

# History of American Taxation



by Monica Haven,  
E.A., J.D., L.L.M.

Although neither a unique nor novel idea, taxation in America has evolved into its present day form through complex legislative changes, supported by a myriad of judicial decisions.

Right from the start, England attempted to tax the Colonies out of existence. A never-ending variety of tariffs and duties were imposed in an effort to foster production in the Old World at the expense of Colonial industry. For example, the Navigations Act of 1651 required that all goods imported into England be transported only on the King's ships, albeit unavailable to enterprising Colonists. This was followed by the Hat Act (1732), the Iron Act (1750), the Currency Act (1764) banning the use of paper money in the Colonies, the Sugar Act (1764), the Molasses Act (1765) and the Townshend Act (1767). For the most part, each act taxed the manufacture and sale of the items named in the title to the point that Colonial goods became prohibitively expensive in England, thus discouraging production in and export of these items from the Colonies.

Then, in 1773, in an effort to support the financially troubled East India Company and encourage its monopoly of the market, the Tea Act was

passed. That was the proverbial straw that broke the camel's back and on December 16th Massachusetts patriots boarded the Dartmouth and off-loaded £10,000 of tea into the Boston Harbor, setting the stage for the Revolutionary War.

Taxation in the post-war era now fell under the jurisdiction of the newly formed American government. In their debate to draft and then ratify the US Constitution (1787), our forefathers were embattled between the Virginia Plan which sought congressional representation based on population (thus giving the South an advantage due to its large slave holdings) versus the New Jersey Plan which preferred the one-state/one-vote approach.

The solution ultimately came in the form of the bicameral Congress, with a fascinating footnote: The House of Representatives was given the power to initiate tax legislation; the Senate could amend and ultimately ratify these laws. What may upon first glance appear as a mere delegation of authority and a convenient division of responsibility was, in fact, intended to ensure that the authority to tax would always stem from the People, not the government. Indeed, no taxation without representation!

Surprisingly, post-Revolutionary America continued to

impose tariff after tariff on its citizenry. But as the country lay divided between North and South, each government needed yet more funding. The Confederacy unwisely chose to fill its war chest through the sale of notes and bonds. Debt was soon out of control and inflation reached the exorbitant level of 9000% (!) by 1865, causing prices to double every two months. Although the Union also issued notes, it managed to raise roughly 21% of its war revenues by instituting the first income tax of the New World in 1862. The rate was set at 3% on any amounts over \$600 of taxable income and 5% on amounts in excess of \$10,000.

With the passage of the Internal Revenue Act of 1863, excise, sin and luxury taxes were introduced and an enforcement bureau was established. Within the span of one year, 4,000 tax collectors were employed and revenues collected increased from a mere \$28.5 million to \$300 million. The tax law became so complex and returns were so difficult to file, that even President Lincoln overpaid his taxes by \$1,250 which auditors discovered only eight years after his assassination. The tax was eventually deemed to be unconstitutional, repealed, and replaced by an inheritance tax enacted

to help defray the costs of the Spanish-American War (1898). But this tax, too, was eventually repealed (1902).

Hoping to build its war chest, the U.S. government once again instituted an income tax. In 1913, the state of Wyoming cast the 37th and decisive vote ratifying the 16th Amendment to the Constitution which specifically recategorized the income tax as an "indirect" tax; thereby sidestepping the prohibition against direct taxation proscribed in Article 1 of the US Constitution. [Thus, you may blame your personal tax woes on the residents of the state whose motto is "equal rights". Presumably, they intended for all of us to have the equal right to misery until we reach Tax Freedom Day roughly 4½ months after the start of each year!]

Congress was now given "the power to lay and collect tax on incomes from whatever source derived", thus subjecting all sources of revenue—even foreign-earned income—to potential taxation. Modern-day tax protesters argue that the 16th Amendment was never properly ratified, since Ohio was not admitted to the Union until after enactment. In fact, Ohio's state constitution was adopted in 1802 but the precise calendar date

# HISTORY

Continued from pg. 9

of admittance to the Union was never properly recorded. Upon celebration of its sesquicentennial in 1953, the US Congress agreed to retroactively rectify the snafu and pass enabling legislation to officially record Ohio's statehood as of March 1, 1803 (long before the ratification date of the income tax).

In the ensuing years, a soak-the-rich attitude prevailed and tax policies were formulated accordingly; however, most

middle class citizens were spared due to a generous \$3,000 exemption. Ultimately, only 2% of all households paid the tax. Instead, much of the war effort was capitalized by the issuance of bonds, later repaid with tax dollars collected from corporations subject to an excess profits tax and an estate tax instituted in 1916.

Capital gains taxes were introduced in 1921. Sales, use and property taxes soon followed to fund the mushrooming needs of the expanding government of the New Deal

era. By 1932, these additional taxes accounted for 38% of all revenues collected. Nevertheless, marginal income tax rates continued to creep up and reached a record high of 94% by the end of World War II! Thereafter, Republicans gained control of both the Presidency and Congress and rates began to decrease.

Today's tax law is based on the two major revisions of the Code (Title 26) of 1954 and 1986. And I'm happy to report that the original 400 pages of legislation have since ballooned

to well over 74,000 pages, guaranteeing my full-employment as a tax advisor for years to come...

Monica Haven is an Enrolled Agent and Accredited Tax Advisor as well as a graduate fellow of the National Tax Practice Institute. Monica has a Bachelor of Science degree in Small Business Management with an emphasis on New Ventures, a Doctorate of Law (J.D.), and a Master of Laws in Taxation (LL.M.) from Loyola Law School in Los Angeles.

The information contained herein is for educational use only and should not be construed as tax, financial, or legal advice. Each individual's situation is unique and may require specialized treatment. It is, therefore, imperative that you consult with tax and legal professionals prior to implementation of any strategies discussed. © 2015 by Monica Haven, E.A., J.D., L.L.M.



## The Illinois Chapter of National Association of Tax Professionals

2 Lane Drive, Paxton IL 60957



FALL 2015, Publication No. 53

Nick Fiorillo, Editor

### 2015 ILLINOIS NATP: BOARD OF DIRECTORS

#### PRESIDENT

**Wendi Olson Ramsay**  
309-692-4016  
wramsay@ramsaycpa.biz

#### SECRETARY

**L. Michelle Linton**  
(630) 729-3138  
ml@mla-accounting.com

#### Terry Hall

847-623-3025  
gypsy@poweruser.com

#### Esther Odle

618-544-3370  
esodle@yahoo.com

#### VICE-PRESIDENT

**Scott Morey**  
217-971-4276  
stmorey@stmorey.com

#### EDITOR

**Nick Fiorillo**  
217-379-4308  
nfiorillo@fiorillo.com

#### Karen Kincaid

217-522-1313  
sterling7@ameritech.net

#### Shannon Stewart

309-662-2264  
info@sterwartstaxservice.com

#### TREASURER

**Phil Euler**  
815-866-2096  
phileuler@mchsi.com

#### Kristin Clay

309-530-3150  
kristin.clay@sta-cpas.com

#### Charlotte Miller

630-250-1251  
idotaxes@prodigy.net

#### Debbie Wallace

217-789-0239  
2girlsandme@msn.com

#### Tracy Danzer

309-692-4016  
tdanzer@ramsaycpa.biz

#### Naomi Miller

217-497-0133  
naomi.miller@frontier.com

#### Gene Wallace

309-444-8087  
genestaxservice@yahoo.com