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FIFTY YEARS OF DEVELOPMENT OF FEDERAL INCOME TAXES

By

JOSEPH BERMAN*

Income Taxes are not a new method of taxation. It was first tried in England in 1798, and used in other European countries from time to time. We first enacted an Income Tax Law during Civil War days. It is now employed as a means of taxation by most civilized nations.¹

Before the Civil War our National Government was financed by (1) customs duties, (2) the sale of public lands, (3) excise and internal taxes, (4) the tariff and (5) by borrowing money with the hope that at some future time a surplus would develop by means of which it will be able to pay back the loans incurred.

At the outbreak of the Civil War the National Government was not financially or psychologically prepared for the long and bitter struggle it had to face. The decline in customs and other revenue funds due to the panic of 1857 caused a Treasury deficit. The National Credit was in bad shape and the New York Banks were hesitating to lend money to the Government at the high rate of 12% interest on a purported floating of a $5,000,000 loan.² Congress decided to finance the War by the following means: 1. fiat money, 2. excise taxes on liquor, tobacco and other goods used for consumption and 3. taxes on individual income.³

The first income tax law was introduced and passed in 1861 but another tax measure was passed in 1862 which provided for the first National Income Tax to be levied throughout the country and it also established the Office of the Commissioner of Internal Revenue. This law was revised in 1864 to provide for more revenue and make its provisions definite and certain. This law as subsequently amended in 1865 and 1866 and thoroughly rewritten in 1867 and 1870 when the government's need for money was not so acute.

The law of 1861 provided for a 3% tax on income of residents of the United States in excess over a personal exemption of $800, and a 5% tax on income of United States citizens living abroad, but on the income from government securities the tax was only 1½%. The 1862 tax law provided a 3% tax on a person's income in excess of $600 and not exceeding $10,000, and a 5% tax on income in excess of $10,000. The 1864 law provided for a 5% tax on income over $600 and not exceeding $5,000, a 7½% tax on income over $5,000 and not exceeding $10,000 and a 10% tax on income over $10,000. The 1865 Act taxed income in excess of $5,000 at 10%. In 1867, the war having ended, the personal exemption was increased to $1,000 and the rate brought down to 5%. In 1870 the exemption was increased to $2,000 and the tax rate reduced to 2½%.

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¹ State ex rel. Bolens v. Frear, 148 Wis. 456, 134 N. W. 673 (1912).
² 36 Congress, 2nd. Session, House Miscellaneous Documents 20, p. 3.
These laws provided for direct dealing between our National Government and the taxpayers, first, in the collection of direct non-shiftable personal taxes, and second, the “stoppage-at-the-source” method of collecting taxes, on government salaries and corporation dividends and interest.

The principle of taxable net income was gradually established. Congress, afraid that taxpayers would deduct too many personal expenses from the gross income, therefore dodged the issue. The laws of 1861 and 1862 only allowed as deductions “national, state and local taxes.” The 1864 act allowed deductions for business expenses, interest, taxes, and rent—even the rent paid for homes—but did not allow depletion of natural resources, although it was under debate. The Act of 1866 and subsequent legislation allowed deduction for “losses actually sustained during the year arising from fires, shipwreck, or incurred in trade, and debts ascertained to be worthless but excluding all estimated depreciation of values.”

After the adoption of the Sixteenth Amendment to the Constitution a good deal of the phraseology of the Civil War Laws were written into the New Revenue Laws.

The law of 1864 taxed the net profits realized from sales of real estate purchased within the year for which income was estimated. In 1867 by amendment Congress taxed the net profits from the sales of real estate purchased within two years previous to the year for which income was estimated. The Office of the Commissioner of Internal Revenue established by the Law of 1862 issued rules and regulations interpreting the vague laws enacted by Congress, and this office was continued after the repeal of the income tax in 1872 so that it could administer the liquor and tobacco excise taxes. Later, when income tax laws were enacted, there existed a nucleus of an administrative organization backed by many precedents and with a valuable know-how.

The Civil War Income Tax was successful and raised $73,000,000 in 1866, and over the ten years of its existence raised $376,000,000. The tax was unpopular because it was: successful and it reached too many influential people. Congress repealed it because of the pressure groups that argued that (1) the revenue was not needed after the war, (2) the law was inequitable in many of its provisions, (3) the administrative methods inquisitorial, and (4) the administration thereof was inefficient and subject to political influence.

Congress thereafter unsuccessfully in each session had Income Tax Bills introduced from 1874 to 1893 inclusive. The authors of these bills were from the South and West and none from the East.

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Joseph Pulitzer, when he became the proprietor of the World in May, 1883, dedicated his paper "to the cause of the people rather than that of purse proud potentates" and included in his platform taxes on luxuries, inheritance taxes, taxes on large incomes, taxes on monopolies, taxes on privileged corporations, etc. The paper kept up this advocacy until 1894 when a new law was enacted. The income tax section which was attached to the tariff bill provided for a 2% levy on taxable income of individuals and corporations. Included in the tax base were the values of all "personal property (not real estate) acquired by gift or inheritance" during the year. There was a personal individual exemption of $4,000. In 1895 the Supreme Court in the case of Pollock v. Farmers Loan and Trust Company, declared the above act unconstitutional on the following grounds: (1) "imposition of a tax on income from state bonds was unconstitutional, since the federal government does not have the power to tax instrumentalities or means of the state." There was a rehearing on it and the majority of the court declared the act unconstitutional since "(1) taxes on rents or income of real estate are direct taxes; (2) taxes on personal property or on its income are direct taxes and therefore unconstitutional and void because not apportioned according to representation, all the sections, constituting one entire scheme of taxation, are necessarily invalid."

Professor Seligman, supra, criticized it and George F. Edmunds in "The Salutary Results of the Income-tax Decision," approved it.

In 1898 an income tax was proposed to finance the Spanish American War, but discarded. In 1907, Cordell Hull (Tenn.) introduced an income tax measure and resolutions to educate Congress on the subject. In 1908 the Democratic Party at its Convention adopted an income tax plank. In 1909 an inheritance tax was passed and tariff rates lowered, and the rates imposed were from 1% to 5% according to the amount of the bequest and the relation of the heir to the decedent.

This act was called "a special excise tax with respect to the carrying on or doing business by such corporation, joint stock company, or association." It provided that every corporation engaged in business in the United States should be subjected to an excise tax of 1% of its entire net income in excess of $5,000 received from all sources, exclusive of amounts received as dividends from corporations subject to tax. It exempted from the tax certain non-profit organizations as agricultural societies, certain fraternal beneficiary orders, building and loan associations organized for the mutual benefit of their members, and labor, charitable, educational and religious organizations "no part of the net income of which inures to the benefit of any private stockholder or individual."

8 Robert McElroy, Grover Cleveland, II:116-117.
11 FORUM 19:513 (July 1895).
12 Cong. Rec. 43:684; and 43:1324 and 43:2532.
14 36 Statutes at Large 112.
Net income was to be arrived at by deducting from gross income; the amount spent for all ordinary and necessary operating expenses, losses actually sustained within the year and not compensated by insurance or otherwise; interest paid on bonded or other indebtedness to an amount "not exceeding the paid-up capital stock . . . outstanding at the close of the year . . . ;" taxes of the United States or any other state or any foreign country; and dividends from stock of taxable corporations.

Income of foreign corporations doing business in the United States, was to be ascertained by deducting from gross income received in the United States the same expenses incurred in the United States as were deductible by domestic corporations.

Taxable companies were required to file by March 1st. of each year the following information as of the preceding December 31st: (a) the total amount of paid up capital stock outstanding, (b) the amount of bonded debt, (c) the gross income, (d) the total amount of all ordinary and necessary expenses, (e) the total amount of all losses, the amount allowed for depreciation, and, for insurance companies, the sums other than dividends paid within the year on policy and annuity contracts, (f) interest paid on debt and as to banks, interest paid on deposits, (g) taxes, showing separately the amounts paid to foreign governments, and (h) the net income after making the authorized deductions. The Commissioner of Internal Revenue had the power to require corporations to file returns if it had failed to do so, and to examine any books and papers of the corporation "for the purpose of ascertaining the correctness of the return or for the purpose of making a return where none has been made, to require the attendance of any officer or employee, and to invoke court aid. All proceedings taken by the Commissioner under the provisions of this section shall be subject to the approval of the Secretary of the Treasury."

Penalty for making a false return with fraudulent intent was put at 100% of the tax; for refusal or neglect to make a return, at 50% of tax due; for failure to pay tax on time, at 5% of the amount of the tax unpaid and interest at the rate of 1% a month from the time tax was due. If a company refused or neglected to make a return it was liable to a penalty of not less than $1,000 and not more than $10,000.

When assessments were made, the returns were to be filed in the office of the Commissioner and were to "constitute public records and be open to inspection as such." This provision was amended in 1910 by adding the following. "That any and all such returns shall be open to inspection only upon the order of the President under rules and regulations to be prescribed by the Secretary of the Treasury and approved by the President." Any one divulging such information "except upon the special direction of the President" was liable to a fine not exceeding $1,000 or imprisonment not exceeding one year, or both, at the court's discretion.
In March 1911 the Supreme Court in the case of Flint v. Stone Tracy Company upheld the law.15

During the years 1909 to 1912 inclusive there was collected under this Act $128,731,945.61.16 During 1913 $35,000,000 was collected.

On June 16, 1909 President Taft sent to Congress a message requesting a joint resolution for an amendment to the Constitution to be ratified by the states, so that the federal government might levy an income tax without regard to apportionment among the states.17

Alabama was the first state to ratify the amendment, and the 36th. state ratified it on February 3, 1913. The Secretary of State certified the adoption thereof on February 25.18

The Act of 1913 is considered as the first modern federal income tax.19 It provided that a tax of 1% be levied on the taxable income of every citizen of the United States, whether residing at home or abroad, and every resident of the United States, including the Philippine Islands and Puerto Rico. In addition a surtax was levied on the amount of taxable net income of individuals over $20,000.

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The Act defines income to include "gains, profits, and income derived from salaries, wages, or compensation for personal services . . . or from professions, vocations, business, trade, commerce, or sales or dealings in property . . . also from interest, rent, dividends, securities, or the transaction of any lawful business carried on for gain or profit, or gains for profits and income derived from any source whatever including income from but not the value of property acquired by gift, bequest, devise or descent."

Proceeds of life insurance and interest from state and United States bonds were exempt. Individuals could deduct the following: (1) necessary expenses incurred in carrying on any business, but not including personal or living expenses; (2) interest paid within the year; (3) federal, state and local taxes, but not including taxes assessed against local benefits, that is, special assessments; (4) losses

17 Cong. Rec. 44:4400-4404.
18 37 Statutes at Large 1785 and Dillon v. Gloss, 256 U.S. 386 (1921).
incurred in trade or from fires, storms, or shipwreck, not compensated by insurance; (5) bad debts charged off; (6) reasonable depreciation and depletion, in case of mines limited to 5% of the gross value of the output; (7) dividends from stock of a corporation taxable upon its net income (allowable only in computing normal tax) and (8) the amount of income on which tax was paid at the source.

Each taxpayer was allowed a personal exemption of $3,000, $1,000 additional if married and living with husband or wife. The law exempted the compensation of state and local officials, of the President of the United States then in office for the term elected, and the compensation of federal judges for terms of office which began before the passage of the law.

The rate on corporations was the same as that of the normal tax on individuals, 1% upon net income, without the flat exemptions allowed by the 1909 law.

Corporations were allowed to deduct (1) all ordinary and necessary expenses paid within the year on the maintenance and operation of its business or properties; (2) all losses actually sustained within the year not compensated by insurance, including a reasonable allowance for depreciation and, for insurance companies the "net addition ... required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts," and (3) interest on indebtedness, but not more than 1/2 of the sum of its interest-bearing indebtedness and its paid up capital stock outstanding at the close of the year;" provided that in the case of indebtedness wholly secured by collateral the subject of sale in ordinary business of such corporation the total interest could be deducted; (4) taxes paid to the United States or any state or foreign government.

The normal tax on individuals was collectible at the source if it amounted to $3,000 or more. In the case of interest on bonds, mortgages or deeds of trust issued by domestic corporations, or in the case of interest or dividends paid by foreign corporations, the tax was withheld if income was even less than $3,000.

It exempted from tax certain non-profit corporations as, agricultural organizations, fraternal beneficiary societies, lodges, civic leagues, educational, religious and scientific societies.

Foreign corporations, were to compute taxable net income by deducting from gross income the amount of income from business in the United States, expenses of conducting business in the United States, and losses incurred in the United States.

Partnerships as such were not taxed separately, each partner was taxed on his respective share of the profits, whether distributed or not.

Returns by individuals who had a net income of over $3,000 were required to be filed on or before March 1, 1914. Corporations had to file their returns on the same date or within 60 days after close of its fiscal year. The maximum penalty for a corporation which refused or neglected to make a return or made a
false return was $10,000. Individuals under similar circumstances were guilty of a misdemeanor subject to a fine not in excess of $2,000.

The Commissioner was empowered to prescribe forms and regulations for the collection of the tax, to authorize suits for recovery of taxes and penalties, to refund taxes illegally assessed or collected, and to compromise any civil or criminal case under the internal revenue laws.\(^{20}\) He had similar authority ever since 1862 when his office was first established.

This Act was declared constitutional on January 24, 1916 in *Brushaber v. U. P. R. R.*\(^{21}\) This Act yielded for the years 1914 to 1916 inclusive $276,509,221.

The purpose of all the tax acts mentioned in this article is revenue. As the Supreme Court stated in *Helvering v. Stockholms Enskilda Bank*,\(^{22}\) "The general object of this act is to put money into the Federal Treasury; and there is manifest in this reach of its many provisions an intention on the part of Congress to bring about a generous attainment of that object by imposing a tax upon pretty much every sort of income subject to the federal power."


The income tax was completely rewritten, its wording clarified and a greatly improved arrangement resulted from its enactment. The normal tax rate was raised to 2% for both corporations and individuals. The surtax for individuals applicable to income over $20,000 was increased from a maximum of 6% on income over $500,000 to a maximum of 13% on income over $2,000,000. Personal exemptions remained at $3,000 for single men and $4,000 for a married couple.

List of exempt non-profit corporations was increased.

Deduction for losses were extended to provide for losses incurred in transactions outside of the taxpayer's regular business or profession, but only to the extent of profits arising from it.

Partnerships were placed on the same basis as individuals as far as deductions were concerned.

Stock dividends were taxable "to the amount of their cash value."\(^{24}\) This was declared unconstitutional in the case of *Eisner v. Macomber*.

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\(^{20}\) R. S. Sections 3173, 3176, 3179, 3213, 3214, 3215, 3220-3229.
\(^{21}\) 240 U.S. 1.
\(^{22}\) 293 U.S. 84, (1934).
\(^{23}\) Cong. Rec. 53:13297, 12293, 13852-13858; 39 Statutes at Large 756.
\(^{24}\) 252 U. S. 189 (1920).
In defining income the word "lawful" was omitted from the phrase "business carried on for profit."

Tax payments were advanced to June 15.

The section defining depletion of mines was rewritten in more general terms, omitting the phrase "5% of the value of output at the mine."

Non-resident aliens were subjected to tax on income from bonds with underlying assets situated in the United States.

A special additional income tax of 12 1/2% was levied on the net profits of manufacturers of munitions, but the profits from dynamite, blasting powder, cartridges and caps used for industrial purposes were excluded.

A capital stock tax on all corporations was levied at a rate of 50 cents per $1,000 fair value of the capital stock after allowing an exemption of $99,000.

A tax was imposed "upon the transfer of the net estate of every decedent . . . whether a resident or non-resident of the United States." Residents were granted a $50,000 exemption, for non-residents the exemptions and deductions were in proportion to the amounts of their estates situated in the United States. The rates were graduated from 1% on amounts that did not exceed the exemption by $50,000 to 10% on amounts that exceeded the exemption by over $5,000,000.

The first excess profits tax was passed with the enactment of the Revenue Act of March 3, 1917. It contained 13 titles but we are only concerned in this article with three: (I) War Income Tax; (II) War Excess Profits Tax; and (XII) Income Tax Amendments. This Act is an Amendment to the Act of September 8, 1916.

Title I provided for a normal tax of 2% on individual net income, and 4% on that of corporations in addition to the 1916 rates, making a total of 4% for individuals and 6% for corporations. For the additional 2% tax the personal exemption of individuals was reduced from $4,000 for heads of families and $3,000 for single individuals to $2,000 and $1,000. A head of a family was allowed an additional exemption of $200 for each dependent.

The surtax in addition to that already in effect (with maximum rate of 13%) was graduated from 1% on amounts by which income exceeded $5,000 and did not exceed $7,500 to 50% on amounts over $1,000,000 making a 63% total on the highest bracket.

Title II provided for the War Excess Profits Tax, applicable to individuals, partnerships and corporations, levied on the difference between the prewar normal profits and those of 1917. The basic normal years chosen were 1911, 1912 and 1913. A deduction was allowed of an amount equal to the same percentage of invested capital for the taxable year which the average amount of the net income for the prewar period was of invested capital for the prewar period, but not less than 7% nor more than 9% of invested capital for the taxable year, and $3,000 for corporations and $6,000 for individuals and partnerships.
If there was no income from business during 1911, 1912 and 1913, or the relation of net income to capital was low in comparing it with other concerns in similar business, the Secretary of the Treasury was empowered to grant a deduction equivalent to that granted such concerns.

The tax rate was graduated from 20% to 60%.

Contributions of individuals to educational and philanthropic organizations were allowable deductions not exceeding 5% of taxable net income.

A new penalty tax of 10% was levied on undistributed corporate earnings except such as were "actually invested in the business or . . . retained for employment in the reasonable requirements of the business," or invested in United States obligations issued after September 1, 1917, and if the Secretary of the Treasury found that any portion of the surplus was "not reasonably required in the business, the tax was 15%.

This was provided for to compel corporations to distribute its unnecessary and unused earnings to shareholders in higher brackets who were subject to surtax. The Revenue Act of 1918\(^2\) became effective on February 24, 1919. It was a complete entity composed of 14 titles, but we in this article are only concerned with the first four and the last three.

The income tax sections were completely rewritten and rearranged. The normal tax rates for individuals for 1918 income were 6% on the first $4,000 and 12% on the remainder. For each calendar year thereafter the rates were 4% on the first $4,000 and 8% on the remainder. Surtax rates began at 1% on income in excess of $5,000 and increased by 1% for each of the succeeding brackets until reaching a maximum of 65% on the amount over $1,000,000.

The corporation income tax rate was 12% on income for the calendar year 1918 and 10% for each year thereafter. For railroads then under federal control, 10% for 1918 and 8% for each year thereafter.

The War-Profits and Excess Profits Tax rates applicable to corporations only were 30% to 80%. Certain sections were written in permitting liberal deduction for amortization of buildings, machinery and equipment constructed or acquired after April 6, 1917, for the prosecution of the War. A provision was also made for substantial loss from depreciation in value of inventories. The law provided that a corporation created or used to prevent imposition of surtax upon its stockholders by permitting accumulation of gains and profits would be taxed as a personal service corporation.

Personal service corporations and partnerships were not subject to the corporation income or war-excess profit taxes.

The allowance of $200 for dependents was enlarged extending it to other dependents including children.

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\(^{25}\) 40 Statutes at Large 300.
\(^{26}\) 40 Statutes at Large 1057.
Consolidated corporate returns were provided for. Title XII levied a 10% tax on the net earnings of mines, quarries, factories or other establishments employing children under 16 years of age. This was declared unconstitutional by the case of Bailey v. Drexel Furniture Co.\(^{27}\)

This law was too complex and a good many of its provisions were unenforceable and caused a good deal of litigation.

The Revenue Act of 1921\(^{28}\) eased the tax burden by reducing the rates of the surtax, eliminated the excess profits tax after 1921, permitted the carry-over of net losses for 2 years, and granted the option of filing consolidated returns. The new treatment of capital gains and losses was an important innovation which was followed up to 1932.

There were 13 Titles of which Title II—Income Tax Rates, Title III—War Profits and Excess Profits, and Title XIII—General Administrative Provisions are of importance to us in this article.

No change was made in the rates of the normal income tax which was 4% on net income of $4,000 or less and 8% on income in excess of that amount. The personal exemption for those with income of $5,000 or less was increased from $2,000 to $2,500 for a head of a family and for a married couple, but remained at $1,000 for a single person. The exemptions for dependents was increased from $200 to $400. The surtax rates for 1922 and thereafter was reduced from 65% on income of $1,000,000 to 50% on that in excess of $200,000. For 1921, the Act of 1918 rates were retained, the rate in this law for income in excess of $2,000,000 was 60%.

Stock dividends were not subject to tax. A general rule was established as to distributions in liquidations. Distributions were to be treated as partial or full return of cost of stock or shares to the distributor, and, if stockholder received more than the cost of his stock, he was taxable on the excess as though the stock was sold. Gains made before March 1, 1913, were not taxable.

In order to avoid tax evasion by way of gift of property that appreciated in value, a new rule was established: the basis for determining loss or gain in case of property acquired by gift after December 31, 1920, was to be the same as if the last preceding owner has sold it.

A section provided for taxation of capital gains. Profits from the sale of assets held over two years could be separated from other income and taxed at 12\(\frac{1}{2}\)% instead of the regular tax rate if the taxpayer so desired, provided that the taxpayer did not pay less than 12\(\frac{1}{2}\)% upon his entire net income.

Depreciation changes were made in this law permitting it to be made at cost or in the case of property acquired before March 1, 1913, the fair market value.

\(^{27}\) 259 U.S. 20.
\(^{28}\) 42 Statutes at Large 227.
of the property involved on that date. This was changed in order to clarify the cases of Goodrich v. Edwards$^{29}$ and Walsh v. Brewster.$^{30}$

It made generous provisions as to allowances for deductions. Net losses carry overs were forwarded for two years, but were allowed only as to losses incurred in the operation of taxpayers trade or business. Travelers were allowed to deduct for meals and lodgings while away from home. Building and loan association exemptions were limited to those who confined the making of loans only to their members.

The corporation tax was raised from 10% to 12½%. An exemption of $2,000 was allowed to those with net income of $25,000 or less. Consolidated or separate returns were permitted but once choice was made the pattern had to be followed unless change was allowed by the Commissioner.

Insurance companies, except mutuals, were taxed on the basis of "their investment income from interest, dividends and rents, with suitable deductions fairly chargeable against such investment income." Life insurance companies were relieved of excess profits tax and capital stock tax for 1921, and for all other insurance companies the new tax was substituted instead of all other taxes for 1922 and succeeding years. The tax rate was 12½%.$^{31}$

This law treated "personal service corporations" as such and taxed them accordingly for 1922 and following years.

Final settlement of income tax cases was allowed by written agreement between the Commissioner and taxpayers. A provision was inserted making the government liable to the payment of interest on taxes improperly collected. A Tax Simplification Board was established, three members representing the public and three, the Bureau.

The Revenue Act of 1926$^{32}$ of which Titles I, II, III, X, XI and XII covered income and estate tax rates and administration problems. The rate on individual income was reduced 1½% on the first $4,000 taxable income, 3% on the next $4,000 and 5% on the remainder. The surtax rates started at 1% on income in excess of $10,000 and went up to 20% on income exceeding $100,000. Personal exemptions were increased to $1,500 for a single person and for a head of a family or a married person living with husband or wife the exemption was $3,500. Dependents exemption remained at $400. Earned income was allowed a 25% credit in tax rates and $20,000 instead of $10,000 was the upper limitation as to what was considered earned income.

The tax on capital stock of corporations was repealed and tax on corporations was raised from 12% to 13% for 1925 and 13½% after that, with the exception

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29 255 U.S. 527.
30 255 U.S. 536.
32 44 Statutes at Large 9.
made for insurance companies, whose tax was left at 12 1/2%. The exemption of $2,000 on net income of $25,000 or less remained the same as before.

Section 220 was modified, relaxing the penalty if the stockholders reported in their individual returns the distributive shares of net income for taxable year, whether gains were distributed or not.

The section on mining depletions were rewritten allowing oil and gas wells a 27 1/2% of the gross income depletion, and not over 50% of the net income of taxpayer from the property involved.

New provisions were made to determine gain or losses in sale of properties received as a gift or in exchange for other property. In case of installment sales express provision was made defining net income.

Exempt corporations were increased to include "farm or other mutual hail, cyclone, casualty, or fire insurance associations or companies . . . the income of which is used or held for the paying of losses or expenses." Stricter limits were imposed on exemption of farmers, fruit growers and similar cooperative marketing organizations.

Inspection of tax lists were liberalized. Slight changes were made in assessment procedures, reducing period in which additional assessment can be made to three years instead of four.

The estate tax exemption was increased to $100,000 and rates of taxation were decreased not only for estates subject to the 1926 law but also those subject to the 1924 law. Rates were graduated from 1% to 40%. Credit was given up to 80% on death duties paid to states of the amount of federal tax. Transfers of property made within two years of death were considered made in contemplation of death.

The number of members of The Board of Tax Appeals was reduced to sixteen, their tenure of office to twelve years. A $10,000 fee was provided for the filing of petitions. Stenographers' minutes were required on hearings and written reports except in dismissed cases. Appeals from the Board's decisions could be taken to the Circuit Court of Appeals where the taxpayer was a resident, or to the Circuit Court of the District of Columbia. Its judgment was final except that it could be reviewed by the Supreme Court.

The office of General Counsel for the Bureau of Internal Revenue in the Treasury was created to assume the duties of the Solicitor of Internal Revenue in the Department of Justice.

The Revenue Act of 192883 contained five Titles: I—Income Tax; Title II—Miscellaneous Taxes; Title III—Amendments to the 1926 Income Tax; Title IV—Administrative Provisions, and Title V—General Provisions.

In Title I, Income Tax, the maximum amount that could be considered earned was increased from $20,000 to $30,000. The corporation tax was reduced to

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83 45 Statutes at Large 791.
12%. An exemption of $3,000 was allowed if the annual net income was $25,000 or less.

A section was added permitting employers who established pension reserve funds to transfer them to a pension trust and deduct that amount from its gross income. On distribution, individuals receiving earnings of the fund were taxable for it. Exemptions were extended to real estate boards not organized for profit, teachers retirement fund associations and to financing corporations organized by marketing associations.

A taxpayer could carry forward net losses until the third succeeding year in computing net income. Title II, Miscellaneous Taxes, dealt with estate taxes, taxes on admissions and dues, automobiles, cereal beverages, liquors, narcotics and foreign-constructed boats. Excises were reduced. Taxes on manufacturers of automobiles were repealed. Taxes were increased on foreign-built yachts and admission to prize fights.

The Commissioner was given power to enter into closing agreements with taxpayer and make new regulations.

The Revenue Act of 1932 was composed of nine titles: I—Income Tax; II—Additional Estate Tax; III—Gift Tax; IV—Manufacturers Excise Tax; V—Miscellaneous Taxes; VI—Estate Tax Amendments; VII—Tax on Transfers to Avoid Income Tax; IX—Administrative and General Provisions.

A normal tax of 4% was imposed on the first $4,000 of taxable net income of individuals and 8% on the remainder. A surtax at 1% was imposed on net income in excess of $6,000 which increased by 1% steps to a maximum of 55% on net income exceeding $1,000,000. Personal exemption was reduced to $1,000 for single men and $2,500 for head of family or married people. Rates on corporations were increased to 13 1/4%. Consolidated returnees had to pay an additional 3/4 of 1% tax.

Interest incurred in carrying or purchasing an annuity was not deductible. No loss was deductible from gross income if claimed for estate tax purposes. Non-resident employees of the United States were subjected to income tax. The $300 exemption for dividends for building and loan associations was eliminated. Stricter limitations were made on losses sustained from the sale or exchange of securities held two years or less. Salaries of presidents of the United States and federal judges taking office after June 6, 1932, were subjected to income tax.

Reorganization provisions were amended to prevent evasion. The law was clarified and strengthened as to "wash sales." Sulphur, coal and metal mines were no longer allowed discovery depletions.

A graduated tax on estates was imposed over that of the 1926 Act so that rates were more than doubled. Gift taxes were imposed at graduated rates from 3/4 of 1% on net gifts in excess of $10,000 to a maximum of 33 1/2% on amounts

84 47 Statutes at Large 169.
exceeding $10,000,000. A $50,000 flat deduction was allowed and gifts made to
the United States or any state or political subdivision for public purposes were free
of gift tax; the same rule applied to corporations, trusts or foundations organized
for religious, charitable, scientific or educational purposes; and to organizations of
war veterans.

In the case of installment rates, the tax was collectible on each payment; and in cases of overpayment of excise taxes, refunds and credits were allowed
without interest.

The Revenue Act of 1934 contained seven titles: I—Income Tax; IA—
Additional Income Tax on Personal Holding Companies; II—Amendments to
Estates Tax; III—Amendments to Prior Act and Miscellaneous; IV—Excise Taxes;
V—Capital Stock and Excess Profits Tax; VI—General provisions.

The income tax on individuals was a normal 4% rate. The surtax rates gra-
uated from 1% on income over $4,000 and not over $6,000 to 59% on income
exceeding $1,000,000. A credit of 10% was allowed for earned income not exceeding $14,000; the first $3,000 income from any source was assumed earned.

Railroads were the only taxpayers permitted to file consolidated returns at a
2% additional privilege tax.

A new method was devised for taxing capital gains and losses of individuals.
A tax was imposed upon improperly accumulated surplus of any corporation organ-
ized and availed of by individuals to evade surtaxes.

Amendments made to restrict deductions; estate, inheritance and gift taxes
could not be deducted from gross income. Contributions were not deductible if
made to lobbying or propaganda organizations. Deductions of losses from gambling
were limited to gains. No loss could be taken on any sale or exchange of property
between members of a family, except in liquidations, nor between any individual
and a corporation in which he owned, directly or indirectly, more than 50% of
outstanding stock.

The provision for excluding annuities from gross income was revised. Reor-
ganization provisions were tightened to prevent tax evasion in distribution of its
stock or securities tax free to shareholders. Publicity "pink slip" provisions were
inserted in the act.

A surtax was imposed on undistributed income of personal holding companies,
on the so-called "incorporated pocket books."

Estate Tax rates were increased to a maximum of 60% on estates in excess
of $10,000,000.

Excise taxes were levied on imports of coconut and other edible oils, includ-
ing whale and fish oil. The soft drink tax was repealed, but the tax on gasoline
was continued. The stamp tax on sales of produce for future delivery was reduced.

85 48 Statutes at Large 680.
It reenacted the capital stock tax at $1.00 for each $1,000 of the adjusted declared value of capital stock of every taxable corporation.

The Revenue Act of 1936 was divided into nine titles: I—Income Tax; IA—Additional Income Taxes; II—Capital Stock and Excess Profits Tax; III—Taxes on Unjust Enrichment; IV—Export, Charitable, etc. Refunds and Floor Stocks Adjustments under AAA; V—Amendments to Taxes on Certain Oils; VI—Miscellaneous Provisions; VIII—General Provisions; VII—Refunds of Amounts collected under the AAA. For our purpose we are only interested in Titles I, IA, II and VIII.

Shareholders were subject to normal as well as surtax on corporation dividends received.

Corporations were taxed at the following rates on their "normal tax net income," 8% on income not exceeding $2,000, 11% on excess of $2,000 to $15,000, 13% on excess of $15,000 to $40,000, and 15% on excess of $40,000. Banks and insurance company rates were 15%.

"Normal tax net income" was defined as net income minus (a) interest on obligations of the United States, (b) 85% of dividends received from corporations subject to tax. Mutual insurance companies were not allowed the second deduction ("b" above) but were credited with dividends paid.

A new surtax imposed on corporations intended to force them to distribute their profits. The rates had five graduated steps. "Adjusted net income" was defined as net income deducting therefrom the normal tax and interest from United States obligations and that of its instrumentalities. Affiliates of holding companies and national mortgage associations were given additional credits. "Undistributed new income" was defined adjusted net income deducting from it (a) dividends paid during taxable year, and (b) credit allowed because of contracts entered into prior to May 1, 1936, restricting dividend payments.

Banks, insurance companies, foreign corporations, bankrupt corporations, corporations deriving 50% or more of their gross income from sources within U. S. possessions, corporations organized under China Trade Act, and Joint Stock Land Banks were exempt from surtaxes.

Penalties for improperly accumulating surplus were imposed on corporations not subject to surtax on undistributed profits, 25% of amount of retained net income not exceeding $100,000 plus 35% of amount of retained net income exceeding $100,000. Corporations subject to surtax on undistributed profits, 15% of amount of retained net income not exceeding $100,000 plus 25% of the amount in excess of $100,000.

Distributions by corporations in either stock or money, at the election of shareholders constituted a taxable dividend in the hands of shareholders. A small penalty was imposed on taxpayers for failure to file a duplicate return.

86 49 Statutes at Large 1648.
The tax rate on undistributed income of personal holding companies were reduced to a minimum amount of 8% and a maximum of 48%.

Capital stock tax was reduced to $1.00 for each $1,000 of value of capital stock. The excess profits tax rate remained unchanged.

The Revenue Act of 1937\(^\text{37}\) was an amendment of the 1936 act. It increased the tax rate on undistributed income from 8% to 65% on income not exceeding $2,000, and from 48% to 75% on the remainder. "Personal holding company" was redefined in order to plug previous loopholes as to "incorporated talent" and rents, yachts, estates, etc.

Foreign personal holding companies were taxed by including their undistributed income in gross income of its stockholders within the jurisdiction of the United States whether citizens, residents, corporations or partnerships.

The Act disallowed deductions for losses from sales or exchanges of property between (a) members of a family, (b) an individual and the corporation of which he owned more than 50% of its stock, (c) two corporations of which individual owned more than 50% of its stock, (d) a grantor and a fiduciary of any trust, (e) a fiduciary of two trusts, if the same person was their grantor, and (f) a fiduciary of a trust and any beneficiary thereof.

A $1,000 exemption was granted to trusts only if they did not permit or require accumulation of any portion of income. Its fiduciaries were required to file returns no matter what was the amount of their income.

Non-resident aliens were taxed 10% on income from United States sources if the net income did not exceed $21,000, if greater the regular and normal surtax rates were imposed.

The Revenue Act of 1938\(^\text{38}\) was a new law containing seven titles: I—The Income Tax; IA—Personal Holding Companies; II—Estate and Gift Taxes; III—Capital Stock and Excess Profits Taxes; IV—Excise Taxes; V—Miscellaneous Provisions; VI—General Provisions.

It changed the computation of gain or loss from sale of capital assets for individuals. Profits from such sales of capital assets held for 18 months only were designated "short term capital gains" and those held over 18 months were designated "long term capital gains." Short term capital gains were taxed at regular normal and surtax rates. Short term capital losses were allowed only to the extent of short term capital gains, but if "short term capital losses" exceeded "short term capital gains" in any year, the net loss could be carried forward for one year provided and to the extent that it did not exceed the ordinary net income of the year in which such short term net loss was sustained as an offset against short term capital gains in succeeding year. (Consult the 1938 Act, supra, for various other changes made some of which were severe in nature).

\(^{37}\) 50 Statutes at Large 813.

\(^{38}\) 52 Statutes at Large 447.
Every partnership was compelled to separate for other income gains or losses from sale of capital assets. Tax on capital gains was computed, even though in the hands of an individual, on the basis of 100% of short term gains and 66 2/3% or 50% of long term gains.

Changes were made in the taxation of corporate net income; they are elaborate and those interested should consult 52 Statute at Large, supra. The undistributed profits tax was eliminated as far as most corporations were concerned, but the law was not greatly simplified. On the contrary, the formulae for computing taxes in special cases were very complicated. (See 52 Statute at Large, supra).

Every trust having an income of $100 or more for the taxable year had to file a return. Contributions made by corporations were restricted to those paid within the taxable year. Individuals were restricted to contributions made to domestic institutions. Corporations were restricted in the same manner by the 1936 laws. The provision for improperly accumulating surplus was revised, placing the burden of proof on the taxpayer. Producers and processors of non-ferrous metals, copper, brass and tanners were allowed to inventory their raw materials in order of acquisition.

The method of computing surtax on personal holding companies was changed. (See 52 Statute at Large, supra).

Individual gift tax exemption for donor was reduced to $4,000 for each gift and gifts in trust were not granted an exemption.

Capital stock and excess profit taxes were slightly amended. Many excise taxes were repealed. Closing agreements were permitted between Commissioner and taxpayer in gain or loss transactions.

The Revenue Act of 1939\(^89\) consists of four Titles amending the Internal Revenue Code: Title II—Income Tax Amendments; Title III—Capital Stock and Excess Profits Taxes; Title IV—Miscellaneous Amendments.

For corporations with net income of more than $25,000 there were tax deductions (see 53 Statutes, supra).

\textit{Bona fide} purchasers of securities were freed from federal liens. It was made unlawful to sell information obtained from income tax returns.

The Revenue Act of 1940\(^40\) in Title I—changes surtax rates on individuals and corporations by increasing the rates on them. (For full details see §§ 2 and 3 which amend §§ 12b and 13b of the Internal Revenue Code). It also increases from 10% to 15% the tax on non-resident alien individuals (for full details see § 4 which amends § 211 (a) (1) (A) and 211 (c) (2) and § 211 (c) of the Internal Revenue Code. § 5 (a) and (b) amends § 143 and 144 of the I.R.C. as it relates to withholding of taxes at the source. § 6 amends § 25 (b) (1) of the I.R.C. changing personal exemptions, and § 7 amends § 51 (a) of the

\(89\) 53 Statutes at Large 862.
\(40\) Public Law 656-76th. Congress, Ch. 419-3rd. Session.
I.R.C. amending the requirements for individual returns and amends § 142(a) of the I.R.C. as to requirements of fiduciary returns, and amends § 147(a) of the I.R.C. as to information returns. § 8 refers to treaty obligation and § 9 to taxable years to which the law is applicable.

Title II—Income Tax, § 201 amends the I.R.C. by adding § 15 which provides for a defense tax for five year. § 202 amends § 143 of the I.R.C. by inserting a new subsection (h) increasing the rates of withholding from 15% to 16½%. § 203 amends § 500 Personal Holding Companies Tax by inserting (a) General Rule at the beginning of the paragraph and (b) a defense tax for five year. § 204 amends Excess Profits Tax, § 600 of the I.R.C. inserting (a) general rule and (b) a defense tax for five years. § 205 amends Capital Stock Tax § 1200 of the I.R.C. inserting § c defense tax for five years, and § 206 amends Ch. 3 of the I.R.C. as to Estate Tax by inserting § 951 providing for a defense tax for five years. § 207 amends § 1001 for the I.R.C. referring to gift taxes inserting § d defense tax for 1940 to 1945. § 208 amends § 1250 of the I.R.C. referring to tax on transfers to avoid income tax inserting § b a defense tax for five years. § 209 amends § 1801, 1802, 3403(f)(1), 3452, 3460(a), 3465, 3481(b) and 3482 of the I.R.C. extending and continuing excise taxes to 1945. § 210 Miscellaneous adds to Ch. 9A. Defense taxes for five years on fifty-four items.

The second Revenue Act of 194041 Title I, § 101 amends I.R.C. § 13 (b) Corporation Income Taxes by increasing them substantially. Title II, § 201 amends the I.R.C. as to Excess Profits Tax by adding on subchapter E, changing substantially the law on the subject. Title III, § 301 amends the I.R.C. § 123 to amortization deduction. Title V, § 501 amends § 115 and § 373 of I.R.C. as to earnings and profits of corporations and personal service corporations.

In 194142 Congress amended the Internal Revenue Code substantially, changing the excess profits tax in a very elaborate manner.

The Revenue Act of 194143 amended by Title I, § 101, § 12 (b) I.R.C. as to surtax rates on individuals, corporations, mutual investment companies, tax on non-resident alien individuals, tax on foreign corporations, withholding taxes at the source, etc. Title II § 201 amends § 710 I.R.C. as to Excess Profits Tax. Title III, § 301 amends § 1200(a) I.R.C. as to Capital Stock Tax and Declared Value Excess Profits Tax. Title IV, § 401 amends § 935(b) I.R.C. as to Estate and Gift Taxes. Title V, § 501 amends § 3452 I.R.C. as to Excise Taxes and imposes additional new excise taxes and transportation taxes, taxes on use of motor vehicles and boats, a processing tax on certain oils, and Title VI imposes a non-essential Federal Expenditure Tax.

benefits of ownership and be relieved of the attendant burdens.”

41 Public Law 801-76th. Congress, Ch. 757-3rd. Session.
42 Public Law 10-77th. Congress, Ch. 10-1st. Session.
43 Public Law 250-77th. Congress, Ch. 412-1st. Session.
The Revenue Act of 1942,\textsuperscript{44} Title I, amends Ch. I, dealing with individual and corporation income taxes, taxes on non-resident alien individuals, taxes on foreign corporations, income received from Estates under gifts, bequests, devises and inheritance. It excludes from taxes pensions and annuities from disability resulting from military service; excludes income from discharge of indebtedness; railroad corporations and discharging indebtedness in certain judicial proceedings; improvements by lessees; recovery of bad debts; and prior taxes and delinquency amounts under certain circumstances. It admits additional allowance for non-commission military and naval personnel and establishes last-in-first-out inventory rules. It provides as to alimony and separate maintenance payments and non-trade or non-business deductions for deductions allowable to purchasers for State and Local Retail Sales Taxes, and for deductions for stock and bond losses on securities in affiliated corporations, (2) for bad debts, (3) corporate contributions to the United States, or for charitable use outside United States, (4) amortizable bond premiums, (5) for medical, dental expenses, and (6) for amounts paid to cooperative apartment corporations. It reduced personal exemption and credit for dependents and exempted voluntary employee associations. It amended gifts provisions and provides for percentage depletion for coal, fluorspar, ball and sagger clay, rock asphalt and metal mines and sulphur and for capital gains and losses and war losses, and recovery of unconstitutional federal taxes. It also amends establishment of foreign tax credits and extends the privilege of consolidated returns to certain corporations. It treats aliens and foreign corporations as non-residents. It amends pension trust law and taxation of life insurance companies; also that of insurance companies other than life or mutuals and mutual marine insurance companies and mutual insurance companies other than life or marine. It also adds on a number of important administrative changes and a "Chapter on Regulated Investment Companies" and a victory tax on individuals. It amends the personal holding companies sections. Title II, § 201 amends the Excess Profits Tax and adds on § 250 and § 780 as to post war refunds of Excess Profits Tax. Title III, § 301 covers amendments to capital stock and declared value excess profits taxes. Title IV, § 401 amends estate and gift taxes. Title V—amends prior revenue acts and miscellaneous provisions. Title VI amends excise taxes. Title VII amends the Social Security Act. Title VIII amends renegotiation of war contracts.

Current Tax Payment Act of 1943\textsuperscript{45} adds subchapter "D" on the collection of income tax at the source on wages and subchapter "E" establishes certain general administrative provisions.

Revenue Act of 1943,\textsuperscript{46} Title I, amends individual and corporation income taxes and withholding of tax at the source on wages. Title II, amends Excess Profits Tax and post war refund of Excess Profits Tax. Title III, amends excise taxes; Title

\textsuperscript{44} Public Laws 753-77th. Congress, Ch. 619-2nd. Session.

\textsuperscript{45} Public Law 68-78th. Congress, Ch. 120-1st. Session.

\textsuperscript{46} Public Law 235-78th. Congress, Ch. 63-2nd. Session.
VI, amends federal unemployment taxes; Title VII determines renegotiation of war contracts; and Title VIII controls repricing of War Contracts.

The Individual Income Tax Act of 1944, was passed by Congress with the idea of simplifying individual income taxes which became difficult to understand.

The Tax Adjustment Act of 1945 was passed by Congress in order to facilitate reconversion.

The Revenue Act of 1945 was passed by Congress in order to reduce taxes. Title I reduces normal and surtax on individuals and the surtax on corporations. Title II repeals Capital Stock Tax and Declared Value Excess Profits Tax, Title III repeals certain Excise Taxes, and Title IV revises Social Security Taxes.

The Revenue Act of 1948 reduces normal and surtax. Title II establishes credits against net income for normal tax and surtax. Title III provides for splitting of income between husband and wife and repeals the 1942 Community Property Amendments. It establishes Marital Deductions for bequests to spouse. Part III provides for the Law as to Gifts of Community Property. Title IV Adjusted gross income of less than $5,000; Title V reduction of withholding tax at source on wages. (For a full discussion on the subject consult my article on Effect of the New Tax Law on Wills and Trusts, Bar Bulletin New York County Lawyers Association Vol. 6, No. 1, May 1948*).

The Revenue Act of 1950 Title I increases normal tax and surtax on individual income taxes. Part II increases rate on corporation income taxes. Title II makes Miscellaneous Income Tax Amendments. Extends time in case of discharge of indebtedness. Creates Income Tax exemptions for members of armed forces serving in combat areas. Title III provides for the method of treatment of gifts and bequests to certain exempt organizations. Title IV provides for Income Taxes on Life Insurance Companies. Title V amends Estate Tax as to transfers in contemplation of death. Title VI adds certain new sections to excise taxes. Title VII directs study in report as to Excess Profits Tax.

The Excess Profits Tax of 1950, Title I, provides additional revenue by imposing a corporate excess profits tax. Title II increases corporation surtax. Title III provides for miscellaneous amendments and provisions as to consolidated returns, foreign tax credits, expenditures for advertising and good will, and certain technical amendments.

47 Public Law 315-78th. Congress, Ch. 210-2nd. Session.
51 Public Law 814-81st. Congress, Ch. 994-2nd. Session.
52 Public Law 900-81st. Congress, Ch. 1199-2nd. Session.
Conclusion

The law governing income taxation is to be found in:

1. The 16th Amendment to the Constitution of the United States, which provides for the taxation of “income from whatever source derived.”

2. The Internal Revenue Code and subsequent Congressional Legislation on the subject.

3. The Treasury Department “regulations” which interpret, augment and apply by way of illustration the Internal Revenue Code and the statutes.

4. The court decisions on the subject.

5. Decisions of the Tax Court.


The Internal Revenue Code, which came into being on February 10, 1939, is a codification of the law on the subject.

There are various Supplements to it, as, for example, Supplement E—on Estate Taxes etc.

Congress of recent years is annually revising the law, raising or lowering taxes as the necessity of the government requires it, continually attempting to plug loopholes in the law. It is a battle of wits between the tax experts and the Congress, and, as the Supreme Court aptly stated in Burnett v. Wells58 “One can read in the revisions of the revenue acts the record of the Government’s endeavor to keep pace with the fertility of invention whereby taxpayers had contrived to keep the larger benefits of ownership and be relieved of the attendant burdens.”

58 289 U.S. 671 (1933).