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THE EARLY YEARS OF TAXATION IN AMERICA

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Taxation by all agencies—federal, state, municipal—is regularly condemned by nearly every American citizen. However, who would sacrifice police protection, national defense, streets and highways, public education and the many other services provided by taxation dollars? Throughout history governments have had to tax to provide services and, often, to wage war. Unequal and unfair taxation has often led to revolutions.

This paper emphasizes taxation in America prior to the ratification of the Sixteenth Amendment to the Constitution in 1913. In order to understand the development of early taxation in America, it is important to examine some basic philosophies of public finance and taxation.

Philosophies of Taxation

The benefit theory of taxation was embraced in England during the 18th century as evidenced by the use of consumption taxes. It was assumed that government benefits were best measured by what an individual consumed. Although most theorists emphasized taxes only on luxury, the parliament levied taxes on practically every necessity of life [Groves, 1974].

Adam Smith (1731-1790) was the founder of the classical school of economics. He is best known for his celebrated maxims of taxation (found in his 1776 *Wealth of Nations*), as elaborated on by Harold Groves:

> First said Smith, taxes should be equal or *equitable*, falling on individuals "like the expense of management to the joint tenants of a great estate, who are obliged to contribute in proportion to their respective interest in the estate." Further, "the subjects of every state ought to contribute to the support of the government, as nearly as possible in proportion to the revenues which they respectively enjoy

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> under the protection of the state."
>
> Taxes should be *certain* and not arbitrary, "Clear and plain to contributor and every other person. Otherwise the taxpayer may be subject to extortionate administration."
>
> Taxes should be *convenient* as to the time and manner of their levy.
>
> And finally, taxes should be *economical*—that is, not too expensive to collect and not unduly obstructive and discouraging to the taxpayer [Groves, 1974, p. 18].

Although Smith was not happy with excise taxes, he regarded some as necessary and suggested excluding all necessities from tariff duties (import taxes). His main contribution seems to have been the popular introduction of the ability-to-pay theory of taxation.

Musgrave and Peacock [1958] made the following observation about Adam Smith's influence:

> Through most of the nineteenth century, writers in the English tradition mainly concentrated on the problem of defining "ability to pay" more exactly. Viewing the problem of taxation as more or less independent of that of determining public expenditures, their concern was with translating the principle of ability to pay into an actual pattern of tax distribution. As income came to be accepted widely as the index by which to measure ability to pay, the question became one of deciding whether taxation in accordance with ability to pay should require regressive, proportional, or progressive taxation in relation to income [pp. ix-x].

British economist, John Stuart Mill (1806-1873) followed Smith. Mill's work was really a refinement of Smith's ideas, but Mill did an effective job of wiping out the benefit theory of taxation which was still predominant in many tax writings. His book, *Principles of Political Economy*, was first published in 1848.

> He (Mill) observed that the benefit theory had usually been associated with the governmental function of protection and that this by no means encompassed all that governments were expected to do. Moreover, even in the protection function, the poor probably benefit more from government than do the rich because the former are far less capable of protecting themselves. Government must be regarded as so preeminently a concern of all, that to determine who are most interested in it is of no real importance [Groves, 1974, p.29].

With Mill, Smith's "taxation according to the ability to pay" became that of "taxation so as to inflict equal sacrifice." He suggested that taxation which inflicts equal sacrifice will also lead to the distribution of the tax burden which minimizes total sacrifice.

Although these two philosophers/economists were writing in England and their ideas reflected conditions in that country, many conditions were similar in the colonies and, later, the young American nation. The most striking difference was that most public dollars were raised by states and cities in America during its early existence. The federal government, until recent times, was adequately supported by tariffs and excise taxes. The ability-to-pay doctrine was firmly implanted in the thoughts of American colonists by 1763, before Adam Smith's work was published [Becker, 1980].

Taxation in American Colonies Before the Revolution

In a discussion of the colonies' taxation policies prior to the Revolution, it is difficult to consider all of them as one group. Although each of the colonies had separate taxation policies, their commercial, farming, political activities, and geographical locations make it possible to divide them into three sub-groups—New England, the middle colonies, and the South. The following descriptions of the colonies draw from Becker's [1980] history of taxation.

New England

Property taxes were assessed by towns in New England, with taxpayers submitting their own property lists to the town selectman. Property taxes presumed the ability to pay, but assessments were often inequitable. Even as late as 1755, most residents were farmers and the colonial law-making bodies were greatly influenced by the men from the country. Assemblies passed tax laws that undervalued agricultural land and products. By the 1770's, all of the New England colonies had started to tax the non-farmers with a faculty tax which was based on the income from skills or abilities, such as those of a craftsman or tavern keeper. Poll taxes were assessed by all colonies on adult males and the amount paid was the same regardless of wealth or income. Becker pointed out that the remarkable thing about New England was not that there was so much debate over taxes, but that so little of the debate centered on the principles of taxation. All of the colonial assemblies were firmly committed to the ability-to-pay theory. Yet the regressive nature of the poll tax and undervalued agricultural lands in property taxation was accepted with little visible protest.

Middle Colonies

Underlying the middle colonies' tax laws was the implicit principle that the interests of the wealthy landowners should be protected whenever possible (whenever the politicians could get away with it). The property tax laws of New York and Pennsylvania offered numerous loopholes to these wealthy owners of land.

The faculty tax was used less extensively here, although New Jersey and Pennsylvania taxed some occupations. New York used excise taxes and import duties to ease the property tax burden which was unpopular with rich politicans. The people of the middle colonies complained about the application of the laws, but did little to challenge their justice. This was particularly due to the fact that the taxes in both the middle colonies and in New England were a very light burden when compared to taxation in England.

South

The uniformity among the Southern colonies' tax laws was that they discriminated against the poor and favored the rich landowners who dominated the Southern legislatures. Each colony had a different mixture of poll, property and commercial (excise and faculty) taxes.

On the whole, the tax systems of the Southern colonies were more regressive and less equitable than those in the middle and New England colonies, and they departed from the ability-to-pay principle much more openly. As a result, there was greater

> discontent that occasionally led to violence. And there were many more complaints not only about the application of the law but also about the nature of the taxes themselves. Men and groups that hoped to gain by tax reform fought against the legislators who drafted and protected the tax systems that so well served the interests of the great planters. Others who, for reasons of principle or interest or ambition or all three, sought to replace the existing legislative leaders and seized on discontent over taxes to rally public support [Becker, 1980, p. 182].

Taxation in the States During the Revolution

War in 1775 and the Declaration of Independence in 1776 did not bring thirteen stubborn states together. In each one the rebels had widely divergent views as to what direction the Revolution should take. Becker [1980] lists four trends that on the whole were common to all the states:

> First, the rebel legislatures found that by declaring independence they had not escaped the conflicts over taxation that marked the late colonial years. These disputes had to be resolved or somehow bypassed before effective revenues could be raised to fight the war.
>
> Second, the war raised new problems for all legislatures and created new rivalries and new interest groups, complicating the search for equitable and efficient tax systems.
>
> Third, the rebel governments in all sections soon faced widespread popular opposition to tax collections, opposition that ranged from petitioning and demonstrating through tax withholdings to attacking assessors and rioting. Rebel legislators had to keep the anticipated public reaction in mind as they debated tax laws, and this often reduced the efficiency of the ones they adopted.
>
> Fourth, there were in most states during the war movements for tax reform that sought to bring under taxation income, property, and wealth that had previously gone untaxed and to reduce or eliminate taxes popularly thought to be unfair, unequal, and discriminatory against the poor and the many as opposed to the rich and the few [pp.116-117].

In New England, the structure of taxation was little changed by the Revolution. Reforms were sought by many, but almost none were granted, as the men who were in power wrote the tax law and did not allow change to be made.

In the middle states, especially New York, the war brought about substantial reform in the administration of taxes. People simply refused to pay unfair property taxes until the valuations became more equitable. Additionally, publicly-elected assessors, less vulnerable to fraud, were demanded by the majority of the taxpayers.

The Southern colonies had the most unpopular and regressive tax laws prior to the revolution, and the changes there were more pronounced than reforms elsewhere.

In North Carolina, for instance, the delegates attending the constitutional convention secured a general and equal land tax to replace the poll tax. Similar reforms were achieved in other states.

> By the end of the war or shortly thereafter, four of the five southern states had taken long steps in the direction of fundamental tax reform, steps that brought their respective revenue systems more in line with the ability-to-pay ideal than they had ever been before [Becker, 1980, p. 218].

The Early Years of American Federal Taxation

In the 1780's and 90's, Alexander Hamilton, an advocate of strong federal government, as Secretary of the Treasury designed and began to put into effect a full program of excise and direct taxes to supplement the tariffs allowed to the central government by the Constitution. This program was strongly opposed by many groups and was never totally operative. Internal taxation by the federal government was infringing on the powers of the states and riots and opposition such as the Pennsylvania Whiskey Rebellion occurred. The entire excise tax and direct tax program was repealed when Jefferson became President in 1801 [Forsythe, 1977]. Previts and Merino [1979] indicated that the internal excise tax on whiskey, even though it was later withdrawn, set a precedence as the federal government had made clear its power to levy internal duties in case of need.

This need occurred during the War of 1812, when in 1813 Congress passed a package of excise taxes almost identical to Hamilton's program. These taxes were quietly and efficiently collected. "A nation in the midst of a war is more concerned with survival" [Forsythe, 1977, p.61].

Until the Civil War the federal government secured its revenues primarily from duties on imports, the sale of surplus public lands, and the sale of public debt using treasury notes. However, large expenditures were necessary to meet the costs of the Civil War, and a new tax was levied.

Civil War Tax

Emphasis on the ability-to-pay principle resulted in the first national personal income tax in 1861:

> The first law called for a flat rate of three percent on income in excess of $800. This was changed in 1862, when a degree of progression was introduced by a levy of three percent on all incomes between $600 and $10,000 and a levy of 5 percent on the excess. The rates were subsequently increased to five percent on the amounts between $600 and $5,000 and ten percent on the excess. In 1867, however progression was abandoned and five percent was placed on incomes in excess of $1,000. Finally in 1872, the tax was completely abandoned having yielded in the entire period some $350 million [McKay, 1949, p. 568].

Direct taxation was prohibited to the federal government by the Constitution and the 1862 income tax law was challenged in the Supreme Court. However, it was determined at that time that income tax was within the category of an excise or duty tax.

Taxation After the Civil War

> The history of the movement

for the restoration of the federal income and inheritance taxes between 1873 and 1894 is bound up with the history of the efforts of the farmers, workers and small businessmen to adjust themselves to changing economic conditions. The rise of industrial monopoly and the beginnings of financial capitalism after the Civil War accentuated the difficulties of the common man [Ratner, 1967, p. 145].

Thus, the attempt by Congress to tax personal incomes, which was revived in 1894, received the support of Western and Southern representatives. Wealthy Easterners pretended to oppose the income tax only because it was a "class tax" designed to make distinction between the rich and the poor. The 1894 law provided for a two percent tax on incomes over $4,000.

The constitutionality of this law was also tested. In a split decision, the court was of the opinion that the law, insofar as it levied a tax on the rent or income of real estate, was in violation of the Constitution [McKay, 1949]. Therefore, federal personal income taxation was set aside until the constitutional amendment proposal by Congress in 1909. The sound ability-to-pay principle had gained much popular appeal during this period and would not be forgotten by the many non-wealthy interest groups.

In the early 1900's, the profits of gigantic industrial and commercial enterprises brought envy and discontent to the small businessman. He feared that the large corporations would force him out of business or reduce him to a subsistence level. The farmer felt he was being forced into paying higher prices for manufactured goods on the domestic market controlled by the big corporations, while he had to sell his products in a market of world-wide competition. The industrial worker was dissatisfied with the increases in the cost of living. He received low wages which were kept low by the use of child labor, the heavy influx of immigrant labor, and the resistance of corporations to the unions [Ratner, 1967].

> The workers, farmers, small businessmen, and professional men suffered frustration in their attempts to lead a rich and independent life in a society which professed democracy, but which in actuality was dominated politically and economically by an oligarchy, the captains of industry and finance, and their political henchmen, machine-party bosses. Dissatisfaction led to rebellion against vested interests and to an attempt at governmental and economic reorganization, which took on the character of a crusade for social justice [Ratner, 1967, p. 254].

Primarily as a result of demands of the groups involved in the crusade, in July, 1909, Congress agreed to a joint resolution calling for an amendment to the Constitution to give the federal government the power to tax income without apportionment among the states according to population. This income tax amendment (the Sixteenth) was ratified in 1913, and the first income tax law was enacted in October of that year. This was a dramatic change in the method of raising revenue.

In Conclusion

> Everywhere history reveals that as people become more progressive, more socially minded and more mature

economically, governments assume new functions and thus, of necessity, increase their expenditures. This, in turn, calls for increased contributions in the form of taxes. More and more we are impressed with the fact that man does not live and prosper alone [McKay, 1949, p. 566].

Since the ratification of the Sixteenth Amendment, the personal income tax has been subject to continous change and modification. Many men and women feel the complexity in tax law has become an intolerable burden and long for the days of simple regressive poll taxes and faculty taxes.

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TRUSTEES AND CURRENT MEMBERS STATE KEY ASSUMPTIONS ABOUT THE ACADEMY OF ACCOUNTING HISTORIANS

In the Spring, 1990 issue of *The Accounting Historians Notebook,* 26 tentative key assumptions were listed. These assumptions were then circulated to these groups: (1) current trustees; (2) past trustees; and (3) some key members. I then ranked these assumptions in order of strongest agreement to disagreement (#15, #26, and #18). I think you will find the rankings quite informative and very helpful in understanding the workings of the Academy.

We should strive to maintain our 501C3 status (#1) and our warm relations with the AAA (#4), as well as with ourselves (#2). While these three could be looked at as "Motherhood" type issues, they should never be forgotten. The remaining five items in the first category represent action areas for the Trustees: continuity of The Academy (#17); continue the international flavor of The Academy (#5); a long term plan for the Academy (#20); encouraging student members at all levels (#25); and approval of the long term plans of The Academy (#16). These eight items might be classified as "imperatives" for the Trustees.

The next grouping of items gives us some ideas on guidance for operating matters. Repeat terms should be possible for the Treasurer (#22) and the Secretary