

History of Taxation in the U.S.

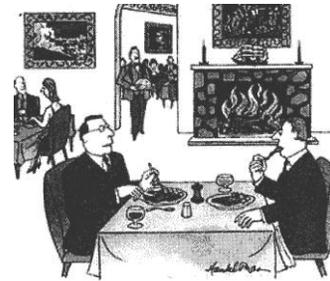
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- The U.S. Tax Code has
- 17,000 PAGES of tax regulations
 - 5.5 MILLION words
 - 569 DIFFERENT income tax forms
 - 6.1 MILLION hours spent to comply
 - 110 MILLION calls made to the IRS annually
 - 73% of inquiries answered CORRECTLY

It all started with a tea party: No taxation without representation! Today we have plenty of both. With elections looming, allow Monica Haven, E.A. to guide you through the evolution of our tax structure, its constitutional basis, and its relative merits, as well as provide you with an update of all relevant tax code changes as they might affect you.

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.

The first Biblical tax was flat (Genesis 41:34-35): Predicting that seven years of famine will follow the current agricultural boom, Joseph proposed that the Pharaoh "lay up" 20% of all grain crops during years of plenty. Later, as starving Egyptians applied for ware housed food—the same grain that had previously been taken from them—they were forced to deed their land to the Pharaoh who benevolently allowed them to continue to farm in return for a 20% share of their crops in perpetuity (Genesis 47:20-26). Priests, however, were exempt from taxation, an exemption that was upheld by the Persian King Artaxerxes who notified his tax collectors that "it shall not be lawful to impose tribute, custom, or toll upon any one of the priests, the Levites, the singers, the doorkeepers, the temple servants, or other servants of the House of God" (Ezra 5:24).



This fresco depicts the arrival in Capernaum of Jesus and the Apostles (Matthew XVII: 24-27). The artist has included three different moments of the story in the same scene: The tax collector's request, with Jesus' immediate response indicating to Peter how to find the money necessary, is illustrated in the centre; Peter catching the fish in Lake Genezaret and extracting the coin on the left; and on the right, Peter hands the tribute money to the tax collector. Critics have interpreted this painting to be a reference to proposed tax reform in Florence which was settled in 1427 with the institution of an official tax register that ultimately led to a fairer system of taxation.

- 1651 Navigations Act**
All goods exported to England must be transported on British ships—intended to foster British production at the expense of Colonial industry.
- 1673 Revenue Act**
Imposes a plantation levy and creates the **first revenue collecting agency**.
- 1732 Hat Act**—prohibits Colonial export of finished hats.
- 1750 Iron Act**—intended to stem the development of Colonial manufacturing by restricting the supply of raw metals.
- Mid-1750's** Colonists begin to consume more than they export.
British lend money & consumer debt is rampant.
- 1763** Colonists **begin to rebel** when they are asked to pay for the Seven Years' War (a war not their own).
- 1764 Sugar Act**
1st act to be enforced by Vice Admiralty Courts, not a jury.

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Burden of proof is shifted to taxpaying merchant.

1765 Molasses Act (6 pence/gallon) & **Stamp Act**
Ben Franklin demands representation if British want to impose tax. **Congress is formed** to request repeal. Mob uprisings and protests result.
Sons of Liberty becomes the first organized group of **tax protesters**.

1767 Townshend Act—duties on glass, lead, paper, paint, tea.
Act is repealed three years later, but duty on tea remains → Colonists boycott British tea in favor of Dutch.

1773 Tea Act—enacted to support financially troubled East India Company by making British tea cheapest.
December 16th: Patriots board the *Dartmouth* and **dump £10,000 of tea** into the Boston Harbor.

1774 Coercive (a.k.a. Intolerable) Acts—intended to reign in unruly Colonists.

1777 Articles of Confederation = America's **1st constitution** does not give govt. the power to tax--Congress is forced to request moneys from the states which instead borrow from the French and Dutch, as well as print money → inflation results.

1787 U.S. Constitution is ratified--Congress is given the power impose tariffs & coin money.

Virginia Plan (representation based on population) versus New Jersey Plan (one vote/state) → dual congressional chambers are created: **House may initiate tax bills which must be ratified by the Senate** (thus, the authority to tax stems from the People, not the states)

Article 1, §9, Clause 4: "No capitation, or other direct, tax shall be laid unless in proportion to the Census" → intended to account for slaves (= property) and thereby increase the number of southern delegates, while northern states prefer to exclude slaves entirely. Compromise counts slaves as 3/5 of a person and gives South 4 of the first 5 presidents. "Direct" tax is never clearly defined, but is intended to exclude tariffs and excise taxes.

1791 Whiskey Tax—7-18¢/gallon on distillers of spirits.
But since whiskey is effectively used as currency in western Pennsylvania, this amounts to a currency tax and leads to the Whiskey rebellion which is forcibly quashed by 13,000 federal militiamen.

Treasury Secretary Alexander Hamilton establishes **Office of the Commissioner of Revenue**.

1794 Carriage Tax
Comparable to modern-day tax on luxury automobiles.

1797 Death Tax—enacted to fund naval build-up.

1799 Britain enacts an income tax.

1812 An income tax is suggested but never enacted.

1816-60 Ever-changing tariffs are used to raise revenues and regulate trade.

1819 Supreme Court decision involving Maryland's right to tax decrees that national statutes supersede state laws. This eventually leads to **tax-free status of muni. bonds** in 1894.

1861-65 Civil War—scrip is issued to fund war.
Treasury Secretary Salmon P. Chase decrees that dollar bill should be green → **"Greenbacks"**

This represents the watershed in taxation: Confederate government relies on each state to raise the requisite war revenue which they usually do by incurring debt or printing money--75% of the revenues result from Treasury notes while the remainder is borrowed and less than 2% is raised by taxes → Inflation runs rampant and reaches 9000% (!) by 1865

The Union relies on an established Treasury and tariff system: 65% of the war capital is raised by issuing war bonds. 1862: **Legal Tender Act** gives the Treasury the power to issue \$150 million in treasury notes (a.k.a. Greenbacks) → Inflation reaches "only" 80%

1862 1st **Income Tax** is enacted by the Union which raised 21% of its war revenues in this manner (expires in 1872)

It is considered an **"indirect" tax** and is thus believed to be constitutional (upheld by Supreme Court decision in 1881 which deems only property and slave taxes to be "direct").

The tax is first collected in 1862—the rate charged is 3% on amounts over \$600 and 5% on amounts over \$10,000.

The act allows for **tax withholdings** on government employees.

1862-65 Internal Revenue Act

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- 1927** Supreme Court decision declares that even illegal gains are taxable (**bootlegging profits**).
- 1929** California enacts **Bank and Corporation Franchise Tax Act**, creating a revenue collection agency that has 33 employees and a budget of \$68,000 (versus 3400 employees and a budget of \$177,000 in 1990).
- 1930's-40's** Tax rates begin to creep up again and reach a high of 94% (!) by the end of WW II.
- 1931** Al Capone is convicted of tax evasion.
- 1936** **California enacts the Income Tax**: 400,000 returns are filed and \$12 million are collected (versus \$17 billion in 1990).
- 1942** General Counsel for Treasury Department Randolph Paul persuades President Roosevelt to expand income tax system, adding millions of middle-income Americans to the tax rolls. Paul was a passionate advocate for the income tax, insisting that it was "the most direct and equitable method of reaching taxpaying ability." [Paul died in 1956 while testifying before a congressional committee as he outlined his complaints about President Eisenhower's tax and budget policies, chastising the administration for tolerating inequities in the federal tax system.]
- Deductions for medical and investment expenses are introduced.
- 1943** Payroll withholding is instituted to increase to compliance.
- 1944** The Standard Deduction is created.
- Post-WWII** Republicans gain control of the Presidency and Congress and lower tax rates.
- As a result of Congressional hearings due to corruption scandals, IRS is reorganized and **computer system** is installed.
- 1948** Married-Filing-Jointly filing status is introduced.
- 1950** California's **Franchise Tax Board** is created.
- 1954** **Internal Revenue Code of 1954** was passed by both houses of Congress as House Resolution 8300 and signed into law by President Eisenhower on August 16th, becoming Public Law 83-591. Ward M. Hussey, Legislative Counsel for the U.S. House of Representatives and the principle drafter of the 1954 Code has been quoted: "I think the best way is to use English and not Latin and to use simple sentences, to use all sorts of readability devices like headings and cut-ins... It is a complicated area... but I think we can help it by clarity of thought and by expressing ourselves simply."

Sec. 1212. Capital loss carry-backs and carryovers

- (b) Treatment of amounts allowed under section [1211\(b\)\(1\)](#) or (2)
- (A) In general
- For purposes of determining the excess referred to in subparagraph (A) or (B) of paragraph (1), there shall be treated as a short-term capital gain in the taxable year an amount equal to the lesser of –
- (i) the amount allowed for the taxable year under paragraph (1) or (2) of section [1211\(b\)](#), or
- (ii) the adjusted taxable income for such taxable year.

The Tax Code now has 875 pages.

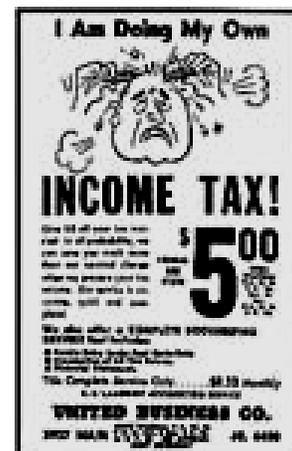
- 1955** The personal **income tax filing deadline** is changed from March 15th to April 15th.
- Henry and Richard Bloch offer tax preparation for \$5.

Until the mid-1950s, the Internal Revenue Service had actually filled out tax returns at no charge for anyone who went to their local IRS office. However, errors were common, and taxpayers' complaints led to the elimination of the service. The Bloch brothers' first ad appeared at the same time that Kansas Citians were discovering the IRS would no longer prepare their tax returns.

Based on the initial success of their Kansas City office, the brothers decided to expand to New York in 1956, opening six more offices. The business was called H&R Block, changing the "h" to a "k" to make the company name easier to pronounce and spell.

Through franchising, offices quickly sprung up across the country, and by 1970, H&R Block had opened more than 4,300 offices, including locations in Canada. By 1978, one out of every nine tax returns filed in the United States had been prepared by H&R Block.

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1961 **Taxpayer identification numbers** (usually Social Security numbers) are now required.

The IRS opens its first dedicated computer center.

1962 KEOGH retirement plans are introduced.

1964 Marginal tax rates range from 16 to 77%.



A little boy wanted \$100 badly and prayed for two weeks but nothing happened. Then he decided to write God a letter requesting the \$100. When the postal authorities received the letter addressed to God, USA, they decided to send it to President Bush.

The President was so impressed, touched, and amused that he instructed his secretary to send the little boy a \$5.00 bill. President Bush thought this would appear to be a lot of money to a little boy.

The little boy was delighted with the \$5.00 and sat down to write a thank you note to God, which read: "Thank you very much for sending the money, however, I noticed that for some reason you had to send it through Washington D.C. and, as usual, those crooks deducted \$95.00."

1968 A 10% surcharge is imposed to fund the Vietnam War effort.

1974 The Employee and Income Security Act (ERISA = Every Ridiculous Idea Since Adam?) gives the IRS regulatory responsibility for employee benefit plans.

1981 President Reagan decreases rates and indexes tax brackets.

401(k) Plans are introduced and IRAs become widely available.

1983 Casualty loss deductions must exceed 10% of Adjusted Gross Income (AGI)—Congress did not want to be the taxpayer's personal insurer.

1986 **Internal Revenue Code of 1986** (Public Law 99-514) is enacted: 14 tax brackets are reduced to 2 (15 and 28%).

Limited e-filing begins.

1990 President Bush raises rates to 31%.

1993 President Clinton adds marginal tax rates of 36 and 39.6%

1996 **Taxpayer Bill of Rights**—establishes Office of Taxpayer Advocate.

1997 **Taxpayer Relief Act**—creates education incentives, cuts capital gains rates, and introduces the child credit.

1999 IRS Commissioner Charles Rossotti develops a blueprint for modernization of the Service, hoping to increase voluntary compliance by promoting a more friendly organization.

2001 \$600 "advance refunds" are offered to each household.

2003 A temporary tax cut reduces taxes on dividends and long-term capital gains.

2004 California requires all tax practitioners who prepare more than 100 returns to **file electronically** on behalf of their clients.

Number of Words in the Internal Revenue Code and Federal Tax Regulations, in Thousands 1955-2005

Internal Revenue Code	1955	1965	1975	1985	1995	2005
Income Tax Code Only	172	243	395	776	1,060	1,286
Entire Tax Code	409	548	758	1,332	1,791	2,139
<i>Period-to-Period Percentage Growth</i>						
Income Tax Code Only	*	41.4%	62.8%	96.4%	36.6%	21.4%
Entire Tax Code	*	33.8%	38.3%	75.7%	34.5%	19.4%

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A Comparison of Presidential Returns: Clinton vs. Bush

1040 U.S. Individual Income Tax Return 1999

For the year Jan. 1, 2000 - Dec. 31, 1999, or other taxable beginning 1999, ending 2000, ending

Label: William J. Clinton
 Your first name and initial: William J.
 Last name: Clinton
 Social Security number: 111-11-1111

Spouse's label: Hillary Rodham Clinton
 Your first name and initial: Hillary
 Last name: Clinton
 Social Security number: 111-11-1111

Home address: 1600 Pennsylvania Avenue, N.W., Washington, DC 20500

Filing Status: Married filing jointly (even if only one had income)

Exemptions: 1 Yourself, 2 Spouse, 1 Dependent (Chelsea V. Clinton)

7	Wages, salaries, tips, etc. (Attach Form(s) W-2)	200,000
8	Taxable interest (Attach Schedule B if required)	6,008
9	Ordinary dividends (Attach Schedule B if required)	11,396
10	Taxable refunds, credits, or offsets of state and local income taxes (see page 21)	
11	Alimony received	
12	Business income or loss (Attach Schedule C or C-EZ)	20,214
13	Capital gain or loss (Attach Schedule D if required. If not required, check here <input type="checkbox"/>)	179,849
14	Other gain or (loss) (Attach Form 4797)	
15a	Total IRA distributions	
15b	Taxable amount (see pg. 20)	
16a	Total pensions and annuities	
16b	Taxable amount (see pg. 20)	
17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. (Attach Schedule E)	
18	Farm income or loss (Attach Schedule F)	
19	Unemployment compensation	
20a	Social security benefits	
20b	Taxable amount (see pg. 24)	
21	Other income	
22	Add the amounts in the far right column for lines 7 through 21. This is your total income.	417,467
23	IRA deduction (see page 26)	
24	Student loan interest deduction (see page 26)	
25	Medical savings account deduction (Attach Form 8853)	
26	Moving expenses (Attach Form 3903)	
27	One-half of self-employment tax (Attach Schedule SE)	
28	Self-employed health insurance deduction (see page 28)	1,428
29	Keogh and self-employed SEP and SIMPLE plans	
30	Penalty on early withdrawal of savings	
31a	Alimony paid (b Recipient's SSN)	
31b	Add lines 23 through 31a	1,428
32	Subtract line 31b from line 22. This is your adjusted gross income.	416,039

1040 U.S. Individual Income Tax Return 2000

For the year Jan. 1, 2001, 2000, or other taxable beginning 2000, ending 2001, ending

Label: GEORGE W. BUSH
 Your first name and initial: GEORGE W.
 Last name: BUSH
 Social Security number: 111-11-1111

Spouse's label: LAURA W. BUSH
 Your first name and initial: LAURA W.
 Last name: BUSH
 Social Security number: 111-11-1111

Home address: C/O MORTENSON TRUST CO, PO BOX 803338, CHICAGO, IL 60680

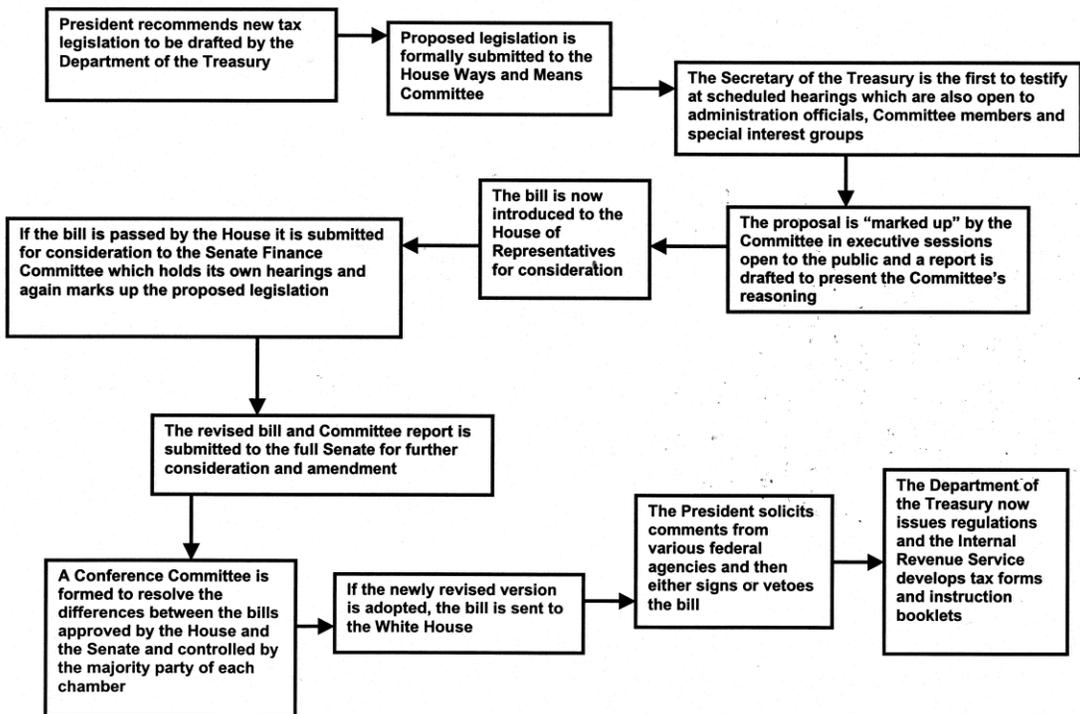
Filing Status: Married filing jointly (even if only one had income)

Exemptions: 1 Yourself, 2 Spouse, 1 Dependent

7	Wages, salaries, tips, etc. (Attach Form(s) W-2)	397,768
8	Taxable interest (Attach Schedule B if required)	38,201
9	Ordinary dividends (Attach Schedule B if required)	15,716
10	Taxable refunds, credits, or offsets of state and local income taxes (see page 21)	
11	Alimony received	
12	Business income or loss (Attach Schedule C or C-EZ)	
13	Capital gain or loss (Attach Schedule D if required. If not required, check here <input type="checkbox"/>)	42,075
14	Other gain or (loss) (Attach Schedule 4797)	
15a	Total IRA distributions	
15b	Taxable amount (see pg. 20)	
16a	Total pensions and annuities	
16b	Taxable amount (see pg. 20)	2,029
17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. (Attach Schedule E)	
18	Farm income or loss (Attach Schedule F)	
19	Unemployment compensation	
20a	Social security benefits	
20b	Taxable amount (see page 27)	
21	Other income. List type and amount (see page 29)	
22	Add the amounts in the far right column for lines 7 through 21. This is your total income.	765,801
23	IRA deduction (see page 26)	
24	Student loan interest deduction (see page 26)	
25	Medical savings account deduction (Attach Form 8853)	
26	Moving expenses (Attach Form 3903)	
27	One-half of self-employment tax (Attach Schedule SE)	
28	Self-employed health insurance deduction (see page 28)	
29	Keogh and self-employed SEP and SIMPLE plans	
30	Penalty on early withdrawal of savings	
31a	Alimony paid (b Recipient's SSN)	
31b	Add lines 23 through 31a	
32	Subtract line 31b from line 22. This is your adjusted gross income.	765,801

The Birth of Tax Legislation

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