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In the spring of 1909, President Taft conceived the idea of imposing a tax upon the incomes of corporations as a source of revenue and as the opening of what he felt was a legitimate field of taxation. Under the constitution of the United States, as it stood at that time, an income tax as such could not lawfully be levied. President Taft was then, as now, a clever lawyer, and with the assistance of his attorney general he devised a tax which was in all essentials identical with an income tax levied against the incomes of corporations, but cleverly evaded the constitutional limitations by terming it an excise tax or a tax upon the privilege of doing business in the United States as corporations and using the income of the taxpayer as the unit by which the amount of the tax was measured.

The attorney general of the United States at that time was George W. Wickersham, who had indicated high abilities as a lawyer previous to his taking office and who has since occupied an enviable position in his profession.

In drafting the corporation-tax law of 1909 a course was followed quite unlike that which characterizes the consideration of tax laws at this time. There was then under consideration a tariff act upon which depended a considerable part of the revenues of the federal government. The corporation-tax law was made a part of the tariff act then under consideration. In drafting this act the attorney general apparently discharged the duty of draftsman. It has been stated that the attorney general was a lawyer of high standing. It has not been stated that he was then or has since become an accountant of either experience or ability. In consequence of his lack of knowledge of accounting principles and their application, the language of the corporation-tax law of 1909 was curiously out of accord with the methods of determining income then or since in use in the United States, or for that matter, anywhere. When the language of the act became known to the leading accountants of the country they were quick to call the attorney general's attention to the fact that the income of a corporation was not, as the act implied, the difference

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between its cash received as income and its cash paid out for expenses. The attorney general, however, was perfectly serene and did not for a moment admit that his knowledge of what constituted income could possibly be exceeded by that of any other person—accountant, banker, merchant or economist. He replied to the accountants that what they were talking about was not what he was talking about and that the act meant just what its terms implied.

From the correspondence which transpired between the representatives of the American Association of Public Accountants and the attorney general on the subject of the language of the 1909 corporation-tax law the accounting fraternity and the business community became convinced that the attorney general could easily be a much better lawyer than he was an accountant.

After the act was passed and the business community began to recover from its stunned surprise, it was the privilege of the writer to be one of a delegation which called upon President Taft to seek from him assurance that no attempt to put the tax law into effect would be made until after the supreme court had had an opportunity to pass upon its constitutionality. President Taft received the delegation with great cordiality and even singled out one member thereof whom he called Bill and whom he reminded of some escapade at Yale where both were members of the same class. He made every member of the delegation feel that he was one of the best-natured men in the world, but he also made them understand that their mission was an idle one; that the law would be immediately put into effect and that in his opinion when the supreme court did pass upon the act it would hold it constitutional in every particular. Subsequent events proved the president to have had an excellent judgment of what the supreme court would do. The law was held constitutional and for something like four years the corporations of the country were busy making up tax returns in the form required by the commissioner of internal revenue, but in arriving at the taxable income both the taxpayers and the commissioner of internal revenue utterly disregarded the peculiar ideas of the attorney general. The rate of taxation was one per cent. upon the net corporate income and the amount thereof was comparatively small.

The business family was a happy one though protests might be heard here and there against the idea of the government collecting a tax upon corporate incomes, but the worst was yet to come.

President Taft and his administration had, figuratively speaking, tasted blood and they wanted more. The machinery of the government was set in motion to bring about an amendment to the constitution of the United States which would permit the federal government to levy a tax upon the incomes not only of corporations, but of individuals, partnerships, associations and every kind of business organization as well. The proposed amendment was submitted by congress to the states and the adoption by three-fourths of the states was accomplished on February 28, 1913. The date was one that has no doubt long remained in the memory of President Taft, since it marked the last important action of his administration. Four days later he was succeeded in the presidency by Woodrow Wilson, who, owing to certain differences which had arisen between President Taft and Theodore Roosevelt, had been elected to the presidency by the largest plurality that had at that time been recorded in a presidential campaign.

The policy of imposing a tax upon the incomes of individuals and business organizations was one that had the hearty support of President Wilson. The democratic party, of which he was the head, had long been of the opinion that some means should be devised by which wealthy men and wealthy corporations should be made to pay in taxes an amount proportionate to their wealth. Almost immediately after President Wilson took office the ways and means committee of congress began to busy itself with the preparation of a new tariff law more in accord with the policies of the democratic party than the act which had been passed during President Taft's administration in 1909, and also decided to give immediate attention to the enactment of an income-tax law such as the new constitutional amendment had made possible.

For the purpose of drafting a satisfactory income-tax law Congressman Cordell Hull of Tennessee was made chairman of a sub-committee of the ways and means committee. At about this time the American Association of Public Accountants took cognizance of the pending changes in income-tax legislation and instructed its committee on federal legislation to confer with Congressman Hull for the purpose principally of securing the right to corporations to render their income-tax returns upon a fiscal-year basis instead of the arbitrary basis of December thirty-first, as provided in the 1909 law.

The committee on federal legislation was then composed of Arthur Young, chairman, George O. May and the writer of these chronicles. The committee was received by Judge Hull at his apartment and was promptly advised that he knew nothing about incomes or income-tax laws and was a sincere seeker after information. As the senior members of the committee had been trained in Great Britain, they were able capably to advise the congressman concerning the British income-tax laws and their administration. The third member of the committee indicated his domestic origin so plainly by his accent and certain other peculiarities that he was not expected to know anything. At this conference there was present a member of congress from the state of Washington, who held what may be called advanced ideas on economic subjects. At least they were in an advanced state of decomposition. He rather vehemently insisted that interest paid should not be deductible from gross income but his voice sank to a whisper when he was reminded that the enterprises of his own state were operating on borrowed money and would be the chief sufferers if his idea should prevail.

The impressions of the committee were that Congressman Hull, a kindly, courteous and unassuming gentleman, was desirous of framing an income-tax law that would be creditable to him and to his party and was ready to accept any suggestion that would help to produce that result. His parting request was that the committee itself frame an income-tax law which would indicate its ideas and which he could use as a framework around which to build the act which would be finally enacted. This the committee did, and a few scattered fragments of its language are to be found in the respectable parts of the act of 1913 and of each of the succeeding revenue acts, but in the main congress itself constructed and should be held responsible for the 1913 law, with its crudities and absurdities.

In September, 1916, an act was passed that introduced the novelty of rates graduated according to the amount of income, much to the disgust of poor people with incomes in excess of a million dollars, who were required to pay 13 per cent. thereof as income taxes. The 1916 act was introduced and enacted without much public discussion and created only a mild interest, but the business community sat up and took notice when the amendatory or supplemental act of March 3, 1917, came into being, for it introduced the first version of an excess-profits tax on the profits

of business enterprises. On the profits of corporations, partnerships and sole traders, above the exempted sum of $5,000, a tax of 8 per cent. was imposed and paid with ominous growling. Perhaps, if Germany had been a trifle less obstreperous and more mindful of the national dignity of our country, the act of 1916, as amended in March, 1917, would have had a longer and more glorious career. But with the declaration of war there came the need of tremendous revenues resulting in the passage of the act of October 3, 1917, imposing income taxes, excess-profits taxes, estate taxes, excise taxes and stamp taxes in a bewildering variety and at staggering rates. In the consideration of the act of October 3, 1917, the advice of leading members of the American Institute of Accountants was sought and to some extent was followed. In truth, most of the 1917 law that indicated scientific treatment in its drafting was the work of the accountants called in as advisors and consultants.

Since all the returns for 1917 have not yet been audited—at least properly—it would serve no good purpose now to enter into a lengthy discussion of the provisions of the law under which they were made, particularly as most of this audience is utterly familiar with each word of the act. It is worth while to note, however, that the act of 1917 was responsible for the appearance of that charming dream book known as *Regulations 41*, the first-born child of the fruitful brain of the department. As light reading it was not a best seller, but to an accountant it contained more jokes than Joe Miller ever dreamed of. But they were sad jokes and provoked only mirthless laughter. Many a taxpayer and many an accountant cursed the day when congress authorized the commissioner to promulgate regulations or to exercise a misguided discretion. But we are doing too much honor to the act of 1917. As the preparations for war went on at an increasing pace, the need of still more revenue became apparent and congress begot the revenue law of 1918, which was christened before it was born, its birth being arranged as one of the leading events of the next year.

On February 24, 1919, the revenue law of 1918 was passed, approved, and became effective. It was a great improvement on all acts that had preceded it and bore many evidences of the applied skill, learning and wisdom of the members of the American Institute of Accountants who sat in with the committees of the house and senate while it was being framed. We have said that the new act was better than its predecessors—and it was—

but it afforded an opportunity for the issue of another edition of the commissioner's *Regulations*, this time numbered 45, and was therefore not an undiluted blessing.

The revenue law of 1918 made history for accountants. It grappled with the most complex questions involving the constituent parts of invested capital and the deductibility of countless items held by the taxpayer to be a proper charge against his operations, but held by the commissioner to be something else.

It would require volumes to write the history of accountants' adventures with the revenue law of 1918. Indeed the history is by no means complete, nor does it seem that it will be complete while the present generation lives.

The granting of wide discretion to the commissioner of internal revenue and the authorization given him to prepare and enforce regulations soon indicated that it is unsafe to lodge too much authority with a public officer. The regulations promulgated by the commissioner, the rulings emitted from his office and the arbitrary positions assumed by his subordinates demanded that there be set up a superior authority not charged with the duty of collecting taxes, but charged solely with the duty of determining tax liability. This situation gave birth to the thought in the mind of one of the members of the Institute that a board of tax appeals should be created to sit in judgment upon the findings of the commissioner and the contentions of the taxpayer. A bill was therefore prepared, independent of the revenue law, creating such a board of tax appeals. This bill was exhibited to various taxpayers, all of whom pronounced it a desirable piece of legislation, and through the Ohio Manufacturers Association it was handed to Warren G. Harding, then senator from Ohio, for introduction. Senator Harding was first of all a man of party regularity. The leader of his party was Senator Boies Penrose of Pennsylvania and the proposed piece of legislation was immediately submitted to him. He glanced over it and stated that it seemed to be of high importance and that he would be glad to take it home with him in order that he might study it more carefully. This was late in 1919 and immediately after returning to his home in Philadelphia Senator Penrose became ill and his illness continued for several months, finally terminating with his death in the summer of 1920. The original copy of the bill remained in the possession of Senator Penrose throughout his illness and was no doubt found among his papers after his death.

In the meantime, however, Warren G. Harding had been nominated for president of the United States. His senatorial activities were over and immediately after his election in the fall of 1920 agitation was begun for the enactment of a new revenue law. The member of the Institute who had prepared the bill for the board of tax appeals believed there was a possibility of securing consideration of a section of the new revenue law which would provide for the creation of a body of that kind. An effort was made to interest congress in the creation of a board of tax appeals. The effort was unsuccessful, due to the domination of legislation by the secretary of the treasury and his cohorts. Agitation, however, was started among commercial bodies and when the law of 1924 was under consideration the suggestion for the creation of a board of tax appeals had been pushed so industriously and had met with so much favor in circles of great influence that the secretary of the treasury in a statement made by him to congress indicated the desirability of the creation of a board of tax appeals, but with the important difference that such board was to be a part of the organization of the treasury department attached to the office of the commissioner of internal revenue. The whole movement which had been forwarded by the business community for the creation of a board of tax appeals rested upon the necessity of such board being independent of the treasury in order that it might be in position to exercise impartial judgment in the treatment of issues existing between the government and the taxpayer. An issue therefore at once arose between the proponents of a board of tax appeals as an independent body and the secretary of the treasury, who desired a board of tax appeals as additional machinery for the collection of taxes. The fight was taken before the ways and means committee of congress and was won there by the proponents of an independent board. It was not won, however, without a struggle and all the artifices and wiles of the representatives of the treasury department were used in an attempt to make the board of tax appeals a mere sideshow for the treasury department. It is exceedingly creditable to congress that it was not deceived by the representations of the treasury officers. The fairness and justice of the arguments of those who proposed an efficient board of tax appeals were admitted by the members of the ways and means committee and when their recommendation of a revenue bill was made to congress a provision was found therein creating a board of tax appeals as an in-

dependent part of the executive branch of the government. The victory won before the ways and means committee was easily held in the senate, and the act of 1924, when it had been passed by both houses of congress and had received the approval of the president of the United States, contained the much desired provision which its proponents believed would mark the beginning of the end of the arbitrary power exercised by the commissioner of internal revenue in his dealings with taxpayers.

It is true that in the selection of appointees as members of the board of tax appeals President Coolidge followed strictly the recommendations made by the treasury department. Candidates for appointment to the board of tax appeals had their applications referred immediately to the secretary of the treasury who in turn, it is believed, referred them to the commissioner of internal revenue. There was a feeling of great disappointment among those who had expected the president to ignore the treasury department in making these appointments, but when the appointments were finally made and the board began to function and render its decisions it was found to the delight of the proponents of the board that the domination of the treasury over the members of the board had ceased with their appointment. It is true that among accountants there was some disappointment that the board of tax appeals was made up almost entirely of lawyers and that being so constituted it was organized along the formal lines of a court of law. It had been the hope and intention of the proponents of a board of tax appeals that it would be so organized as to be representative of the professions of law and accountancy and perhaps also of other callings. It was hoped likewise that practice before the board of tax appeals would be highly informal, consisting of the presentation by the commissioner of internal revenue of his contentions, to be answered by the proof and arguments of the taxpayer. The board of tax appeals, however, decided in favor of greater formality and while there is reason for disappointment that the hearings were not made more informal, yet because of the fair-minded attitude of the board and the justice manifestly aimed at in its decisions, those who are interested in the work of the board can easily overcome any disappointment due to its formal rules.

One of the rules promulgated by the board of tax appeals requires the taxpayer to assume the burden of proof. A great deal may be said in defense of this rule and there can be no doubt that

the board sincerely feels that the rule is fair. In many cases this is true, but in many more cases the contrary rule would have had a restraining effect upon the commissioner of internal revenue, leading him to more carefully considered conclusions, and would have relieved many taxpayers of the necessity of defending a claim by the commissioner which was predicated upon an arbitrary opinion and insufficient information. There have developed cases also where assessments made by the commissioner were predicated upon grounds that were not substantial, but which were exceedingly difficult to disprove. In such cases the rule referred to does a very grave injustice. However, it is the first objection that should be given major importance. Nothing better in the administration of the bureau of internal revenue could have occurred than that there should have been placed upon the commissioner a curb such as would have resulted from his being required to assume the burden of proof where he claimed that the taxpayer had not reported his full income for taxation or had in some other respect failed to pay the amount of taxes which the law imposed. Every accountant who is engaged in tax practice is able to recall instances where his clients have been forced to defend assessments that were ridiculous, both in amount and in the pretended facts upon which they were based. Thousands of journeys to Washington have been made in the attempt to elucidate to incompetent representatives of the commissioner not only the facts controlling the cases at issue but the theory of accounts which was involved. Perhaps the commissioner of internal revenue has done as well as he could in the selection of his employees.

Congress is notoriously parsimonious in allowances made for salaries and it is true that if the employees of the commissioner of internal revenue had been competent to discharge the functions of their positions they would have been worth, in private employment, not less than twice the salary paid them by the government. However that may be, except in a few outstanding instances the work of the bureau of internal revenue has not been done with the capability which should have characterized it.

During the period of struggle with the various revenue laws the courts were appealed to in numerous instances to settle controversies that it seemed impossible to settle otherwise. This is not the time to go into a review of all of the litigation that has transpired between the commissioner of internal revenue and

various taxpayers, but there are two outstanding cases which should be commented upon.

The first was the so-called stock-dividend case. Under the law of 1916 stock dividends were specifically subjected to taxation as income. Under the law of 1913 the commissioner had taken the attitude that stock dividends were taxable. His position in this case was assailed with successful results. Likewise, the act of 1916, in so far as it sought to impose a tax upon stock dividends as income to the recipient, was declared unconstitutional by the supreme court. The decisions with respect to stock dividends must be applauded for their soundness and for their recognition of the accounting principles involved. They do great credit to the court which rendered them and particularly to that great jurist, Mr. Justice Holmes, whose wonderful opinion will live long in the history of income-tax law.

The other principal issue that was passed upon by the supreme court was the determination of the amount of invested capital, the issue being whether invested capital meant the amount of cash or property put into an enterprise or the value at March 1, 1913, of the property of the enterprise, less its debts. The outstanding case involving this issue, it will be recalled, was the La Belle Iron Works case. The taxpayer showed that while it had acquired a certain iron-bearing property for a consideration of approximately $2,000,000, subsequent exploration of the property resulted in a discovery of values which justified an increase of valuation on the books of the corporation amounting to $10,000,000. The corporation contended that its investment was the value of its property, less its debts. The government contended that its invested capital was the cost of the property to it. The supreme court held that the government's contention was right and found for the government. It has always been believed by many observers that in this case, as in some others, the supreme court was controlled by a consideration of expediency. It was made apparent to the court that the administration of the excess-profits law would be far more difficult if it were necessary to determine the actual value of the property of the taxpayer at March 1, 1913, or at a later date, rather than to take from the books of the taxpayer the items of the cost of property. It is true that to have valued all of the property of all the business enterprises of the country would have been a gigantic undertaking, but that does not, in the opinion of many, dispose of the question. The con-

venience of the commissioner of internal revenue in discharging the duties of his office should in no circumstances have been permitted to deprive the taxpayer of the rights to which he was manifestly entitled. If the La Belle Iron Works Company had sold its property for $12,000,000 and had invested the proceeds of such sale in another property it would have been entitled to have claimed as invested capital the property purchased with the proceeds of the sale of its original holdings and the purchaser of the original holdings of the La Belle Iron Works Company would likewise have been entitled to have claimed an invested capital of the $12,000,000 paid by it for the property acquired. In view of the ease with which the position that the value of the property was not the test by which to judge the volume of invested capital could be reduced to an absurdity it is astonishing that the supreme court of the United States could have found that the actual cash or other property at its original value could be held to represent the sum total of invested capital. The conclusion was erroneous on the face of it and it served to reduce in an appreciable degree the respect of the business community for the opinions of the supreme court. It would have been far more in harmony with the decisions of that court and all other courts for the taxpayer to have been upheld with the suggestion to congress that the remedy could be found for the condition then existing in an increase of rates and not in the promulgation and enforcement of a false theory.

The revenue law of 1926 has only begun to function. It contains some improvements over the laws that preceded it, but it does not go far enough in introducing changes of a beneficial kind. Accountants, however, have reason to rejoice that the board of tax appeals is retained as an established tribunal for the determination of issues between the government and the taxpayer; that the term of office of the members of the board has been suitably lengthened and that the salaries of members have been made more liberal than they were.

The revenue law of 1926 differs materially, so far as its legislative history is concerned, from all its predecessors. In all other sessions of congress when a revenue law was proposed by the majority there was found at hand a militant minority insisting upon the consideration of its views on every question involved. In the present congress the minority was not heard to indicate any difference of opinion. As a result many reforms in the law were

impossible of accomplishment. It may be fairly said that the 1926 revenue law contains no word, phrase, sentence or page that was not fully and heartily approved by the secretary of the treasury or his representatives. They had the ear of congress to the exclusion of all others. It is true that hearings were had and that recommendations were made by people competent to form a judgment as to what was needed, but the fact remains that congress was under the domination of the administration and that the administration was, so far as legislation was concerned, the secretary of the treasury and that the minority, far from being militant and insisting upon changes both necessary and desirable, meekly bowed to the dictum of the majority and made the administration measure their own measure.

To one who lived through the stirring times when the democratic party was in the ascendancy and when it had leaders such as Grover Cleveland, Thomas F. Bayard, John G. Carlisle, Allen G. Thurman, William L. Wilson and Richard Olney, the spectacle presented by the representatives of that party in their attitude toward the revenue law of 1926 was one to engender apprehension as to the preservation of the theory of representative government.

It would be unkind and unfair, however, to refrain from mentioning, when reviewing the history of income-tax legislation, the splendid attitude of Congressman John N. Garner of Texas, the leading minority member of the ways and means committee. Mr. Garner plainly indicated a better understanding of revenue legislation than any other member of his committee and plainly indicated also his purpose of securing such legislation as would treat the taxpayer fairly. His admirers may be sure that his failure to impress himself upon the law of 1926 more forcibly was due to the desertion of the members of his party who in this particular matter made a record for political cowardice unequaled in the history of the republic.