MARK A. LUSCOMBE, J.D., LL.M., CPA, is a Principal Analyst at Wolters Kluwer Tax & Accounting.

Tax Trends

Taxes Magazine Begins Publication 100 years ago as the Federal Income Tax Secures a Firm Foothold in the U.S. Tax System

By Mark A. Luscombe

When Taxes Magazine began 100 years ago, the U.S. income tax was 10 years old, having been enacted in 1913. However, income taxes had been enacted a couple of times before. An income tax was enacted in 1862 to provide funds for the Civil War, but it was allowed to lapse in 1872. In 1894 another income tax was enacted; however, it was ruled unconstitutional in 1895 by the U.S. Supreme Court in *Pollack v. Farmer's Loan and Trust*.

The federal government had generally relied on tariffs and excise taxes as its principal sources of revenue. However, growing support for free-trade and a push for reduction in protective tariffs led to growing support for an income tax. Many also viewed tariffs as a more regressive tax than an income tax. In 1909, Congress proposed a constitutional amendment to authorize Congress to collect taxes on the income of individuals and corporations. To the surprise of many, the 16th Amendment was ratified by the states, with Wyoming becoming the 37th state to ratify the amendment in 1913. The same year, the Underwood Tariff Act (also known as the Revenue Act of 1913) significantly lowered tariffs and enacted a one-percent tax of individuals with incomes in excess of $3,000, with additional surtax rates ranging from one percent to six percent, with the six-percent surcharge applying to incomes above $500,000. It was estimated that the income tax applied to only about three percent of the population. A one-percent corporate income tax was also enacted, applying to all corporations and replacing a one-percent tax on corporate net income over $5,000 that had been styled as an excise tax. At this point, the income tax contributed only a relatively small part of federal revenue—only an estimated one in 271 people paid an income tax.

World War I brought significant changes to the income tax. The war resulted in a decline in tariff revenue. The Revenue Act of 1916 raised the income tax rate from one percent to two percent on incomes over $3,000, with additional surtax rates up to 13 percent with incomes over $2 million. The 1916 law also doubled the corporate income tax rate from one percent to two percent, introduced an excess profits tax, and introduced a federal estate tax with an exemption of $50,000 and rates up to 10 percent. The War Revenue Act of 1917 lowered the income level at which the individual two-percent tax rate to incomes in excess of $1,000 and added surtaxes up to 63 percent in addition to an increase in the corporate tax rate. The legislation also required reporting of payments on Form 1099. With this legislation, the income tax began to apply to many more individuals. The Revenue Act of 1918 added further to these rate increases, with individual surtax rates reaching 77 percent. The income tax had grown from less than one-fourth of federal revenue to over half. The Bureau of Internal Revenue, the predecessor to the Internal Revenue Service, was complaining about being understaffed with too much work, including being tasked with enforcing prohibition starting in 1918.

With additional changes to the Internal Revenue Code coming for 2022, resources to help taxpayers and their tax advisors understand and interpret Tax Code provisions, IRS guidance, and court decisions have continued to grow to meet the demand. TAXES Magazine continues in its 100th year to provide that assistance.

It was in 1923 when TAXES Magazine commenced publication. Although there were significant tax rate reductions during the 1920s, proposals to repeal the income and estate taxes were largely unsuccessful and the income tax continued to be a significant part of federal revenue. The great depression brought a significant decline in government revenues, and the Revenue Act of 1932 expanded the tax base by reducing exemptions and raising rates. By 1939, with the codification of the revenue statutes into the Internal Revenue Code, an estimated one out of 32 citizens was paying an income tax. With the start of World War II, by 1943 as estimated one out of three people was paying income taxes and withholding was introduced. Individual surtax rates reached as high as 91 percent in 1944. Top individual tax rates remained relatively high following the war, with top individual tax rates still as high as 70 percent in 1981.

A decline in individual rates started in the 1980s, reaching a top rate as low as 31 percent in 1991 and in more recent years as high as 39.6 percent. Throughout the post-war years, the income taxes were increasingly used as a tool in social engineering, with ever-expanding tax provisions to achieve certain societal goals, such as helping families, helping with education, helping with home purchases, helping with health care, promoting charitable contributions, helping disaster victims, helping with retirement, and helping business start-ups, research and development, and particular industries. The Internal Revenue Code became ever more complicated over these years in spite of some token efforts at simplification, with the most significant simplification effort in the Tax Reform Act of 1986.

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