

Nature of Indirect Taxes

This paper will show that income taxes on labor are economically different from income taxes on business and industry. The original intent of federal income taxation was to tax wealth or those who had the ability to pay, which for the first 70 years of operation had subjected only two to five percent of the population to the tax.¹

The ability to shift taxes is the key component of indirect taxes. In describing the nature of indirect taxes, the Internal Revenue Service succinctly describes them as “**A tax that can be shifted to others.**”² The US Supreme Court would elaborate on this freedom to shift indirect taxes:

As the means by which the burdens of taxes may be shifted are as multiform and as various as is the power to contract itself, it follows that the argument relied on, if adopted, would control almost every conceivable form of contract, and render them void if they had the result stated. Thus, the price of all property, the result of all production, the sum of all wages, would be controlled irrevocably by a law levying taxes if such a law forbade a shifting of the burden of the tax and avoided all acts which brought about that result. It cannot be doubted that to adopt by implication the view pressed upon us would be to virtually destroy all freedom of contract, and in its final analyses would deny the existence of all rights of property. American Express Co. v. Michigan, 177 U.S. 404 (1900)

Corporations, businesses, employers, and other entities have the ability to pass or shift the taxes they owe onto their products and services. While some might elect to lessen their profits, decrease wages, or take other measures, commerce still prevails for profit. A huge complex of lawyers, CPAs, and tax specialists is a testament to the industry of reducing and shifting taxes.

Workers and wage earners already shift their employee’s portion of Social Security (OASDI, FICA) tax and Medicare taxes, but they cannot shift their personal income taxes due to personal income tax liability. Employers also pay Social Security (OASDI), Employer Medicare (HI), and FUTA taxes. Payroll taxes

¹ Teach Democracy
<https://teachdemocracy.org/online-lesson/the-income-tax-amendment-most-thought-it-was-a-great-idea-in-1913/>

² IRS: Understanding Taxes, <https://apps.irs.gov/app/understandingTaxes/student/glossary.jsp#directtax>

and other payroll costs are generally embedded in the prices of final products and services.

Personal income tax on wage earners is very different from business income taxes; one able to shift the burden, the other not.

We know that income taxes are classified as direct taxes by every world government, including the IRS.³ Indirect taxes, including excises, duties, imposts, including sales taxes on fuel and energy, among many other items, are collected during the course of commerce; it is the consumer or final user that ultimately provides the money to cover various costs of production including any profits and taxes.

The employer provides the funds from which employees pay their income taxes. In essence, this is really a tax on employers since it is an added cost to payrolls. As Adam Smith put the phrase:

“A direct tax upon the wages of labour, therefore, though the labourer might perhaps pay it out of his hand, could not be said to be even advanced by him;”⁴

Laborers and wage earners cannot shift their personal income tax liability, unlike businesses who have the ability to pass or shift income taxes onto products and consumers. The Constitution permits Congress to tax wages indirectly “from whatever source derived,”⁵ as a true excise or duty tax, but prohibits requiring citizens to pay a direct tax without apportionment. The Supreme Court recently reaffirmed the constitutional language that requires direct taxes on persons or their property (wealth) to be apportioned.

“... direct taxes must be imposed “in Proportion to the Census of Enumeration.” U.S. Const., Art. I, §9, cl. 4; see also §2, cl. 3. In other words, direct taxes must be apportioned among the States according to each State’s population.” Moore v. United States, 602 U.S. 572 (2024),

³ IRS Understanding Taxes, Teacher Materials,:
https://apps.irs.gov/app/understandingTaxes/teacher/whys_thm04_les04.jsp

⁴ Adam Smith, The Wealth Of Nations: <https://www.rrojasdatabank.info/Wealth-Nations.pdf>

⁵ US Constitution, 16th Amendment: “The Congress shall have 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.” (emphasis added)

Congress has indeed levied indirect taxes on employment. Social Security (OASDI), Employer Medicare (HI) and FUTA taxes are levied and applied indirectly without any employee taking action. In contrast, employees can control the amount of withholding and the income tax becomes a personal liability applied directly onto the individual.

Economists will note that the employer is the source of funds for payrolls and taxes, whether a tax or fee is applied to the employer or employee. Any tax applied to labor and employees increases the cost of labor more than the increase in taxes. The employer pays these costs, though it may temporarily decrease money given to labor, but it adds to labor costs more than the cost of the tax. Again, as Adam Smith observes:

*“Whatever was the proportion of the tax, the wages of labour must in all cases rise, not only in that proportion, but in a higher proportion. If the tax, for example, was one-tenth, the wages of labour must necessarily soon rise, not one-tenth part only, but one-eighth.”*⁶

Exacting taxes directly from the wage earner denies them the rights, privileges, or immunity that comes from indirect taxation. IRS and other world governments classify these income taxes as direct taxes.

In contrast, the Supreme Court has always classified income taxes as indirect.

Because income taxes are indirect taxes, they are permitted under Article I, §8 without apportionment. As this Court has said, Article I, §8’s grant of taxing power “is exhaustive,” meaning that it could “never” reasonably be “questioned from the” Founding that it included the power “to lay and collect income taxes.” Brushaber, 240 U. S., at 12–13. In 1861, Congress enacted the Nation’s first unapportioned income tax. 12 Stat. 309. The Civil War income tax was recognized as an indirect tax “under the head of excises, duties and imposts.” Brushaber, 240 U. S., at 15; see also Springer v. United States, 102 U. S. 586, 598, 602 (1881).

This distinction became central when the Supreme Court struck down portions of the 1894 income tax in *Pollock v. Farmers’ Loan & Trust Co.* (1895), holding that taxes on income from certain forms of property were direct taxes requiring apportionment, while holding that labor income, or income from earning wages, was forms of duties and/or excise taxes that fell under the classification of

⁶ Adam Smith, *The Wealth Of Nations*: https://www.ibiblio.org/ml/libri/s/SmithA_WealthNations_p.pdf

indirect taxation that need not be apportioned. This decision would have relieved real estate and invested personal property from income taxation, but instead declared the whole income tax act unconstitutional because that:

*"...would leave the burden of the tax to be borne by professions, trades, employments, or vacations, and in that way what was intended as a tax on capital would remain, in substance, a tax on occupations and labor"*Pollock v. Farmers' Loan & Trust Co., 157 U.S. 429 (1895)

The Supreme Court has ruled that the 16th Amendment did not create or destroy the plenary powers of taxation, but only "that the Amendment was drawn for the purpose of doing away for the future with the principle upon which the Pollock case was decided." The Court reasoned that:

"the contention that the Amendment treats a tax on income as a direct tax although it is relieved from apportionment and is necessarily therefore not subject to the rule of uniformity as such rule only applies to taxes which are not direct, thus destroying the two great classifications which have been recognized and enforced from the beginning, is also wholly without foundation since the command of the Amendment that all income taxes shall not be subject to apportionment by a consideration of the sources from which the taxed income may be derived forbids the application to such taxes of the rule applied in the Pollock case by which alone such taxes were removed from the great class of excises, duties, and imposts subject to the rule of uniformity, and were placed under the other or direct class."

The 16th Amendment allows Congress to levy income taxes without apportionment to directly overcome the obstacles that the Pollock decision presented. The Supreme Court recently reaffirmed that opinion with this:

"Because income taxes are indirect taxes, they are permitted under Article I, §8 without apportionment" (Moore v. US, 2024).

This paper asks that indirect taxes, like other excise, import, duties, and income taxes, to be collected at the source without making each wage earner personally liable.