A TIME TO TAX:

THE ACCOUNTING PROFESSION RESPONDS TO WARTIME CHANGES IN THE U.S. TAX CODE

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Abstract

During the midst of the most desperate struggle America has ever known, the nation's tax system underwent drastic change. To facilitate this change, the United States needed men of integrity, ability, and leadership – and accountants rallied to the cause. Through no act of compulsion, other than patriotic zeal, the accounting profession responded by lobbying for tax simplification, and time extensions, while laboring tirelessly to educate preparers, the taxpaying public, and congressional authorities.

Introduction

At first glance the topics of taxation and war appear to be strange bedfellows indeed with little in common. However students of history are quick to point out that a major factor in the American Revolutionary War was taxation without representation. In fact, it seems that as a rule in America, times of war often give rise to new taxes or to significant changes in those existing. During the American Civil War, both the Union and the Confederacy imposed progressive income tax systems on their respective citizenry. One year prior to the outbreak of World War I in Europe, the U.S. Congress ratified the Sixteenth Amendment, which established the income tax as "a permanent fixture of American Life."[1] N. Loyall McLaren, a former president of the AIA, recalled that in America the income tax "rates were insignificant until 1916. However, during the war period there [was] an enormous increase in tax rates both for individuals and corporations."[2] By the time the Great War ended in 1918, the income tax occupied center stage in the nation's federal revenue system. However, everything that came before was but a prelude to the changes that emerged during World War II.

"In 1939 fewer than 6% of all individuals in the United States were legally required to pay any federal income tax. By the end of World War II, over 74% of a larger population had to pay it."[3] As originally structured, the nation's income tax system primarily affected only the affluent and most average Americans offered little objection to this 'soak the rich' policy. However, during World War II this 'class tax' mutated into a broad-based 'mass tax.' No longer

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[1] Gary John Previts and Barbara Dubis Merino, *A History of Accountancy in the United States: The Cultural Significance of Accounting,* Historical Perspectives on Business Enterprise Series, (Columbus: Ohio State University Press, 1998), 181.

[2] N. Loyall McLaren, *Norman Loyall McLaren, Business and Club Life in San Francisco: Recollections of a California Pioneer Scion,* An Interview by Gabrielle Morris and Ruth Teiser, The Society of California Pioneers Oral History Series, The Bancroft Library, (1977-1978), 80-81. http://www.archive.org/stream/clublifeinsanfran00mclarichclublife#page/80/mode/2up/search/income.

[3] Ray M. Sommerfeld and John E. Easton, "The CPA's Tax Practice Today – And How It Got That Way," *Journal of Accountancy* 163, no. 5 (May 1987): 170

just the bane of the wealthy, the income tax became a working man's tax and part of the patriotic duty of all Americans. Only under the cover of war was such a tremendous expansion possible without violent protest.

Substantial increases in income tax rates likewise accompanied the massive expansion in the tax base. During the war period, top marginal rates for individuals soared to 94%, while those for corporate taxpayers "doubled from 19% to 38%."[4] The end result -- these changes established the federal income tax as the dominant source of financing for the country and firmly ensconced the accounting profession in general and the tax practitioner in particular as an indispensable partner in 'all things tax.'

In order to properly frame the difficulties facing the accounting profession, tax practitioners in particular, and the public at large, a brief history of the relevant revenue acts is provided next. This history builds into a storm or sea of complexity that sets the stage for the accounting profession's response that follows.

Wartime Tax Legislation

As 1941 dawned, World War II was raging in Europe, Asia, and Africa. America, though still neutral, was equipping her military for either defensive or offensive operations depending on unfolding events. Wars and even national preparedness efforts require adequate financing. A year earlier in January of 1940, President Roosevelt had requested less than $2 billion dollars for national defense, but following the fall of France and the majority of Western Europe to the Axis powers, the President called for "defense expenditures of $6.4 billion for 1941."[5] In the U.S., the question of how to obtain such financing was paramount. As in previous times, Congress turned in part to taxation for the answer.

[4] Ibid.

[5] Roy G. Blakey and Gladys C. Blakey, "The Federal Revenue Act o f 1942," *The American Political Science Review* 36, no. 6 (December 1942), 1069.

The Revenue Act of 1941

The first answer came in the form of the Revenue Act of 1941. The Act implemented sweeping changes in the nations' income tax system. In addition to broadening the base by reducing the amount allowed for personal exemptions, surtax rates were increased while the previous $4,000 surtax credit was removed. Under the Act, the individual income tax rate consisted of two components a "Normal tax," applied at 4% to net income and a "Surtax," with graduated rates ranging from 6% to 77%, which was applied to net income.[6] Personal exemptions, which had been reduced in 1940 from $2,500 to $2,000, were further lowered under the new law to $1,500 for married couples. Not since the 16th Amendment was ratified in 1913 had the personal exemption credit been lower. As a result, the Revenue Act of 1941 significantly "increased the personal income tax payable and created a vast army of new federal income taxpayers."[7]

Other taxes also increased under the revenue act. Excise taxes were increased on tires and alcohol; and prior increases were made permanent. The Excess Profits Tax, which had been enacted in the preceding year, also saw its top marginal rate increased to 60%. Nor were corporations spared, their income tax rates rose to 31% in the top marginal bracket.[8]

Perhaps the most lasting impact of the 1941 Revenue Act was the creation of an optional simplified version of the tax return form – the 1040A. This form was available for use by resident aliens or citizens whose "gross income d[id] not exceed $3,000 and consist[ed] wholly of salary, wages, compensation for personal services, dividends, interest, rent, annuities or

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[6] Ibid., 322; the normal tax was applied to net income after deductions of personal exemption, dependent credits, interest on federal bonds, and the earned income credit. The surtax was applied to Net income after deductions of personal exemption, and dependent credits.

[7] Nicholas Salvatore, "Comparison of Federal and New York State Income Tax Requirements," *New York Certified Public Accountant* 12, no. 5 (February 1942): 316.

[8] Blakey and Blakey, "Act of 1942," 1074.

royalties, or some combination of . . . these forms of income."[9] Such a format was necessary in order to convert a tax on the elite into a mass tax. Its popularity was immediately apparent.

Almost as many taxpayers filed their returns using the simplified form 1040A in 1942 (10,369,708) as did in total in 1940 (11,389,562).[10]

The Revenue Act of 1942

The disaster at Pearl Harbor brought war planning, including the financing of such, to a fever pitch. In January, 1942, President Roosevelt responded to the war crisis by calling for "$50 to $60 billion (or more than half of the expected national income) to prosecute the war."[11] To help pay for the defense outlays, the Federal Revenue Act of 1942 aimed to provide approximately $25 billon. Of this total, two-thirds was to be derived from individual income taxes and the remaining one-third from corporate income taxes and excise taxes.

To carry out these goals, the 1942 Revenue Act increased individual and corporate income tax rates while reducing the personal and dependent exemption amounts. The changes were substantial for individuals. "Under the previous law, the maximum income surtax rate of 77 per cent applied to income in excess of $5,000,000; under the Act of 1942, the maximum surtax rate of 82 per cent applied to income over $200,000."[12] Exemption amounts were also significantly reduced. The Personal Exemption was slashed by 25%, reducing it to $1,500 for married persons, while that for a single person was cut by 33% from $750 to $500. The obvious impact of these changes required greater numbers of citizens to file tax returns, paying higher rates of taxation on greater sums of income.

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[9] J. M. Maguire, "Federal Income Tax Returns in 1942," *Bulletin of the American Association of University Professors* 28, no. 1 (February 1942): 102.

[10] Blakey and Blakey, "Act of 1942," 1078; from 1940 to 1942 the number of filed tax returns more than trebled.

[11] Blakey and Blakey, "Act of 1942," 1069.

[12] Ibid., 1072.

In 1942, corporations likewise saw their top rate rise from 31% to 40% for income in excess of $25,000. At first glance, this appears somewhat mild in comparison to individual income tax rates. However, appearances can be deceptive. In addition to the corporate income taxes, companies were also subject to the Excess Profits Tax. This tax, after permitting a $5,000 exemption, imposed a confiscatory flat rate of 90% on all excess profits. As steep as these rates appear the worst was yet to come.

The Revenue and the Current Tax Payment Acts of 1943

The Current Tax Payment Act and the Revenue Act of 1943 provided defining moments in American history. First, on June 9, 1943, the Current Tax Payment Act was signed into law and Americans witnessed an innovation in the collection method of income taxes -- the permanent installation of withholding at the source.[13] Under this collection method, employers withheld income taxes from each employee's paycheck and then remitted the collected taxes quarterly.[14] Needless to say this fostered greater compliance while easing the administrative burden and lowering collection costs.

Until this time there had been, by design, a large lag in tax payments. For example, taxpayers were required to pay their taxes for one year on March 15th of the following year; thus income taxes for 1940 were due on March 15, 1941. Now under the new law, income would be taxed and payments collected as wages were earned rather than in the following year. Accordingly, on July 1, 1943, the Current Tax Payment Act went into effect and employers began withholding 20% of employee income after allowing appropriate exemptions.[15]

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[13] Withholding had been utilized in the Civil War and in 1913 but these earlier attempts had faded with time – this time withholding became a permanent fixture in the tax code.

[14] IRS, "Historical Highlights of the IRS," IRS.gov http://www.irs.gov/irs/article/0,,id=101101,00.html.

[15] Roy G. Blakey and Gladys C. Blakey, "Federal Revenue Legislation, 1943-1944," *American Political Science Association* 38, No. 2 (April 1944): 325-330. 328.

Then, on February 22, 1944, President Roosevelt vetoed the proposed Revenue Act of 1943.[16] Two days later, the House voted overwhelmingly to override his veto. When the Senate voted in like manner on February 25, 1944, it marked the first time in the history of the nation that Congress had overridden a presidential veto of a revenue bill.[17] That this occurred in the midst of the greatest war the country had ever witnessed made the event all the more remarkable. Sparks flew on Capitol Hill. Majority leader Alben Barkley, incensed by the President's dressing down of Congress, characterized Roosevelt's rebuttal not only as misleading, but also as "a calculated and deliberate assault upon the legislative integrity of every member of the Congress of the United States."[18] Expressing his displeasure, Barkley submitted his resignation as the majority leader.

As for the Revenue Act, it raised the corporate excess profit tax rate from its already lofty 90% to a pinnacle of 95%. Still, some relief was provided for corporations by raising the specific exemption for the excess profits tax from $5,000 to $10,000. Nevertheless, for multi-million dollar industries the increased exemption proved a negligible benefit at best.

Individuals fared little better. While tax rates on individual incomes remained stable, Congress raised the yield on individual income taxes by reducing the available deductions. The Victory tax rate was trimmed from 5% to 3% but the provision for a postwar refund was scrapped. For taxpayers in the highest bracket the maximum combined "amount of normal tax, surtax, and Victory tax" was capped at 90% of net income.[19] Finally, most all excise taxes were

[16] Franklin D. Roosevelt, "Veto of a Revenue Bill: February 22, 1944," in John T. Woolley and Gerhard Peters, *The American Presidency Project* [online]. Santa Barbara, CA. http://www.presidency.ucsb.edu/ws/?pid=16490 (accessed 9/21/2010).

[17] Roy G. Blakey and Gladys C. Blakey, "Federal Revenue Legislation, 1943-1944," *American Political Science Association* 38, No. 2 (April 1944): 327.

[18] Ibid., 326.

[19] Ibid., 329.

increased including those on alcohol, jewelry, telephones and other luxury items with the increases becoming effective on April 1, 1944.

The Individual Income Tax Act of 1944

In January 1944, President Roosevelt submitted his 1945 budget request and explained that in 1943 the government had spent approximately $80 billion. He continued that over 95% of those expenditures were for military-related activities and to service interest on public debt. For the current fiscal year, the President predicted that government expenditures would exceed $99 billion of which 95% would be war-related.[20] To help meet these financial requirements the Individual Income Tax Act was passed on May 29, 1944.

After much complaining by the President and the public at large, Congress finally passed a simplified income tax law that helped to streamline the tax process for individuals. The first step in the simplification effort led to the elimination of the Victory tax. With this obstacle removed, individual taxpayers were once again subject to only two taxes, the normal and surtax. An additional measure, an optional "standard deduction," further simplified the effort required to fill out a tax return by permitting taxpayers to quickly calculate their deduction on Form 1040.[21] Previously, taxpayers had to list each deduction in a separate statement, and then deduct that sum from gross income to determine the amount of income on which the income tax would be assessed. Streamlining this process, the Individual Income Tax Act permitted taxpayers to take a $500 deduction if gross income exceeded $5,000 and a deduction of 10% of income "for those whose gross income was less than $5,000."[22] However, for all their efforts the new law was far

[20] Ibid., 330.
[21] IRS, "Historical Highlights of the IRS," IRS.gov http://www.irs.gov/irs/article/0,,id=101101,00.html.
[22] Albert D. Early, "The Simpler 1944 Income Tax," *The American Journal of Nursing* 45, No. 1 (January 1945): 38. http://0-www.jstor.org.umiss.lib.olemiss.edu/stable/pdfplus/3417150.pdf?acceptTC=true

from simple. It permitted three methods of reporting income taxes. Now variety may be the spice of life, but permitting multiple options only added to the law's complexity.

A Sea of Complexity

Brutal -- the yearly revisions, convoluted language, and retroactive provisions of the Revenue Acts created a potent brew of complexity from which few desired to drink, but all were bidden. Adding to the morass of confusion, were novel tax experiments including the introduction of the Victory tax in 1942, the frequent increases in excise taxation, and the ever changing provisions of the Excess Profits Tax. With the tax brackets, rates, and rules in a constant state of flux, taxpayers and accountants alike faced increasing difficulties in their attempts to interpret and apply the code as the war progressed.

As previously mentioned, the Victory Tax, established in 1942 and abolished in 1944, was one factor that increased the complexity of individual income taxation. Passed as part of the Revenue Act of 1942, the Victory Tax first went into effect in 1943 and could be best described as an income tax for the masses.[23] It applied a 5% rate to a taxpayer's net annual income after allowing for a $624 deduction. The operation was such that an individual or married person who had $1,000 gross income would owe $18.80. Had this been the only tax individuals faced on income, it would probably not have been viewed harshly. Unfortunately, individual taxpayers had been and still were subject to 'normal' and 'surtax' rates on their incomes. A third tax with distinct rules was a bridge too far.

Nevertheless, the Victory Tax contained several interesting elements and was similar to plans in Great Britain and Canada that combined a compulsory savings plan with collection-at-the-source features. The savings portion was in the form of postwar credits or rebates of 25% or

[23] Blakey and Blakey, "Act of 1942," 1075.

40% of the Victory tax for single and married persons respectively. However, the truly revolutionary feature was not the tax itself but in its method of collection. Collection-at-the-source had been envisioned in laws thirty years before but was previously rejected. Now for the first time it was put into practice. While this was a great boon for collection efforts, it merely transferred the difficulties from one group, hourly employees, and transferred them to another, employers.

Businesses, already burdened with detailed record-keeping for Social Security Tax purposes, and payroll deductions for war bonds, were now further imposed upon to collect victory taxes for the federal government. To fulfill this unfunded mandate, payroll and accounting departments across the nation were laden with the task of calculating the five percent victory tax on the earnings of some 43,000,000 employees.[24] The calculations were made every pay period and had to take into account the fixed exemption. This would be a daunting task even with computer technology – which they lacked.

Many were displeased with the introduction of the Victory tax because of its incumbent complexities. Although it added many lower income taxpayers to the tax rolls, the existing structure of the income tax could have accomplished the same end without the addition of an entirely new tax. The President strongly objected to its retention in the proposed Revenue Act of 1943, and bitterly complained, "It ignores the most obvious step toward simplifying taxes by failing to eliminate the clumsy Victory Tax."[25] Ultimately, the Victory Tax was repealed in May 1944 with the passage of the Individual Income Tax Act. As for withholding, it was established

[24] L. J. Benninger, "Business and Witholding Taxes," *Accounting Review* 19, no. 3 (July 1944): 303; The Victory Tax provision applied to some 43,000,000 employees.

[25] Franklin D. Roosevelt, "Veto of a Revenue Bill: February 22, 1944," in John T. Woolley and Gerhard Peters, *The American Presidency Project* [online]. Santa Barbara, CA. http://www.presidency.ucsb.edu/ws/?pid=16490 (accessed 9/21/2010).

as a foundational element of our current tax structure by the Current Tax Payment Act in June, 1943.

Another factor adding to the difficulty of the tax environment was the use of retroactive provisions in the tax legislation. Such provisions increased the uncertainty for businesses and their financial advisors and reduced planning to guess work. As an example, on October 21, 1942, President Roosevelt signed the Revenue Act of 1942 into law. While this Act allowed the new rates for excise taxes to go into effect on November 1st, the amendments related to individual and corporate income tax provisions were "applicable generally to taxable years beginning after December 31, 1941."[26] Imagine a football game that is played where one learns neither the rules nor what constitutes a score until half-way through the fourth quarter. This is precisely the situation that confronted taxpayers and their advisors during 1942. Thus with only two months left in the year there was little opportunity for taxpayers to minimize their income taxes or for planning to occur.

Excepting all else, just the process of deciphering a new revenue law or laws each year needlessly burdened taxpayers and their accountants. Numerous governmental agencies were already flooding industry with requests for statistical and financial reports. The manpower crisis affecting the accounting profession had also taken its toll on industry by eating into managerial ranks through the draft and the enormous wartime industrial expansion. Stretched thin, businesses and their management groups were subjected to the further demands of staying up to date on the myriad provisions of an ever changing tax code.

Authors of the period, commenting on the complex language of the 1942 Revenue Act, observed, that "Involved sentences, phrases, and clauses, and endless cross references to other sections of this law and also to various sections of the Code, are very trying to inexpert readers

[26] Blakey and Blakey, "Act of 1942," 1075.

and taxpayers who try to decipher the law; but they should furnish unlimited and unending employment to lawyers, accountants, and courts."[27] Time heals many wounds; unfortunately the tax code was not one of them.

No less an authority than President Roosevelt waded into the debate on tax complexity. Vetoing what eventually passed as the Revenue Act of 1943, FDR railed that the proposed legislation, was "not a tax bill but a tax relief bill providing relief not for the needy but for the greedy."[28] Continuing, he warned Congress, that

> The Nation will readily understand that it is not the fault of the Treasury Department that the income taxpayers are flooded with forms to fill out which are so complex that even Certified Public Accountants cannot interpret them. No, it is squarely the fault of the Congress of the United States in using language in drafting the law which not even a dictionary or a thesaurus can make clear.[29]

Of course one thing that complexity in any field brings about is a clearer understanding of the need for professionals. This fact was not lost upon the profession.

The Profession Responds

On January 11, 1943, J. K. Lasser addressed the NYSSCPA's meeting on Federal Taxation at the Waldorf-Astoria Hotel and commented, "We have had a great many drastic changes in our tax laws. . . . Fundamentally, these changes look like the tax man's paradise."[30] However, one must be careful for what they wish -- all that glitters is not gold. While these changes were a boon to the tax profession, they came to pass at a time when the profession was ill-equipped to take on large volumes of additional work because of critical manpower shortages.

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[27] Blakey and Blakey, "Act of 1942," 1075.

[28] Franklin D. Roosevelt, "Veto of a Revenue Bill: February 22, 1944," in John T. Woolley and Gerhard Peters, *The American Presidency Project* [online]. Santa Barbara, CA. http://www.presidency.ucsb.edu/ws/?pid=16490 (accessed 9/21/2010).

[29] Franklin D. Roosevelt, "A Roosevelt Tribute," *The Spokesman* 14, no. 6 (March 1944): 4.

[30] J. K. Lasser, "Corporate Taxes under the 1942 Law," *The New York Certified Public Accountant* 13, no. 4 (January 1943): 151.

Filing Extensions

As one of the first steps in addressing this situation, the accounting profession repeatedly called for extensions of time for filing tax returns. The American Institute of Accountants' Committee on Federal Taxation was the Institute's main arm on tax matters in its dealings with administrative and legislative authorities during the war. On one occasion, in January 1943, the Committee met in Washington "with representatives of the Bureau of Internal Revenue [the precursor of the IRS] and the Treasury Department . . . and submitted in writing a plan under which extensions of time for filing tax returns might be granted without inconvenience or disadvantage to the Treasury."[31] At the AIA Council's midyear meeting, the Committee on Federal Taxation reported the positive outcome of their lobbying efforts, "which led to the granting of extensions of time for filing federal income-tax returns of corporations and to extensions of time for filing claims under Section 722 of the Internal Revenue Code."[32] The Committee also "persuaded the Bureau of Internal Revenue to maintain a reasonably flexible policy in permitting changes from calendar-year to fiscal-year closings."[33]

Nor was this the first time the AIA had campaigned for the availability of time extensions. Before the passage of the Revenue Act of 1942, its Federal Taxation Committee "recommended to the House Ways and Means Committee that corporate taxpayers should have an absolute right to an extension up to three months for the filing of federal tax returns with the

[31] American Institute of Accountants, "Activities of the American Institute of Accountants: Committee on Federal Taxation," *Certified Public Accountant* 23, no. 2 (February 1943): 2.

[32] American Institute of Accountants, "Council Meeting: Federal Taxation," *Certified Public Accountant* 23, no. 6 (June 1943): 7.

[33] John Carey, *The Rise of the Accounting Profession: To Responsibility and Authority, 1936-1969*,(New York: American Institute of Certified Public Accountants, 1970), 49.

understanding that the time for payment of the first installment would not be extended."[34] This effort was supported by other societies.

The New York State Society of Certified Public Accountants' (NYSSCPA) Committee on Federal Taxation added their support to the endeavor by publishing Wartime Problems Release No. 16 on July 20, 1942. Release No. 16 called attention to the need for swift action by NYSSCPA members in order to secure adequate provisions for time extensions "in the revenue act now pending."[35] It specifically urged them and their clients to write "to their Congressmen, indicating their reasons for the adoption of the proposal."[36]

The results of such coordinated efforts reduced the work overload that accountants were facing at the peak of their busy season by allowing them to spread out corporate tax return filings over a much longer period of time. Because many firms were already seriously shorthanded, it was imperative to place as much distance as possible between year-end audit work and corporate tax filings. The Bureau of Internal Revenue also benefited.

> This war time scarcity of technical personnel was well illustrated by the reported explanation given by the New York office of the Commissioner of Internal Revenue when it was stated that three different results had been tentatively approved by the Commissioner's office on the same set of tax facts. The reported explanation for this inconsistency was that most of the tax experts have been taken into the armed forces and that those remaining possessed questionable and varied tax-determining abilities.[37]

The extensions, so vigorously lobbied for by the profession, without question, lessened the strain on Bureau personnel who were likewise shorthanded.

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[34] "Wartime Problems Releases: Release No. 16," *New York Certified Public Accountant* 12, no. 11 (August 1942): 581.
[35] Ibid.
[36] Ibid.
[37] Lawrence W. Sherritt, "Preliminary Considerations to the Installation of the Cost System," *New York Certified Public Accountant* 14, no. 6 (March 1944): 270.

Legislative Recommendations

In addition to their advocacy of time extensions, the professional societies actively advised Congress on a multitude of other issues. The AIA's Committee on Federal Taxation "made countless recommendations on legislative proposals, as well as administrative policies, related to wartime taxes."[38] The pay-as-you-go tax plan was one such important issue.

The Institute took a strong stand in support of changing to the pay-as-you-go basis. On January 26, 1943, newspapers carried articles that indicated sixteen members of the AIA, acting on their own behalf, "had reviewed the text of a letter from Beardsley Ruml, sponsor of the pay-as-you-go plan . . . and had expressed their opinions with respect to Mr. Ruml's conclusion concerning the fiscal status of the Treasury under such a program."[39] Their opinion, in part, follows:

> Since the United States Treasury operates on a cash-receipts basis there is, in my opinion, no reason to suppose that the receipts from taxation of individuals in 1943-1944 would be any less if the pay-as-you-go system were adopted than on the present basis. Furthermore, over a long period of years it is likely that the income of this country will increase and the receipts under the pay-as-you-go system would be greater with the same tax rates than under the present system.[40]

Their strong endorsement was quickly followed by that of the AIA's executive committee, who in a meeting two days later passed a resolution that contained, in near verbatim text, the previously cited opinion. Additionally, the executive committee's resolution stated as fact that the AIA had for "over twenty-five years" "advocated the collection of federal income taxes on a current basis, by withholding at the source as much of the tax as possible, to make

[38] John Carey, *The Rise of the Accounting Profession: To Responsibility and Authority, 1936-1969*,(New York: American Institute of Certified Public Accountants, 1970), 49.

[39] American Institute of Accountants, "Institute Members Comment on Pay-As-You-Go Tax Plan," *Certified Public Accountant* 23, no. 2 (February 1943): 4.

[40] Ibid.

payment easier for taxpayers and collection more certain for the government."[41] In further support, the executive committee authorized the AIA's president to disseminate the resolution and the AIA's Committee on Federal Taxation to appear before and "to correspond with Congressional committees on any accounting questions which may be referred to it on the subject."[42]

Acting on that authority, the Committee on Federal Taxation reported in early May that one of its committee members had appeared "before the House Ways and Means committee, endorsing the 'pay-while-we-earn' principle."[43] The Committee also disclosed that they would be presenting proposed amendments to the Tax Code, "at the next hearing of the House committee."[44] These efforts were not in vain. On June 19, 1943, the Current Tax Payment Act, which incorporated withholding, was signed into law.

The accounting profession was also vocal in challenging retroactive provisions in proposed tax laws. On July 10, 1942, the chairman of the Institute's Committee on Federal Taxation, Mr. Walter Cooper, mailed a letter to the chairman of the House Ways and Means Committee, Mr. Robert Doughton, that opposed "provisions of the pending tax bill which would make changes in the law and in tax rates applicable to fiscal years beginning in 1941 and ending in 1942."[45] Although these retroactive provisions had been "retained by the House," the Committee on Federal Taxation planned to officially "oppose their enactment in a statement . . . presented before the Senate Finance Committee."[46]

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[41] American Institute of Accountants, "Pay-As-You-Go Tax Resolution," *Certified Public Accountant* 23, no. 2 (February 1943): 4.

[42] Ibid.

[43] American Institute of Accountants, "Council Meeting: Federal Taxation," *Certified Public Accountant* 23, no. 6 (June 1943): 7.

[44] Ibid.

[45] American Institute of Accountants, "Activities of the Month," *Certified Public Accountant* 22, no. 8 (August 1942): 1.

[46] Ibid.

In addition to the efforts of the AIA, the New York State Society of Certified Public Accountants (NYSSCPA) was also an active participant in the federal legislative process. On March 4, 1942, the Society's Committee on Federal Taxation provided the U.S. Treasury Department with no less than "twenty-five recommendations for changes in federal income and excess profits taxes."[47] The proposed "changes were designed to simplify computations and [to] liberalize relief provisions under the new revenue act."[48]

While not all of their proposals were accepted, a surprisingly high number were. Speaking at a war time conference in March of 1943, Maurice Austin observed the success of the professional societies and commented,

> Last year this Society [NYSSCPA], the American Institute and many other accounting organizations, made numerous and detailed recommendations to Congress for technical amendment of the tax laws. The vast majority of these – a percentage far higher than ever before – were accepted and constitute the bulk of that part of the 1942 legislation which is not directly concerned with tax rates.[49]

Education

To aid their members on taxation issues, the professional societies held numerous educational meetings and, when need arose, turned to direct correspondence. One such meeting was held by the AIA's Committee on Federal Taxation on January 24, 1943. The main items on the agenda of the all-day affair covered "extensions of time for filing tax returns and relief claims, practice before the United States Tax Court, and proposals for new tax legislation."[50]

On another occasion, the Committee on Federal Taxation received items of such importance that they were immediately forwarded to the membership. For instance on February

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[47] Wentworth F. Gantt, ed., "Recommendations of Federal Taxation Committee," *New York Certified Public Accountant* 12, no. 6 (March 1942): 358.

[48] Ibid.

[49] Joseph J. Klein, et al., "Symposium on Post-War Problems of the Accountant held . . . on March 22, 1943," *New York Certified Public Accountant* 13, no. 7 (April 1943): 278.

[50] American Institute of Accountants, "Activities of the American Institute of Accountants: Committee on Federal Taxation," *Certified Public Accountant* 23, no. 2 (February 1943): 2.

11, 1943, the Committee received correspondence from the Commissioner of the Bureau of Internal Revenue that "outlined changes in the policy of the Treasury Department in granting extensions of time for filing corporate income and excess-profits-tax returns."[51] Due to the extremely vital nature of the communication, the Committee mailed this letter to all AIA members and associates on February 11 – the same day it was received. For those who may have been overlooked, the *Journal of Accountancy* carried a reprint of the letter in its March issue.

The NYSSCPA also maintained a steady program of tax meetings during the war. On the evening of January 12, 1942, Andrew Stewart, the president of the NYSSCPA, opened one meeting by offering that the Society had "a serious duty to maintain . . . the important service we render to society and, in so doing, to make our contribution to ultimate victory."[52] To be equipped to perform this service, President Stewart singled out the role of tax meetings that he "considered essential to the successful accomplishment of our national and state tax programs."[53] Continuing, he assured that "monthly meetings will be continued and it is hoped that all of this effort will be not merely an aid to all members . . . but also an inspiration to them to aid the national interest in many other ways."[54] The president's remarks were more than just bluster, the New York Society's Committee on Federal Taxation announced in the March issue of the *New York Certified Public Accountant* that unlike in preceding years their "tax meetings would not terminate on March 15th, but would be continued throughout the year."[55] The Committee believed that the tax problems that would confront the members would "be of such import and

[51] American Institute of Accountants, "Activities of the American Institute of Accountants: Committee on Federal Taxation," *Certified Public Accountant* 23, no. 3 (March 1943): 1.
[52] Andrew Stewart, "January Society Meeting," *New York Certified Public Accountant* 12, no. 4 (January 1942): 239.
[53] Ibid.
[54] Ibid.
[55] "State Society Activities: Federal Taxation Meetings," *New York Certified Public Accountant* 12, no. 4 (January 1942): 355-356; during the war period March 15th was the tax filing deadline.

concern that continuing attention should be devoted to them."[56] Accordingly, they scheduled their next meeting for April 20, 1942.

Through the use of meetings, memos, and society publications, the professional societies assisted their members in staying abreast with the changing tax environment during World War II. The frequency of the changes in tax law complicated this effort but in no way prevented it. By providing for the educational needs of the members in a multitude of formats the societies ensured that tax practitioners would not be left adrift in a sea of complexity. In so doing, the societies provided substantial support to the successful implementation and execution of U. S. tax policy during the war.

Tax Simplification

> Even the experts are so bumfuzzled about this business of paying federal income taxes that they have passed a formal resolution crying for relief. --
> -- *Houston Post*, February 20, 1944

It is possible to have too much of a good thing. Anytime the prime beneficiaries of a law begins to cry for help it is probably well past the time that such advice should have been heeded. Such was the case of tax work for the accounting profession. The sea of complexity brought about by frequent changes in the tax laws may have appeared to be "a tax man's paradise" to J. K. Lasser, but had turned into a nightmare for the average citizen and was approaching a level of complexity that even accounting experts could not tolerate.[57]

So on August 6, 1943, the AIA's Committee on Federal Taxation began the process of organizing and synthesizing recommendations on income tax simplification "in accordance with a request for the advice of the accounting profession received from . . . [the] Joint Committee on

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[56] Ibid.

[57] J. K. Lasser, "Corporate Taxes under the 1942 Law," *The New York Certified Public Accountant* 13, no. 4 (January 1943): 151.

Internal Revenue Taxation."[58] However, this was not the first recognition by accountants of problems in the tax code. The president of the Pennsylvania Institute of Certified Public Accountants, John Parry, waded into the subject in 1938 and wrote that "Self-assessment of taxes sounds well, but when the rules and regulations of the game run into volumes and the self-assessor wanders in a maze . . . it's time to call a halt."[59] His solution – "Tax simplification should receive equal consideration with tax fairness."[60]

Unfortunately, all were not aware of the profession's long drive for simplicity in the tax code. Because of this, the profession received a black eye in September 1943, when several Scripps-Howard newspapers ran editorials that advocated tax simplification but implied that accountants were opposed to such endeavors. The editorials painted with a wide brush and insinuated that "because of the work created for them by tax complexities" both "accountants and Treasury tax experts" were opposed to tax simplification efforts.[61]

After receiving "a flood of indignant letters" the New York *World-Telegram* ran a second editorial on September 28th entitled "Apology and Suggestion."[62] In addition to exonerating the accounting profession, the editorial contained an interesting rebuttal they had received from the AIA that read,

> In contradiction to any idea that a "make-work" policy exists for the benefit of those in practice, the accountancy profession long has been on record as opposed to complicated tax laws, on the ground that they create confusion and uncertainty in the mind of the taxpayer; hamper the orderly planning and conduct of business; make the payment of taxes a burden and, incidentally, make the independent accountant's work more difficult.[63]

[58] American Institute of Accountants, "Activities of the American Institute of Accountants: Federal Taxation," *Certified Public Accountant* 23, no. 9 (September 1943): 4.
[59] John C. Parry, "From Our President," *The Spokesman* 8, no. 5 (March 1938): 1.
[60] Ibid.
[61] American Institute of Accountants, "Accountants and Tax Simplification," *Certified Public Accountant* 23, no. 10 (October 1943): 5-6.
[62] Ibid.
[63] Ibid.

Given the recent attention generated in the press, it is hardly surprising that the issue should reemerge at the American Institute of Accountant's 1943 annual meeting. On October 19th, the AIA set the record straight by adopting a resolution firmly in support of efforts to simplify the tax law. The resolution that emerged stated that "since the enactment of the original income tax law in 1913 there have been twenty . . . revisions of the tax laws [that] have resulted in the creation of a very complex tax structure which is highly detrimental to the prosperity of the country."[64] In closing, the resolution urged Congress to create "a qualified non-partisan commission . . . to write a simple revenue law which will express a permanent and consistent policy of federal taxation."[65]

Soon thereafter, state societies of certified public accountants joined with the AIA in advocating simplification of the tax laws. Societies in Maine, Minnesota, Nebraska, New York, and Wisconsin each adopted tax resolutions similar to the AIAs.[66] Other state societies quickly followed suit. The president of the AIA even contacted the state societies and suggested that all the states should pass such proposals.

The accounting profession's intense lobbying campaign and the general public's near universal agreement and support for simplification was not lost on those in authority. On January 10, 1944, Congress became involved when Kansas Representative Frank Carlson introduced "a joint resolution to establish a Federal tax commission (H. J. Res. 211) and [to] declare the policy of Congress to be . . .

> (1) To simplify the Federal tax system, including forms of taxation, and methods of administration;

[64] T. W. Leland, ed., "Institute Adopts Timely Resolutions," *Texas Accountant* 15, no. 11 (November 1943): 8.

[65] Ibid.

[66] American Institute of Accountants, "Tax Resolutions," *Certified Public Accountant* 23, no. 12 (December 1943): 4.

(2) To establish a streamlined, long range, integrated Federal tax policy designed to meet present and postwar financing needs;
(3) To raise the necessary revenue for the support of the government with the least possible burden on individual taxpayers and business enterprises and with the greatest possible incentive to capital invested in production enterprise . . ."[67]

Yet with all the impetus on simplification, Congress missed the mark. In February 1944, Congress presented the President with their proposed revenue act that unfortunately was plagued with complexity and failed to provide for the additional revenue FDR was seeking. President Roosevelt vetoed it on February 22, 1944. In his veto measure, the President reminded Congress that the "taxpayer has been promised of late that tax laws and returns will be drastically simplified. This bill does not make good that promise. It ignores the most obvious step toward simplifying taxes by failing to eliminate the clumsy Victory Tax."[68] Continuing his strongly worded rebuke, President Roosevelt urged Congress to "act as quickly as possible for simplification of the tax laws which will make possible the simplification of the forms and computations now demanded of the individual taxpayers."[69] He stressed, that "taxpayers, now engaged in an effort to win the greatest war this Nation has ever faced, are not in a mood to study higher mathematics."[70] FDR closed his veto message by reminding Congress of their responsibility "to achieve real simplicity for millions of small income taxpayers. In the interest of strengthening the home front, in the interest of speeding the day of victory, [he] urged the earliest possible action."[71] His veto was promptly overridden and the proposed Revenue Act of 1943 became law.

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[67] I. Russell Bush, "The President's Message," *The Spokesman* 14, no. 5 (February 1944): 1.

[68] Franklin D. Roosevelt, "Veto of a Revenue Bill: February 22, 1944," in John T. Woolley and Gerhard Peters, *The American Presidency Project* [online]. Santa Barbara, CA. http://www.presidency.ucsb.edu/ws/?pid=16490 (accessed 9/21/2010).

[69] Ibid.

[70] Ibid.

[71] Ibid.

Unfortunately, the President could not write laws or even revise those on the books. That authority belonged to Congress. Even so, others were quick to concur with his call for action. One author of the period observed, "It is imperative that the government simplify and stabilize as much as possible the procedures and reports required in collecting taxes at the source. Much of the difficulty in reporting to the government results from the absence of clear-cut and authoritative interpretations and regulations from the governmental administrative bureau in charge."[72]

Accountants showed no sign of backing down from the issue. In Washington, AIA representatives met on March 2, 1944, "with a committee representing the staff of the Joint Committee on Internal Revenue Taxation, the Treasury Department, and the Bureau of Internal Revenue."[73] At the meeting the AIA spokesmen provided recommendations for income tax simplification that were the product of the discussions from "an all-day meeting of the Institute's committee on federal taxation."[74] Moreover state societies continued to push for support. For example, in the *Spokesman*, J. N. Aitken exhorted that members should contact their representatives and voice their support for tax simplification. He also suggested that withholding should only be viewed as a "temporary expedient until the larger problem of a revision of tax laws themselves is disposed of."[75]

Support continued to grow for the AIA's proposal that Congress establish "a non-partisan body of experts" to help simplify the income tax laws. In March 1944, the *Tax Review* dedicated its entire issue to tax simplification plans. "The article referred to the Institute's proposal . . . and analyzed three principal bills [H.J. Res. 23 – Knutson bill; H.J. Res. 211 – Carlson bill; H.R.

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[72] L. J. Benninger, "Business and Witholding Taxes," *Accounting Review* 19, no. 3 (July 1944): 304.
[73] T. W. Leland, ed., "Simplification of Individual Income Tax Returns," *Texas Accountant* 16, no. 4 (April 1944): 8.
[74] Ibid.
[75] J. N. Aitken, "Just Another Column," *The Spokesman* 14, no. 6 (March 1944): 1

4086 – Forand bill] introduced in Congress to give it effect."[76] The article revealed that the ABA was actively supporting the proposal and closed with praise. "Its inauguration would be highly encouraging to all who are now lost in the tax maze, and the successful completion of the task would be enormously stimulating to all taxpayers in the post-war period."[77]

The lament of one weary accountant who in early 1945 called for "simplicity, even at the occasional sacrifice of fairness" revealed that the desired simplification had yet to occur.[78] Yet this sage of old was well on point in offering, "A simple tax law fairly administered is preferable to a fair law so complicated that even the tax administrator is unable to understand it."[79]

Toward the close of 1945, William J. Carter, the NACA vice president, gave an address in New Orleans on Federal taxation trends. Though pointing out that "there never was a perfect tax and never will be," he was definitely in favor of efforts to achieve such.[80] To that end, Carter expressed his opinion that Congress should follow the advice of the AIA and "set up a non-partisan tax commission to make a thorough study of the science of taxation as it applies to all branches of government."[81] Regretfully, he informed his audience that all of the bills that had been "introduced into Congress for such action . . . had been lost in the shuffle."[82]

Although the profession did not achieve the level of income tax simplification that it had strived for during the war, it nevertheless gained the admiration, respect, and good-will of American taxpayers and public officials alike. In hindsight, perhaps this was the greater victory.

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[76] American Institute of Accountants, "Non-Partisan Body of Experts to Help Simplify Tax Laws," *Certified Public Accountant* 24, no. 4 (April 1944): 4-5.

[77] Ibid.

[78] Michael D. Bachrach, "Tax Simplification," *Accounting Review* 20, no. 1 (January 1945): 103.

[79] Ibid.

[80] William J. Carter, "The Trend of Federal Taxation," in "Just Simple Taxes?" *Certified Public Accountant* (December 1945): 14.

[81] Ibid.

[82] Ibid.

Sometimes even in defeat there is victory if the cause is just. While the accounting profession may not have won this legislative battle, it definitely won the public relations war.

Conclusions

Transformative changes took place within the U.S. tax code during World War II. An income tax law initially designed to be a class tax on the wealthy was transformed into an enormous revenue generating mass tax. To accomplish this feat, exemptions were steadily lowered, which brought millions to the tax rolls. In fact, from 1939 to 1945, the number of taxpayers in America rose 975% from 4 million to 43 million or when compared to the population as a whole from 0.33% to 33%.[83] These efforts were so successful that by the close of the war, taxpayers earning as little as $500 were subject to a 23% tax rate.

To broaden the tax base, the tax code inherited many simplifying features still in use today including form 1040A, estimated tax payments, and withholding. Through all of the changes that occurred, accountants were actively involved not only in implementing the final resulting legislation but also in policy formation. As John Carey recalled, "the committee on federal taxation made countless recommendations on legislative proposals, as well as administrative policies, related to wartime taxes."[84] Nor were they alone. Other professional accounting organizations also engaged in cooperative lobbying efforts that gave added weight and additional leverage to overall professional legislative goals. Unsurprisingly, the accounting profession achieved an enviable success rate in Washington. This high degree of success was due in no small part to the high esteem in which the profession was held. One period writer observed that their legislative agenda succeeded "largely because of the high regard with which

[83] United States Department of the Treasury, "Fact Sheet: Taxes," http://www.treas.gov/education/fact-sheets/taxes/ustax.shtml (accessed 9/22/2010).

[84] John Carey, *The Rise of the Accounting Profession: To Responsibility and Authority, 1936-1969*,(New York: American Institute of Certified Public Accountants, 1970), 49.

the accounting profession and the organizations representing it were held in Washington."[85] He continued, "Our profession is accorded very high standing by those in government charged with the administration of these laws. Never in the history of the profession have we been regarded as highly down in Washington and the other centers of tax administration."[86]

If vineyards can be judged by the abundance of their harvest, then professions may likewise be measured. During the war, the accounting profession produced. Time extensions, withholding at the source, countless educational endeavors, promotion of tax simplification, and opposition to retroactive provisions of the tax code are only the most obvious fruits of their harvest. While not all labors led to desired ends, such as in the fight for tax simplification, it is always better to be on the losing side of a just cause than on the winning side of one unjust. Contrary to conventional wisdom, this legislative loss only led to increased prestige for the profession. And their words of wisdom still ring true through the ages, "A simple tax law fairly administered is preferable to a fair law so complicated that even the tax administrator is unable to understand it."[87] As for the quality of their harvest, the best answer may be found in its permanence. Time extensions for filing and continuing professional education are now commonplace. And to this day, our federal income tax system is still built around withholding at the source – a device that the accounting profession advocated for over twenty-five years before its adoption in 1943.

The accounting profession achieved greatness during World War II through tireless service to the nation. The fact that this service was given rather than extracted by legislative

[85] Joseph J. Klein, et al., "Symposium on Post-War Problems of the Accountant held . . . on March 22, 1943," *New York Certified Public Accountant* 13, no. 7 (April 1943): 278.

[86] Ibid.

[87] Ibid.

decree makes this labor even more commendable. If we hope to preserve the high standing of the profession, we must never forget how it was earned and is sustained – through service.

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