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TAXES

It Could Be Worse

The U.S. has a long history of (very) high tax rates. How does 91 percent feel?

By LAURA SAUNDERS

Photograph by John Kuczala

AND NOW FOR a history lesson. As Americans prepare their taxes for April, the annual pain begins. It could be worse: For more than half the time the income tax has been around, the top rate on individuals was sky-high by current standards.

This is the 100th anniversary year of the tax law. Between 1932, when Franklin Roosevelt's rhetoric helped push income-tax rates higher, and 1981, when Ronald Reagan's rhetoric helped roll them back, the top rate wasn't south of 70 percent. The high-water mark was 94 percent, during the last two years of World War II, followed by the 91 or 92 percent rate in effect for much longer: 1951 through 1963.

For some of these years, the income tax was for the truly wealthy. Un- til World War II, the tax applied to less than 10 percent of the population. By one estimate, the personal exemptions of $3,300 for a family of four in 1939 would equal more than $100,000 today.

In 1935 the top income-tax rates in the country applied to only one person.

Brackets were highly graduated as well: According to Joseph Thorndike, a tax historian, 1935's top rate of 79 percent, which kicked in at $5 million, applied to only one person: John D. Rockefeller Jr.

Back then, some individuals even welcomed paying income tax. The eminent Washington tax-policy expert Tom Field recalls his own father's reaction in 1939, the first year he owed the tax. A rags-to-riches sports broadcaster who had thrived during the Depression, the elder Field was delighted. "It was a sign he had arrived," says his son.

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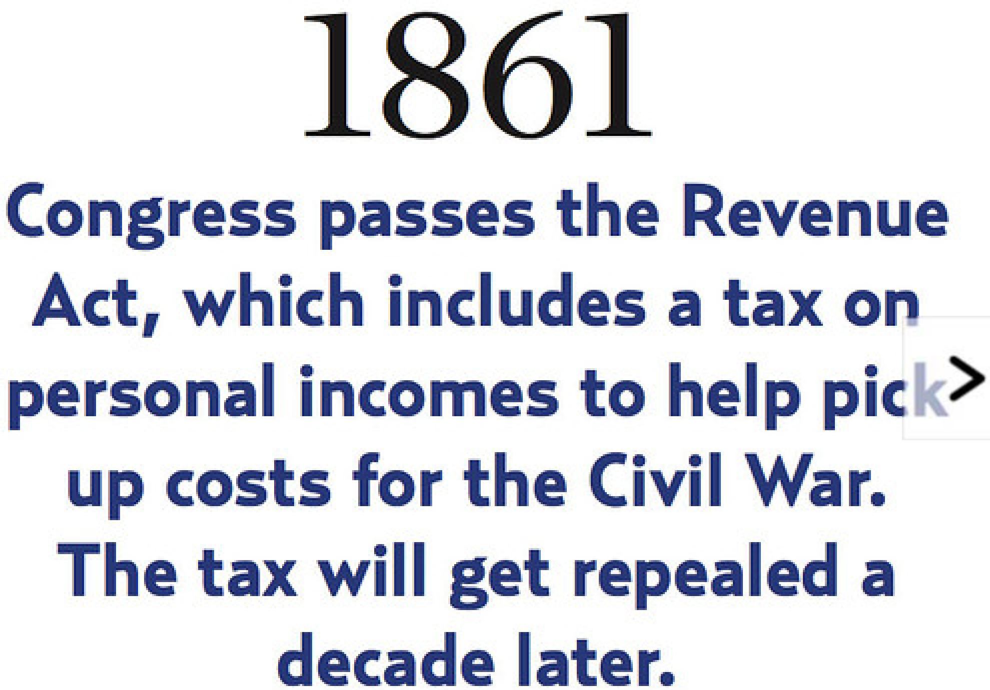
His father's attitude changed as the tax expanded to finance World War II, but even then he refused to engage in tax planning, such as taking out a mortgage, which he saw as "not cricket." Although Field, now 81, thinks his father never earned enough to get to the 90 percent rate, he believes he paid "well over half" his income in taxes.

Others did not, however. Instead, they reaped long-term capital gains taxed at a maximum rate of 25 percent. Thorndike says that while the top rate on income was still 91 percent from the 1950s through the early 1960s, the effective tax rate for high earners dropped from 49 percent to 27 percent, mainly because of this strategy.

We know what has happened since then. By the 1970s, the top rate had dropped to a still-high 70 percent, and a tax-shelter industry was flourishing. Reagan helped push the rate down to 50 percent, and his 1986 tax reform lowered it still further. The 90 percent-plus level has never returned. Following the recent fiscal-cliff compromise, the top capital-gains rate is again approaching 25 percent, while the top income tax rate is about 41 percent (counting surtaxes).

And there it will stay—that is, until Congress changes it.

taxes a family paid in 2011 in the largest city in each state. (Photo: Getty Images)



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