Boris I. Bittker, *Effective Tax Rates: Fact or Fancy?* 122 U. PA. L. REV. 780, 782 (1974).

¹⁸ SAEZ AND ZUCMAN, *supra* note 1, at 41. Commentators also note that the authors assigned all the incidence of the corporate tax on shareholders and none on consumers or workers. See Edward N. Wolff, *Book Review of The Triumph of Injustice: How the Rich Dodge Taxes and How to Make Them Pay*, 18 J. ECON. INEQUALITY 441 (2020).

¹⁹ Brownlee, *Historical Perspectives on U.S. Tax Policy Toward the Rich*, *supra* note 15, at 60; Williams, *supra* note 15, at 426; York, *supra* note 15.

Nevertheless, this debate over effective rates is fundamentally not about tax dodging. Proponents of the return to mid-century tax rates contend that higher tax rates on the very affluent today could help to reduce that inequality, noting that inequality was lower when tax rates were at their highest.²⁰ Opponents respond that the link between tax rates and inequality is not clear, arguing that the high rates were eviscerated by tax dodging,²¹ while proponents insist that the wealthy were still subject to a tax burden during this period that reduced the incentives to seek or demand high compensation, which in turn allowed for a wider distribution of “the fruits of growth.”²² That has led people to take more interest in mid-century tax dodging, but mostly to either support or refute the response to calls for a return to something closer to the period’s high rates on the very affluent,²³ rather than to understand how it operated on a societal level across income groups. Studies that focus on the top 1 percent overlook the way that tax dodging became entrenched as a cultural, mass market, phenomenon during this period, even before the much-discussed boom in tax shelters in the 1970s and early 1980s.²⁴

This book fills in the gap in the literature by offering both a bird’s eye and ground-level view of tax dodging in mid-century America. Far from being an era of vigorous tax enforcement

²⁰ See, e.g., PIKETTY, *CAPITAL IN THE TWENTY-FIRST CENTURY*, *supra* note 2, at 493 (“the progressive income tax . . . played a key role in the reduction of inequality in the last century.”).

²¹ Scott Greenberg, *Tax Rates on the Rich Were Not That Much Higher in the 1950s*, TAX FOUNDATION BLOG, Aug. 4, 2017; James Pethokoukis, *Why We Can’t Go Back to Sky-High, 1950s Tax Rates*, AEI IDEAS BLOG, April 18, 2012; Phillip Magness, *The Progressive Tax Myth*, U.S. NEWS & WORLD REPORT, Oct. 31, 2017. Some proponents also suggest that the rich did not pay that much in income taxes during the 1950s. Nathan Newman, *Give us AOC’s 70% Tax Rates – But Save the 1950s Nostalgia*, JACOBIN, Oct 7, 2019.

²² PIKETTY, *CAPITAL IN THE TWENTY-FIRST CENTURY*, *supra* note 2, at 513. Proponents also contend the rich of the 1950s were simply not as rich as they are today, which makes it an inapt comparison for the relative burden on the wealthy. Marshall Steinbaum, *Effective Progressive Tax Rates in the 1950s*, ROOSEVELT INSTITUTE BLOG, Aug. 8, 2017.

²³ See Joseph J. Thorndike, *Playing Fast and Loose with Lessons from the 1950s*, TAX NOTES, March 25, 2013 (citing a debate between Timothy Noah in the *New Republic* and David Brooks in the *New York Times* over effective rates during the 1950s).

²⁴ For examples of work focusing on the rise and fall of the tax shelter industry in the 1970s and 1980s, see JEFFREY H. BIRNBAUM AND ALAN S. MURRAY, *SHOWDOWN AT GUCCI GULCH: LAWMAKERS, LOBBYISTS, AND THE UNLIKELY TRIUMPH OF TAX REFORM* (1987), as well as in the 1990s and beyond, see DAVID CAY JOHNSTON, *PERFECTLY LEGAL: THE COVERT CAMPAIGN TO RIG OUR TAX SYSTEM TO BENEFIT THE SUPER RICH – AND CHEAT EVERYBODY ELSE* (2003).

and rigid social norms in favor of paying taxes, the 1950s and 1960s were the golden age of tax dodging in the United States. During this period, despite attempts to crackdown on abuse, celebrities pioneered or popularized a variety of tax dodging schemes, corporations structured compensation packages to allow executives to reduce their income tax burden and lobbied for new provisions that enabled them to do this more successfully, and countries such as Switzerland, Lichtenstein, the Bahamas, and the Netherlands Antilles ran advertisements in American newspapers and magazines that boasted not of their magisterial ski slopes or beautiful beaches, but of their attractive tax laws for U.S. businesses and individuals. These all served to publicize, normalize, and legitimize tax dodging, which set the stage for its democratization. Lawyers, accountants, and tax preparers entered into the tax planning business after World War II to serve individuals who previously had not even been subject to income taxes, experts published how-to tax avoidance books promising to deliver information to the ordinary man on “how the ‘insiders’ get rich on tax-wise” investment deals, advertisements for tax shelters started to appear in the most prominent newspapers across the country, and tax dodging tools such as deferred compensation, fringe benefits, and expense accounts spread beyond executives to the salesman and middle-level employees of the American suburb. Quite simply, during the 1950s and 1960s, tax dodging was brazenly public, sometimes outlandish, and often explicitly or implicitly condoned by politicians.

A Pre-History

Tax dodging was not unique to midcentury America; indeed, it is as old as taxation itself. The Roman Empire famously was plagued with tax avoidance, especially at the time of its fall.²⁵

²⁵ JAMES WILLIAM ERMATINGER, *THE DECLINE AND FALL OF THE ROMAN EMPIRE* 69 (2004); JAMES J. O'DONNELL, *THE RUIN OF THE ROMAN EMPIRE* 68 (2009); Amanda Foreman, *Tax Evasion's Bite: From the Ancient World to Modern Days*, WALL ST. J. ONLINE, Sept. 23, 2015. The playwright Bernard Shaw was reported to have said that “the power of Julius Caesar was really based on his effectiveness as a tax-collector. In its later days the empire

According to one account, “many wealthy Romans buried their jewelry or stock of gold coin” to evade the tax collector and “it was largely to avoid taxation that in the late empire all but a few merchants and bankers stopped keeping accounts.”²⁶ In Egypt during Roman rule, it was so common to evade taxes by simply fleeing your village that there was a procedure for announcing it and keeping records of the tax fugitives.²⁷ Similarly, in Japan during the Heian Period around the 12th century, the imperial court went bankrupt because tax exemptions granted to Heian Nobles had removed most of the taxable land from the rolls.²⁸ In the twentieth century, Switzerland’s banks rose to become a center of tax evasion for wealthy individuals seeking to hide their assets in the period immediately following World War I.²⁹ Assets held in Swiss financial institutions by non-Swiss residents rose tenfold between 1920 and 1938.³⁰ Not surprisingly, this rise is attributed mainly to taxes, with the most significant jumps following years of tax rate increases in neighboring France.³¹ Britain’s Inland Revenue faced a similar problem around this time, with one source calling the period from 1922 to 1936 “halcyon days for the tax avoider.”³²

American taxpayers were no less motivated to avoid taxes. In the nineteenth century, before the modern income tax even existed, property tax evasion was rampant, particularly with

could not find men to discharge this hated duty.” Robert B. House, *The Historical Background of the Tax Question*, in STUDIES IN TAXATION: NORTH CAROLINA YEARBOOK, 1927-1928 9 (1928).

²⁶ CAROLYN WEBBER & AARON WILDAVSKY, A HISTORY OF TAXATION AND EXPENDITURE IN THE WESTERN WORLD 141 (1986). This method of tax dodging pre-dated the Roman Empire. See *Tax-Dodging No Modern Discovery, False-Bottomed Silo at Mizpah Shows*, CHRISTIAN SCIENCE MONITOR, May 23, 1929, at 1 (describing the archeological finding in an area from the early Iron Age between 1200 and 800 B.C. of a compartment with a false bottom that was apparently “intended to evade income tax collectors.”).

²⁷ Kerstin Droß-Krüpe, *Not Paying Taxes in Roman Egypt*, in HISTORIES OF TAX EVASION, AVOIDANCE, AND RESISTANCE 71, 76-77 (Korinna Schönhärl, Gisela Hürlimann and Dorothea Rohde, eds., 2023).

²⁸ Foreman, *supra* note 25.

²⁹ GABRIEL ZUCMAN, THE HIDDEN WEALTH OF NATIONS 8-9 (2015).

³⁰ *Id.* at 14.

³¹ *Id.* at 15, 17.

³² David Stopforth, *1922-36: Halcyon Days for the Tax Avoider*, BRITISH TAX REV. 88 (1992).

the rise of intangible property like stocks and bonds.³³ In one year, although the total value of taxable securities listed on the San Francisco Exchange was estimated to be more than \$110 million, only \$5000 worth of these assets were reported on tax returns.³⁴ In Massachusetts, when assessors started to crack down on underreporting, a quarter of the value of the state's intangible wealth disappeared from Boston, only to reappear in a few neighboring towns with taxpayer-friendly assessors.³⁵ The situation was no better at the federal level under the Civil War-era income tax. In 1863, revenues were approximately \$50 million below projections and part of the shortfall was attributed to the fact that so many people “shirk their duty in making their payments,”³⁶ through a combination of what tax historian Joseph Thorndike described as “outright evasion [and] chiseling around the edges,” plus the Bureau of Internal Revenue “let[ing] them get away with it.”³⁷

Corporations also took pains to avoid taxes on their assets. The New York Central Railroad, owned and run by Cornelius Vanderbilt, claimed to have capital of \$143 million on its balance sheet, but only paid tax on \$22 million of it by treating its debt as diminishing the value of its capital stock and then deducting the debt again from the diminished valuation, all in violation of New York judicial decisions that barred the practice.³⁸ Similarly, the Western Union Telegraph Company, by claiming that its wires and telegraph poles were not taxable as real estate, paid taxes on capital of \$1.8 million despite distributing dividends on capital of \$47 million.³⁹ These were

³³ STEVEN A. BANK, *FROM SWORD TO SHIELD: THE TRANSFORMATION OF THE CORPORATE INCOME TAX, 1861 TO PRESENT* 30-31 (2010); HENRY CARTER ADAMS, *THE SCIENCE OF FINANCE: AN INVESTIGATION OF PUBLIC EXPENDITURES AND PUBLIC REVENUES* 382 (1898).

³⁴ CLIFTON K. YEARLEY, *THE MONEY MACHINES: THE BREAKDOWN AND REFORM OF GOVERNMENTAL AND PARTY FINANCE IN THE NORTH, 1860-1920* 58 (1970).

³⁵ *Id.* at 48-49.

³⁶ Joseph J. Thorndike, *The Civil War Income Tax was Failing. Could a Crackdown on Cheats Save It?* 183 *TAX NOTES* 1521, 1523 (2024) (quoting an opinion piece in *Scientific American* dated Jan. 9, 1864).

³⁷ *Id.* at 1522.

³⁸ *Id.* at 62.

³⁹ JAMES H. COLEMAN, *LETTERS & C ON CORPORATIONS AND TAXATION* 9 (n.d.; approx.. 1880).

not isolated examples. “[C]rooked accounts, dishonest bonding, under-assessment, phony indebtedness, the juggling of domiciles, collusion with public officials, or bribing them were all part of the arsenal of corporate tax dodgers.”⁴⁰

Tax dodging continued under the income tax in the 1920s and 1930s. In September 1923, Representative William R. Green, a Republican from Iowa who was Chair of the House Ways and Means Committee, complained in an address before the National Tax Association that “so much ingenuity has been used in inventing methods whereby less taxes would be paid.”⁴¹ Much of it, however, often involved maneuvers that were fully, or at least technically, legal. Populist journalist Ferdinand Lundberg grudgingly conceded this point, while only thinly disguising his outrage: “Various ways were discovered by the rich for evading these taxes. One method was to invest in tax-exempt government securities. . . . Other ways of evading taxes were to invest money abroad; to declare stock dividends and transfer cash earnings to surplus to be held against a day of low taxes for distribution; to build unnecessary plants, hotels, and office buildings; to pay inordinately high salaries to corporation officials; and to resort to technically legal subterfuges such as personal holding companies.”⁴²

Some of these examples of tax dodging probably sound uncontroversial to the modern reader,⁴³ but during the 1920s, they were a frequent source of criticism.⁴⁴ For example, tax-exempt securities were characterized as “the foremost and most immediate of all American governmental

⁴⁰ YEARLEY, *supra* note 34, at 32.

⁴¹ W.R. Green, *Problems of National Taxation*, 2 NAT’L INCOME TAX MAG. 5 (1924).

⁴² FERDINAND LUNDBERG, AMERICA’S 60 FAMILIES 165 (1937).

⁴³ One notable exception is executive compensation. *See, e.g.*, Alan Rappeport, *Biden Calls for Higher Tax on Corporations and the Wealthy*, N.Y. TIMES, March 11, 2024 (proposal to deny deductions for all employee compensation by corporations in excess of \$1 million); “*Outrageous*” CEO Pay Targeted in New Bill from Bernie Sanders, *US Democrats*, REUTERS, Jan. 22, 2024 (proposal to increase a corporation’s tax rate when its CEO-to-worker pay ratio exceeded 50 to 1).

⁴⁴ *Tax Dodging Easy for Rich, Impossible for Poor*, AUSTIN AMERICAN, Oct. 18, 1925, at SM11 (identifying three methods of tax dodging “all sanctioned by law”: Tax-exempt securities, stock dividends, and retained earnings).

problems” because they served as “a refuge for large investors who seek to avoid taxation.”⁴⁵ In the early 1920s, Treasury Secretary Andrew Mellon called for a constitutional amendment requiring the taxation of income from state and municipal securities and Congress even considered legislation to that effect.⁴⁶ Similarly, although the Supreme Court held that stock dividends were non-taxable in 1920,⁴⁷ critics still insisted that “there is something crooked about them, that the surpluses created and thus distributed, or redistributed, in capital, or paper evidences of capital, are a device whereby the rich man is dodging taxes”⁴⁸ Senator Smith W. Brookhart, a Progressive Republican from Iowa, announced his intention to submit a bill “to make stock dividends taxable or curtail their issuance for alleged tax-dodging purposes.”⁴⁹

These political reactions merely mirrored the public intolerance at the time for all forms of tax dodging, legitimate or otherwise. As John Sears, the author of the practitioner treatise, *Minimizing Taxes*,⁵⁰ remarked in a 1921 article, “in the public mind, methods of tax reduction, saving or avoidance are often said to be confused with tax ‘evasion’ or tax ‘dodging’ and to all methods of tax saving is often imputed a moral guilt, if not a legal risk and liability.”⁵¹ In reviewing Sears’ treatise in 1923, University of Minnesota law professor Henry Rottschaefer wrote that there is a “widespread popular sentiment that the skilled tax lawyer is engaged in a reprehensible

⁴⁵ William Hand, *Tax Exempt Bonds Called Nation’s Foremost Problem*, WASH. POST, Feb. 12, 1923, at 4; *Tax Dodging Denied in Municipal Bonds*, N.Y. TIMES, March 17, 1928, at 27; Roy G. and Gladys C. Blakey, *Federal Tax Legislation, 1939*, 29 AM. ECON. REV. 695, 698 (1939).

⁴⁶ *Tax Dodging Check Sought by Cutting Rates on Surtaxes*, CHRISTIAN SCIENCE MONITOR, Dec. 6, 1922, at 1.

⁴⁷ *Eisner v. Macomber*, 252 U.S. 189, 219 (1920).

⁴⁸ Editorial, *Stock Dividends and Tax-Dodging*, BARRON’S, Dec. 25, 1922, at 9. See *Mellon Upholds Oil Stock Melon*, COURIER JOURNAL (Louisville), Oct. 21, 1922, at 3 (Mellon denied charges that Treasury had been lax in enforcing the tax laws by not going after Standard Oil Company of New Jersey for issuing a 400 per cent stock dividend.); See *Tax Dodging Strategy in Standard Oil Companies’ Extensive Stock Dividends*, INDIANAPOLIS STAR, Oct. 18, 1922, at 1 (reporting letter Representative Frear of Wisconsin sent to Mellon calling attention to the dividend as a tax avoidance tactic).

⁴⁹ *Plans Bill to Tax Stock Dividends*, THE SUN (Baltimore), Jan. 6, 1923, at 2.

⁵⁰ JOHN H. SEARS, *MINIMIZING TAXES* 1922.

⁵¹ John H. Sears, *Effective and Lawful Avoidance of Taxes*, 8 VA. L. REV. 77 (1921).

business,” noting that the title of Sears’ book served as “the final proof of the correctness of their position.”⁵²

By the 1930s, with most people scarred by the Crash of 1929 and weary of the Great Depression, the public had little patience for wealthy people who found ways to reduce their taxes, even if legal. This was never more evident than in 1933 when the Senate Finance Committee on Banking and Currency, led by its chief counsel Ferdinand Pecora, held hearings on the causes of the stock market crash.⁵³ In the course of these hearings, the public learned that financier J.P. Morgan and his partners had paid no income tax during the height of the Great Depression in 1931 and 1932.⁵⁴ As historian Joseph Thorndike recounted, “it was a stunning revelation, at least to the popular press. How could this giant of American wealth escape the income tax?”⁵⁵ Morgan was not alone either. It was disclosed that Otto Kahn of the investment firm Kuhn Loeb and Company, which was second only to the House of Morgan among American private banks, paid no income tax between 1930 and 1932.⁵⁶

It made little difference that Morgan, Kahn, and other financiers had paid no income tax because their losses in the stock market in the 1920s had wiped out any income from the early 1930s.⁵⁷ “That point seemed lost on many reporters and lawmakers – not to mention the general public.”⁵⁸ As one observer noted in the aftermath of the Pecora hearings, “it is difficult to consider the question of tax avoidance without immediately encountering the moral issue. This is

⁵² Henry Rottschaefer, *Review: Minimizing Taxes by John H. Sears*, 21 MICH. L. REV. 719 (1923).

⁵³ Stock Exchange Practices, Hearings Before the Sen. Comm. On Banking and Currency on S. Res. 84, 73rd Cong., 1st Sess. 3219-2235 (1933).

⁵⁴ FERDINAND PECORA, WALL STREET UNDER OATH 190 (1939).

⁵⁵ JOSEPH J. THORNDIKE, THEIR FAIR SHARE: TAXING THE RICH IN THE AGE OF FDR 85 (2013).

⁵⁶ PECORA, *supra* note 54, at 190; Theresa M. Collins, *Introducing Otto H. Kahn (1867-1934)*, 28 BUS. AND ECON. HIST. 13 (1999).

⁵⁷ THORNDIKE, THEIR FAIR SHARE, *supra* note 55, at 86.

⁵⁸ *Id.*

particularly so because of the recent Congressional investigations into the incomes and tax payments of large financial houses.”⁵⁹

Thus, in 1934, Judge Learned Hand was trying to counter the bias against legal tax planning when he wrote his famous declaration in the *Gregory* case that “[a]ny one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury, there is not even a patriotic duty to increase one's taxes.”⁶⁰ There was also, as Professor Daniel Shavero later observed, a “curious dual quality” to Hand’s opinion in the case, with fellow Professor Assaf Likhovski agreeing that “it contained contradictory messages.”⁶¹ It was a seemingly pro-taxpayer statement in the context of a decision that sided with the government and found that literal compliance with the words of the statute providing for tax-free treatment of a reorganization of a company was insufficient “even though the facts answer the dictionary definitions of each term under in the statutory definition.”⁶² Thus, Hand recognized that the transaction literally complied with the statute, but still rejected it as violating the spirit of the law, concluding “[t]o dodge the shareholders’ taxes is not one of the transactions contemplated as corporate ‘reorganizations.’”⁶³ In part, this was to address a split among the judges on the three-judge panel deciding the case, which ended up swaying a literalist judge to eventually join the

⁵⁹ George T. Altman, *Recent Developments in Income Tax Avoidance*, 29 ILL. L. REV. 154 (1934).

⁶⁰ *Helvering v. Gregory*, 69 F.2d 809, 810 (2d. Cir. 1934). Both the decision, and Judge Hand’s aphorism in support of tax planning, were affirmed by the Supreme Court. *Gregory v. Helvering* 293 U.S. 465, 469 (1935) (“The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted.”). Hand was not the originator of this aphorism, nor was the *Gregory* case. See, e.g., Oscar W. Underwood, Jr., *Form and Substance in Tax Cases*, 16 VA. L. REV. 327, 329 (1930) (“It is now, and in fact has been for a long time, well settled that every taxpayer has a right, so long as he abstains from fraudulent or deceptive means, to so order his affairs that the least possible amount in taxes will fall upon him,” citing *United States v. Isham*, 84 U.S. 496, 506 (1873) and *Weeks v. Sibley*, 269 F. 155 (N.D. Tex. 1920)).

⁶¹ Daniel Shavero, *The Story of Knetsch: Judicial Doctrines Combating Tax Avoidance* in TAX STORIES 313, 321 (Paul Caron, ed., 2003); Assaf Likhovski, *The Story of Gregory: How are Tax Avoidance Cases Decided?* in BUSINESS TAX STORIES 89, 96 (Steven A. Bank & Kirk J. Stark, eds, 2005).

⁶² *Gregory*, 69 F.2d at 810.

⁶³ *Id.* at 811.

views of the majority.⁶⁴ In part, however, Judge Hand's line-drawing was to address a larger split between the professional legal literature and the political and cultural attitudes towards tax planning.⁶⁵

Lawyers and tax administrators had been trying to draw this avoidance/evasion line since the income tax was first enacted,⁶⁶ but it became a preoccupation of legal scholars in the 1920s and 1930s.⁶⁷ In 1921, Sears published a piece in the *Virginia Law Review* "to point out fundamental differences between methods of avoiding or reducing taxes which may safely be regarded as effective and lawful as distinguished from forbidden evasion."⁶⁸ In his treatise on the subject, Sears contended that "the term 'avoidance' of taxes is used to described some lawful action aimed to affect *taxability in the future*, as distinguished from 'evasion,' which refers to some fraud upon the revenue, past, present, or future."⁶⁹ This definition, of course, still left one to wonder what was "lawful" and what was "fraud." At least in the 1920s, both courts and scholars resolved that question by resorting to formalism and literalism.⁷⁰

Evasion was typically described as an activity that was fully illegal, such as failing to file tax returns or hiding income and assets from the tax authorities. One 1920s tax practitioner offered the example of someone who purchased bonds for investment, but who did not disclose them to the property tax collector when asked to do so.⁷¹ As Randolph Paul, the namesake of the New York law firm of Paul, Weiss, Rifkind, Wharton & Garrison and a Treasury official in the late

⁶⁴ Likhovski, *supra* note 61, at 95-96.

⁶⁵ *Id.* at 110-13, 115-20.

⁶⁶ Marvin A. Chirelstein, *Learned Hand's Contribution to the Law of Tax Avoidance*, 77 YALE L.J. 440 (1968). As far back as 1873, the Supreme Court had said, in the context of the Stamp Act of 1864, that as long as "it is not perceived that the practice is open to the charge of fraud . . . a person has the legal right . . . to avoid the tax." *United States v. Isham*, 84 U.S. 496, 506 (1873).

⁶⁷ Likhovski, *supra* note 61, at 111.

⁶⁸ Sears, *Effective and Lawful Avoidance of Taxes*, *supra* note 51, at 77.

⁶⁹ SEARS, MINIMIZING TAXES, *supra* note 50, at 2.

⁷⁰ Likhovski, *supra* note xx, at 106.

⁷¹ James L. Dohr, *Avoidance vs. Evasion of Tax Liability*, 6 NAT'L INCOME TAX MAG. 370 (1928).

1930s and 1940s, emphasized in his *Restatement of Tax Avoidance*, evasion typically has “elements of deceit, if not fraud, more specifically, if there is evasion, there will be subterfuge, camouflage, concealment, some attempt to color or obscure event, or to make things seem other than they are.”⁷²

Avoidance, by contrast, did not involve concealment or misrepresentation under these interpretations.⁷³ Sears called tax avoidance a “legally innocent method of saving,” even if not everyone agreed that it was morally innocent. In its more controversial form, it may not have involved deceit, but it often involved employing aggressive techniques in which rules were bent and twisted beyond the intentions of the drafters of the original provisions. Since these techniques generally complied with the literal language of the statute, observers tended to characterize them as “loopholes.” One oft-cited instance of this was the so-called “incorporated pocketbook,” in which an individual formed a corporation and contributed his stocks, bonds, and income-producing assets to the corporation in exchange for all of its stock.⁷⁴ The objective was to shield his personal investment income from the high marginal rates applicable to individuals by taking advantage of the lower corporate tax rate that was meant to be an aid to businesses.⁷⁵ Sometimes, however, the term “loophole” may have been thrown around a bit too liberally. For example, one observer argued that the existence of the preferential tax rate on capital gains was a loophole because it

⁷² Randolph E. Paul, *Restatement of Tax Avoidance*, in STUDIES IN FEDERAL TAXATION 9, 16-17 (1937).

⁷³ Id. at 17.

⁷⁴ Samuel Joyce Sherman, *Taxation of Corporations Used to Avoid Taxes Upon Stockholders, Part I*, 13 TAX MAG. 19 (1935); Randolph E. Paul, *Motive and Intent in Tax Law*, 1 PSYCHIATRY 169, 172 (1938). In 1913, even before the term “incorporated pocketbook” came into existence, some argued that the separate corporate tax rate was itself a loophole because Congress did not anticipate that wealthy stockholders like John D. Rockefeller and Andrew Carnegie would “escape” the graduated rates that were supposed to reach their “swollen incomes” simply because the surtax rates only applied if corporate profits were distributed to these stockholders as dividends. *Find Rich Need Not Pay Any Income Tax*, N.Y. TRIB., April 29, 1913, at 4.

⁷⁵ Id. at 19-20.

appeared to have created the over-expansion of the 1920s, which Congress surely could not have intended.⁷⁶

In its less controversial form, sometimes considered a different category altogether called tax planning, tax avoidance involved choosing to take advantage of available tax benefits as a means of minimizing one's taxes. For example, Sears characterized a change of domicile to a new place to avoid the taxes of the old residence, as long as the move actually occurred, as tax avoidance whether undertaken by an individual or a business such as a corporation.⁷⁷ Similarly, purchasing tax-exempt municipal bonds, rather than taxable bonds, was sometimes described as a method of avoiding taxes. Many considered it fully appropriate because it was by design in the statute.⁷⁸ Indeed, the *Wall Street Journal*, using tax-exempt securities as an example, defined tax avoidance as "the acceptance of an invitation extended by the Federal Government, the states, and the municipalities, in the form of enacted statutes, to the taxpayer to reduce his tax liability under the law."⁷⁹ As we have already seen, though, many disagreed that this was any less morally reprehensible than other forms of tax avoidance, expressing loud disagreement with the policy underlying it,⁸⁰ especially when it was used by wealthy individuals.⁸¹

Some used these legalistic distinctions to counter the moral outrage about tax dodging. Sears, for example, argued that "tax avoidance is right morally; that it is right for the tax payer to 'get away with whatever he can', barring misrepresentation and concealment" since by doing so this "tends to make fair what legislators have made unfair" and helps to "make manifest errors in

⁷⁶ F.I. Raymond, *The Capital Gains Loophole*, 10 TAX MAG. 373, 373-74 (1932).

⁷⁷ SEARS, MINIMIZING TAXES, *supra* note 50, at 5-14.

⁷⁸ Dohr, *supra* note 71, at 370.

⁷⁹ Editorial, *Evasion vs. Avoidance*, WALL ST. J., Aug. 2, 1935, at 4.

⁸⁰ See *supra* text accompany notes 42-47.

⁸¹ See, e.g., Charles L.B. Lowndes, *Taxing the Income from Tax-Exempt Securities*, 32 ILL. L. REV. 643, 644 (1938) ("The exemption of interest from governmental obligations from the income tax clearly frustrates the ability-to-pay principle by allocating tax-exempt income to the maximum brackets of the tax.").

tax legislation which should be corrected.”⁸² Harvard law professor John MacArthur Maguire and his student Philip Zimet explained that this “school of practice” believed that in light of the “professionally entrancing thicket of accounting methods, varying rates, challenged interpretations, constitutional controversies, administrative technicalities, etc.” that were operating in “the tax jungle,” taxpayers were essentially free to act in accordance with the literal language of the statute until the legislature changed the law.⁸³ As George Altman, a lawyer and accountant who was a lecturer in law at Northwestern, concluded, “if the government is not to be restrained by any moral aspects of taxation, why look to the taxpayer for salvation?”⁸⁴

These legalistic line-drawing efforts did not seem to have much effect on actual practice or attitudes. *New York Times* reporter Godfrey Nelson observed that “in general tax parlance . . . the terms ‘tax avoidance’ and ‘tax evasion’ have almost come to be regarded as synonymous.”⁸⁵ A 1934 Treasury petition before the Board of Tax Appeals illustrated this, alleging that former Treasury Secretary Andrew Mellon engaged in “fictitious” stock sales in a “comprehensive scheme of tax evasion and avoidance.”⁸⁶ Trying to draw a sharp line between legal tax planning or avoidance and tax evasion may have even backfired, emboldening tax dodgers to push the line, without convincing critics to back off. By 1937, Randolph Paul lamented that “[s]ome taxpayers have reached the point of believing that tax avoidance is one of their inherent rights.”⁸⁷

⁸² Sears, *Effective and Lawful Avoidance of Taxes*, *supra* note 51, at 79.

⁸³ John MacArthur Maguire and Philip Zimet, *Hobson’s Choice and Similar Practices in Federal Taxation*, 48 HARV. L. REV. 1281, 1283 (1935).

⁸⁴ Altman, *supra* note 59, at 156.

⁸⁵ Godfrey N. Nelson, *Rigid Law in View for Income Taxes*, N.Y. TIMES, Jan. 14, 1934, at N7.

⁸⁶ *Treasury Files New Petition in Mellon Tax Case*, ST. LOUIS POST-DISPATCH, Sept. 16, 1934, at 1. A previous tax evasion case filed against Mellon in the spring of 1934 on a different set of facts had been rejected by a grand jury and the Board of Tax Appeals in the new case eventually found him innocent of any fraud, although it did impose liability for other errors in his taxes. W. ELLIOT BROWNLEE, *FEDERAL TAXATION IN AMERICA: A HISTORY* 131 (3rd ed. 2016).

⁸⁷ PAUL, *supra* note 72, at 76-77.

Perhaps inspired by past populist attempts to go after tax dodging,⁸⁸ or for political reasons,⁸⁹ President Franklin Delano Roosevelt's appealed to the popular distaste for tax avoidance and evasion by going after both in his 1937 tax message to Congress. Roosevelt explained that a study of 1936 income tax returns prepared by the Treasury Department "reveals efforts at avoidance and evasion of tax liability, so widespread and so amazing both in their boldness and their ingenuity, that further action without delay seems imperative."⁹⁰ Roosevelt noted that some of these efforts "have the color of legality; others are on the borderline of legality, others are plainly contrary even to the letter of the law," but "all are alike in that they are definitely contrary to the spirit of the law."⁹¹

Roosevelt couched his proposal in moralistic terms, calling these schemes "unethical" and "evil."⁹² He urged Congress to ignore "efforts to befog the issue" such as by those claiming what they are doing is technically legal or are justified because they do not approve of the high income tax rates.⁹³ As public finance economists Roy and Gladys Blakey commented, "the President . . . appears unwilling to distinguish between the moralities of tax evasion and those of tax avoidance, although the legitimacy of avoidance has been recognized by the courts."⁹⁴ Perhaps to emphasize his disdain for the legalistic line-drawing exercises, Roosevelt joked in a subsequent press

⁸⁸ During his run for President as an independent candidate in 1924, Senator Robert La Follette had promised to begin "cleaning up the wide-spread tax dodging which has been permitted by democratic and republican administrations." *"Independent Bloc" to Demand Senate Probe of Income taxes Paid by Multimillionaires*, ATL. CONST., Oct. 26, 1924, at 9.

⁸⁹ Some suggest that Roosevelt's decision to target tax avoidance was because he did not want to break a promise he had made to not increase income tax rates, Roy G. Blakey and Gladys C. Blakey, *The Revenue Act of 1937*, 27 AM. ECON. REV. 698 (1937), while others accused him of using it to go after political enemies. Westbrook Pegler, *Fair Enough: Tax Avoidance*, WASH. POST, Sept. 22, 1937, at 9.

⁹⁰ Franklin D. Roosevelt, *Message to Congress on Tax Evasion Prevention*, June 1, 1937.

⁹¹ Id.

⁹² Id.

⁹³ Id.

⁹⁴ Blakey and Blakey, *The Revenue Act of 1937*, *supra* note 89, at 703. See J. Blake Lowe and John D. Wright, *Tax Avoidance versus Tax Evasion*, BARRON'S, Aug. 20, 1937, at 20 ("In the recent congressional tax inquiry, the words 'tax avoidance' and 'tax evasion' were used both loosely and interchangeably.").

conference that “tax evasion becomes tax avoidance when a wealthy man hires a \$250,000 lawyer to change the word evasion to the word avoidance.”⁹⁵ He sought to capitalize on the populist sentiments against all forms of tax dodging, rather than toe the line drawn by Judge Hand and others.

Not surprisingly, none of the fine legal distinctions made in academic, judicial, and professional circles had seeped into the popular and political discourse that Roosevelt’s proposals ignited.⁹⁶ Raymond Moley, one of the architects of the New Deal who became an opponent by the end of the Great Depression, wrote that “the public cares little about the legal distinction between ‘evasion’ and ‘avoidance’: to the country as a whole a tax dodger is a tax dodger.”⁹⁷ In 1938, tax lawyer Montgomery B. Angell of New York City observed that “public outcry has been raised against ‘evaders and avoiders,’ with no distinction between the two.”⁹⁸ As Lucius Buck, a Special Assistant to the Attorney-General, remarked, “the terms evasion and avoidance are in general lay use and are generally listed as synonymous ones, even in law dictionaries,” so it hardly should have been a surprise that they were used interchangeably in the media and in popular discussions.⁹⁹ Public sentiment against all forms of tax dodging was so charged that it led one tax practitioner to ask, in light of President Roosevelt’s message and the ensuing legislative activity leading up to the adoption of the Revenue Act of 1937, “is it ethical for an attorney to advise a client to take all legal means necessary to avoid the payment of a tax?”¹⁰⁰

⁹⁵ Charles A. Beard, *The New Deal’s Rough Road*, 42 CURRENT HISTORY 625, 626 (1935).

⁹⁶ There were a few exceptions, but they did not seem to do much to counter Roosevelt’s proposals. See, e.g., David Lawrence, *Tax Avoidance Strictly Legal*, ARIZONA REPUBLIC, June 4, 1937, at 1 (“Mr. Roosevelt has introduced the novel theory that the courts of the United States must, in effect, draw no distinction between tax avoidance and tax evasion. He calls both unethical and contrary to the spirit of the law.”).

⁹⁷ Raymond Moley, *The Fine Art of Avoidance*, NEWSWEEK, June 12, 1937, at 44.

⁹⁸ Montgomery B. Angell, *Tax Evasion and Tax Avoidance*, 38 COLUM. L. REV. 80 (1938).

⁹⁹ Lucius A. Buck, *Income Tax Evasion and Avoidance: Some General Considerations*, 25 GEO. L.J. 863, 865 (1937).

¹⁰⁰ William Cogger, *Tax Avoidance v. Tax Evasion*, 15 TAX MAG. 518 (1937).

Despite the best efforts of Judge Hand and others,¹⁰¹ the distinction between avoidance and evasion had become “increasingly blurred.”¹⁰² In 1940, tax lawyer and NYU professor Harry Rudick noted, “for those who prefer to continue the logomachy, the distinction may be cynically but practically expressed in the remark that avoidance is merely successful evasion and evasion is unsuccessful avoidance.”¹⁰³ Randolph Paul had offered a similarly “pragmatic” definition a few years earlier – “avoidance being what *works*, and evasion being what *fails*” – although he still sought in vain to define the two terms so as to offer a “clear cut” distinction.¹⁰⁴

By the 1950s, even if many lawyers and judges still insisted that a bright line could be drawn between evasion and avoidance or planning,¹⁰⁵ popular opinion was no longer as clear about the immorality of either. Not only were “the terms . . . generally indistinguishable in the minds and conversations of laymen and only vaguely differentiable by lawyers,”¹⁰⁶ but the public’s Depression-era resistance to all forms of tax minimization had started to melt away. Most people likely did not openly embrace it, but there was a growing ambivalence about tax dodging. For many people, curiosity replaced shock and envy replaced outrage.

Why did Popular Opinion Shift?

¹⁰¹ See, e.g., *Commissioner v. Newman*, 159 F.2d 848, 850-51 (2d Cir. 1947) (Judge Hand, in dissent, wrote “[o]ver and over again courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant.”).

¹⁰² Harry J. Rudick, *The Problem of Personal Income Tax Avoidance*, 7 L. & CONTEMP. PROBS. 243, 245, n.10 (1940).

¹⁰³ Id.

¹⁰⁴ Paul, *Restatement of Tax Avoidance*, in STUDIES IN FEDERAL TAXATION 9, 14 (1937).

¹⁰⁵ See, e.g., SYDNEY A. GUTKIN AND DAVID BECK, TAX AVOIDANCE VS. TAX EVASION (1958); but see Harrop A. Freeman, *A Problem for Professional Men: The Expanding Concept of Tax Fraud*, 45 A.B.A. J. 577, 578 (1959) (“it has long been recognized that tax evasion and avoidance are closely related and fall either side of a fine and indistinct line.”).

¹⁰⁶ GUTKIN AND BECK, *supra* note 105, at 3.

What accounts for the change in attitudes toward tax dodging? Not surprisingly, two developments – the rise in tax rates and the broadening of the taxpayer base -- combined to make those most affected become interested in tax dodging opportunities. More broadly, however, as this book will explain, it was the backsliding from these high rates through loopholes, special exemptions, and selective enforcement that led to the popular ambivalence toward tax dodging and its structural and cultural entrenchment for decades to come.

The Rise in the Top Tax Rates

As previously mentioned, tax rates soared to pay for World War II and remained high in the decades following the war.¹⁰⁷ More importantly for the purposes of the market for tax dodging, the thresholds at which individuals crossed into the higher marginal tax brackets dropped as well, subjecting more people to those high rates. For example, in 1936, individuals with taxable incomes in excess of \$1 million were subject to a 77 percent marginal income tax rate,¹⁰⁸ but that amounted to only 61 returns that year.¹⁰⁹ By 1954, there were 77,511 individuals subject to a 72 percentage marginal rate bracket or higher.¹¹⁰ The massive increase in the number of individuals subject to a comparable rate in 1954 is attributable to the fact that the threshold beyond which income was subject to the 72 percent rate had dropped precipitously from \$1 million to \$44,000 as the income tax transitioned from a “class tax” to a “mass tax.”¹¹¹ Even the top marginal rate of 91 percent in

¹⁰⁷ STEVEN A. BANK, KIRK J. STARK & JOSEPH J. THORNDIKE, *WAR AND TAXES* 108 (2008).

¹⁰⁸ Tax Foundation, *Historical U.S. Federal Individual Income Tax Rates & Brackets, 1862-2021*, (1936 data) (“Federal Individual Income Tax Rates History”)

¹⁰⁹ U.S. TREAS. DEP’T, *STATISTICS OF INCOME FOR 1936*, Pt. 1, at 5 (1938).

¹¹⁰ U.S. TREAS. DEP’T, *STATISTICS OF INCOME, INDIVIDUAL INCOME TAX RETURNS 1954*, at 56, 57 (1957) (joint, single, and head of households).

¹¹¹ Federal Individual Income Tax Rates History, *supra* note 108 (1954 data); Carolyn C. Jones, *Class Tax to Mass Tax: The Role of Propaganda in the Expansion of the Income Tax During World War II*, 37 *BUFFALO L. REV.* 685, 686 (1988).

1954 applied to income above \$200,000 for single filers, whereas the top combined marginal rate of 79 percent in 1936 only kicked in at \$5 million.¹¹²

One effect was that “[t]he tax-avoidance business,” which had been a little less visible after the Revenue Act of 1937’s crack down, “returned and boomed.”¹¹³ The high rates made tax dodging enticing, as well as cost-effective. William J. Casey and J.K. Lasser explained in their 1952 report on *Tax Sheltered Investments* that the “appalling fact is that a dollar of corporate income can shrivel down to less than a penny by the time it has passed through the wringer of the corporate income tax, the individual tax on dividends and the estate tax payable on passing savings on to one’s family.”¹¹⁴ Not surprisingly then, Mortimer Caplin, a law professor at Virginia and future Commissioner of Internal Revenue, observed that these rates “led to increased interest in tax planning, in means for arranging one’s affairs to minimize taxation, in tax avoidance.”¹¹⁵

The Growth in the Number of Taxpayers

The second development that helped change the public’s attitude toward tax dodging was that the number of people subject to taxation rose considerably. As seen in Figure 1.2, in 1940, at a time when there were 132 million people in America, there were only 7.5 million tax returns filed.¹¹⁶ By 1960, the population had grown over 36 percent to 180 million, but the number of

¹¹² Federal Individual Income Tax Rates History, *supra* note 108 (1954 and 1936 data) .

¹¹³ Richard M. Cooperman, *The Tax Thieves of 1951, Part VI. The True Villains*, NEW REPUBLIC, Dec. 24, 1951, at 10, 11. See Roswell Magill, *The Impact of Income Tax Leakages – A Postscript to Randolph Paul*, 12 TAX L. REV. 1, 1 (1956) (“High rates foster methods and plans for tax reduction and avoidance.”); Mortimer M. Caplin, *Threats to the Integrity of our Tax System*, 44 VA. L. REV. 839, 840 (1958) (High rates have “led to increased interest in tax planning, in means for arranging one’s affairs to minimize taxation, in tax avoidance.”); PAUL, TAXATION FOR PROSPERITY, *supra* note 35, at 279 (“A 90-percent rate proved to be a powerful stimulant to ingenuity . . . the market had never buzzed with so many schemes”). It also may have revived efforts to get states to pass resolutions calling for Congress to amend the Constitution to limit the top federal tax rate to 25%, with an ability to override the limit during wartime. See Frank E. Packard, *Put a Ceiling on Taxes!* CHANGING TIMES: THE KIPLINGER MAGAZINE, August 1951, at 43 (noting that the campaign, which started with a resolution passed in Wyoming had spread to 24 other states).

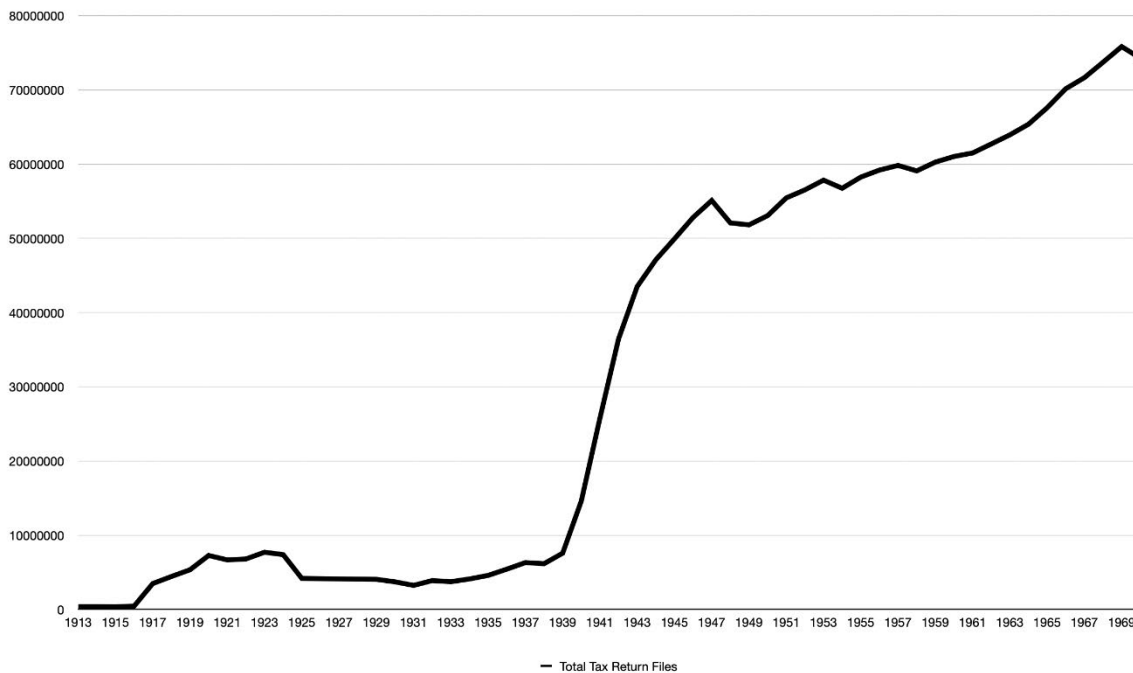
¹¹⁴ WILLIAM J. CASEY & J. K. LASSER, TAX SHELTERED INVESTMENTS 1 (1952).

¹¹⁵ Caplin, *supra* note 113, at 840. See Magill, *The Impact of Income Tax Leakages*, *supra* note 113, at 1 (“[h]igh rates foster methods and plans for tax reduction and avoidance.”).

¹¹⁶ JEROME R. HELLERSTEIN, TAXES, LOOPHOLES & MORALS 13 (1963).

income tax returns filed had grown over 757 percent to 60 million in total.¹¹⁷ This change was attributable to a drop in the exemption threshold. Whereas the income tax did not apply to a single person with earnings below \$1,500 in 1928, it applied to everyone who earned over \$600 from 1948 through 1969.¹¹⁸ As a percentage of the labor force, a mere 5 percent of workers paid income taxes in the mid-1930s, compared to between 65 and 70 percent by the mid-1950s.¹¹⁹

Figure 1.2 : Total Returns, 1913-1970¹²⁰



Not only did the number of taxpayers increase dramatically, but rates for taxpayers in the lowest brackets also jumped significantly. Between 1932 and 1939, the lowest tax rate was 4 percent on income over \$4,000. By 1941, the rate had more than doubled to 10 percent and the

¹¹⁷ Id.

¹¹⁸ Id. Tax Policy Center, Historical Individual Income Tax Parameters, 1913-2023 (May 11, 2023).

¹¹⁹ JOHN F. WITTE, THE POLITICS AND DEVELOPMENT OF THE FEDERAL INCOME TAX 126, fig. 6.2 (1985).

¹²⁰ HISTORICAL STATISTICS OF THE UNITED STATES: EARLIEST TIMES TO THE PRESENT v. 5, Pt. E, 5-112 (tbl. Ea740-747), 5-113 (tbl. Ea748-757) (2006).

income threshold had dropped in half to \$2,000. It jumped again to 23 percent by the end of the war in 1944. It moderated after the war, but the bottom rate remained no lower than 20 percent on income over \$4,000 from 1951 to 1963.¹²¹

The high rates and broadened base of taxpayers contributed to the democratization of tax dodging. Tax advising rapidly transformed in response to the rise in rates and in taxpayers. During the 1920s and 1930s, this field was occupied primarily by a small number of white shoe law firms that represented the wealthiest segment of society. Tax dodging, like much of the income tax itself, was reserved for the upper crust of society, promoted by a small number of prominent New York and Washington, D.C. law firms and discussed in hushed tones in the dark and smokey confines of private dining rooms and clubs.¹²² Taxpayers in the middle or lower brackets were unlikely to consult a tax adviser, let alone to engage in tax dodging. As the *Austin American* wrote in 1925, “ducking the income tax is easy – IF – you have the money! For the poor man, the salaried man, or the man in moderate circumstances, it is virtually impossible – at least legally.”¹²³

Not only did the increase in taxpayers draw lawyers and accountants into tax work, but it spawned an entirely new industry of retail tax preparation and advising services. With extensive advertising, these tax advisers introduced a whole new class of people to the tax system and, in some cases, to the methods for dodging it. These new advisers opened offices in many non-traditional spaces, such as in department stores and in shopping centers, as well as in small storefronts on quaint main streets and gritty back alleys. They wrote newspaper advice columns and do-it-yourself guides, often promising to bring the rich guy’s tax dodging secrets to the little guys. Access to tax advice had never been greater.

¹²¹ It was 20.4 percent in 1951 and 22.2 percent in 1952 and 1953. All rates and income thresholds are from Tax Policy Center, Historical Individual Income Tax Parameters, 1913-2023 (May 11, 2023).

¹²² THORNDIKE, THEIR FAIR SHARE, *supra* note 55, at 202.

¹²³ *Tax Dodging Easy for Rich, Impossible for Poor*, AUSTIN AMERICAN, Oct. 18, 1925, at SM11.

The result was that tax dodging spread throughout society. As tax practitioner Harry Graham Balter wrote in his 1953 treatise, *Fraud under Federal Tax Law*, “To a greater or lesser extent, nearly everyone is guilty of practicing some form of tax evasion, whether we call it ‘fraud’ or not. Failure to report interest in bank deposits, padding of business entertainment expenses, exaggerating contributions to charity, or adding a fictitious dependent, are examples of tax evasion, unfortunately practiced on a wide scale by rich and poor alike.”¹²⁴ A decade later, New York University law professor Jerome Hellerstein observed that this sentiment had not changed, noting that “as so often happens in tax matters, the legitimate has been abused and has fostered the illegitimate.”¹²⁵

A Word about Terminology

The transformation in public attitudes is in some respects symbolized by the transformation in the use of the term “tax dodging” itself. In the 19th and early 20th centuries, tax dodging was typically associated with what we would call tax evasion as a legal matter. Someone described as a “tax dodger” was considered contemptible and unpatriotic. In 1883, the *Chicago Daily Tribune* opined that “tax-dodging . . . is one of the most discouraging of many signs of the laxity of our social ties.”¹²⁶ The newspaper used the term interchangeably with tax evasion, noting that “to evade the payment of the taxes due the State is, just like the disregard of the duties of serving on the jury and going to the polls, an attempt to obtain the benefits of government without giving an

¹²⁴ HARRY GRAHAM BALTER, *FRAUD UNDER FEDERAL TAX LAW* 16 (2d. ed. 1953).

¹²⁵ HELLERSTEIN *supra* note 116, at 127.

¹²⁶ Editorial, *Tax-Dodging*, CHI. DAILY TRIB., Aug. 28, 1883, at 4.

equivalent.”¹²⁷ One writer in 1906 went a step further, describing “tax dodging” to be “as reprehensible and as conclusive evidence of disloyalty as many other treasonable acts.”¹²⁸

The negative connotation of tax dodging continued after the enactment of the income tax. In 1921, the *Atlanta Constitution* described “the tax-dodger” as “selfish and unpatriotic and dishonest,”¹²⁹ while the *Baltimore Sun* compared the tax dodger to a wartime “profiteer.”¹³⁰ Although it was associated with more than simply tax evasion by this point, tax dodgers were still viewed as unpatriotic, with the *Constitution* calling a tax dodger “a thief who steals from his honest fellow-citizens the benefits that accrue from American citizenship and the protection of the American flag.”¹³¹ In 1931, the *Pittsburgh Courier* expressed similar sentiments, writing “the tax dodger is the man who delights in owning nothing to be taxed; he delights in escaping the payment of taxes . . . This type of man is not a citizen – he is a parasite.”¹³²

By the 1950’s and 1960s, a subtle shift emerged. The term “tax dodging” was not free from stigma, but it began to be used with a kind of moral ambivalence that it did not typically have before the war. In fact, “tax dodging” had become sufficiently ambiguous that using the term was a way for observers to comment without making a legal or moral judgment about it. Even those who sought to condemn most of what people were doing in their tax maneuvers used the tax dodging phrase, either to cover more ground or to avoid having to defend their judgment based on where it fell on the side of the now blurry line between evasion and avoidance.¹³³ It had become a catch-all phrase that reflected the myriad ways that some people managed to escape the taxes that hit others squarely in their pocketbooks.

¹²⁷ Id.

¹²⁸ Review, American Citizenship, by John S. Wise, 4 OKLA L. J. 360 (1906).

¹²⁹ Editorial, *The Tax Dodgers*, ATL. CONST., June 21, 1921, at 8.

¹³⁰ *Income Tax Dodgers*, THE SUN (BALTIMORE), Jan. 20, 1920, at 8.

¹³¹ *The Tax Dodgers*, *supra* note 129, at 8.

¹³² *Tax Dodgers*, PITT. COURIER, Jan. 10, 1931, at 10.

¹³³ See, e.g., H.F. MILLIKIN, THE PRUDENT MAN: TAX DODGING AS AN ART 153 (1963).

This book primarily uses the term “tax dodging” both because it came into prominent use during this midcentury period, and because it avoids some of the line drawing distinctions that remain in the legal literature. It does not mean that the tax saving maneuvers discussed in this book are, or were at the time, considered illegal, immoral, risky, or somehow inappropriate. Nor does it mean that all deductions, credits, exemptions, or special allowances enacted by Congress should be considered a “loophole,” which was described by one contemporary observer as “an unfair means of escape from a burden that others are obliged to bear.”¹³⁴ Nevertheless, the tax maneuvers described in the chapters that follow, whether arising from “accidental” loopholes or those “put into the laws deliberately” or from the proper or improper use of certain Code provisions,¹³⁵ were primarily intended to dodge taxes or, if they were motivated at least in part by unrelated reasons, they were structured to dodge as much of the tax consequences as possible.

A Roadmap

This book explores how the themes discussed in this introduction played out in various settings in midcentury America. Part I explores tax dodging that was high profile and influential. It starts by examining two groups that were affected by the high rates and were uniquely positioned to influence public perception of and engagement with tax dodging. The first group was comprised of Hollywood celebrities, who were some of the early users and innovators of tax dodging techniques and shelter transactions. They were income rich, unlike old money wealth who were asset rich, and they had non-tax reasons to be interested both in owning, rather than renting, their talents and in diversifying their investments. Moreover, they had high profiles and were admired,

¹³⁴ LOUIS EISENSTEIN, *THE IDEOLOGIES OF TAXATION* 182 (1961). Eisenstein noted that as the term “loophole” took on a negative air, the word “erosions” is “now in fashion” because it suggests “an objective appraisal.” *Id.* at 193.

¹³⁵ Magill, *The Impact of Income Tax leakages*, *supra* note 113, at 9-10.

which meant that their tax dodging helped to popularize some techniques that might have otherwise gone unnoticed by the public. This part of the book also discusses tax havens, a particular type of tax dodging that was prominently used by celebrities, but also became popular among wealthy taxpayers generally and the businesses that they owned. Tax havens were in part high profile both because of the people and companies that used them, but they had an allure of their own that went beyond that. Because of the extensive advertising undertaken to attract investment in havens and the exotic nature of the locations, they were attractive stories for the press and readers. The second group was comprised of corporate executives. Although not nearly as famous as celebrities, they may have been even more influential over the long run. As some of the highest income-earners, they were especially interested in the taxation of compensation and ways to structure their own company's compensation to dodge the high marginal rates. That was part of the impetus to move toward more deferred compensation, more stock-based compensation, and more non-cash benefits, which were changes that spread across companies and workers at all levels.

These high-profile groups of taxpayers and transactions helped to publicize and entrench tax dodging, which, as Part II explains, led to its spread beyond the higher brackets. As previously mentioned, the creation of a tax advising industry focused on this segment of the taxpaying population and the advertising of both tax advice and self-help schemes introduced an entire generation of taxpayers to the basics of tax dodging. Some of the devices used by high profile taxpayers also became available to groups beyond the highest tax brackets. Middle-level bureaucrats and traveling salesmen, for example, took part in the generous expense account practices that were originally adopted for corporate executives. Not only did more people find ways to dodge taxes, but more people knew people who were dodging taxes, which increased their

desire to seek a “loophole,” “shelter,” or “haven” of their own. Moreover, as the public learned of the special tax benefits Congress provided to the wealthy, they resisted bitterly when Congress sought to curtail their own small measure of tax dodging by proposing, for example, to extend withholding from wages to the interest on their savings accounts.

None of this is to say these developments were the inevitable result of high progressive rates. There were a variety of justifications for the high rates that received support across the political spectrum, from infrastructure investments to expanding federal benefit programs to enhance the social welfare safety net. When the support for the high rates wavered, however, without the corresponding political will to cut taxes directly, Congress settled for implicit tax cuts. By adopting new exceptions, creating loopholes, and watering down the measures they did adopt to address tax dodging, it both emboldened those who benefitted from it and disheartened those who were left out, leaving them to identify their own forms of tax dodging. It was the backtracking from the high rates, particularly in a non-transparent way for the benefit primarily of the rich and famous, rather than the high rates on their own, that helped to make tax dodging a social and cultural phenomenon in mid-century America.