

The United States Taxpayers' Constitutional Protections

*The IRS Bill of Rights and Fiscal Policy
Analysis*

By

Felix Lessambo

**The United States Taxpayers' Constitutional Protections: The IRS
Bill of Rights and Fiscal Policy Analysis**

By Felix Lessambo

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Acronyms

- ACM: Appeals Case Memo
- ACTC: Additional Child Tax Credit
- AO: Appeals Officer
- ATCL: Appeals Team Case Leader
- ATM: Appeals Team Manager
- ATS: Appeals Tax Specialist
- BCA: Budget Control Act
- CAREF: Crypto Asset Reporting Framework
- CDCTC: Child & Dependent Care Tax Credit
- CIT: Corporate Income Tax
- CPI: Consumer Price Index
- CRS: Congressional Research Service
- CTC: Child Tax Credit
- EGTRRA: Economic Growth and Tax Relief Reconciliation Act
- EITC: Earned Income Tax Credit
- EU: European Union
- FLP: Family Limited Partnership
- GDP: Growth Domestic Product
- GFS: Government Finance Statistics
- ILIT: Irrevocable Life Insurance Trust
- IRC: Internal Revenue Code

- IRS: Internal Revenue Service
- LTLC: Lifetime Learning Tax Credit
- NFTs: Non Fungible Tokens
- ODTC: Other Dependent Tax Credit
- OECD: Organization for Economic Development and Cooperation
- OTA: Office of Tax Analysis
- QPRT: Qualified Personal Residence Trust
- RFRA: Religious Freedom Restoration Act
- TANF: Temporary Assistance to Needy Families
- TCJA: Tax Cut and Job Act
- TPAF: Tax Policy Assessment Framework
- UNCTAD: United Nations Conference on Trade and Development
- VAT: Value Added Tax

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- *United States v. Bichara*, 826 F.2d 1037 (11th Cir. 1987).
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Chapter 1

History of Taxation

Taxation has its historical roots in the first years of record-keeping: the earliest signs are recorded on clay tablets found in Sumeria in southern Mesopotamia, part of modern-day Iraq. The next taxation system developed about 5,000 years ago, where the Pharaoh collected a tax equivalent to 20 percent of all grain harvests. The Greek civilization took the idea of taxation to a higher level and spread it throughout the developed world, as they expanded their realm and civilization evolved. Greek city states imposed taxes on commodities when wars were fought or when there was an emergency, but (where some form of democracy applied) usually direct taxation only applied to the part of the population entitled to vote. Under the Roman emperors the reliance on taxes ebbed and flowed. In the US tax was the handmaiden of the Revolution, in particular in the conflict over whether the British Parliament or the American colonies had the power and right to tax.

1.1 General

Taxation is the heart and soul of government. Taxation has its historical roots in the first years of record-keeping: the earliest signs are recorded on clay tablets found in Sumeria in southern Mesopotamia, part of modern-day Iraq. Archaeology confirms that Egypt employed one of the first tax systems: between 3000 and 2800 BC. The next taxation system developed about 5,000 years ago, where the Pharaoh collected a tax equivalent to 20 percent of all grain harvests. Each farmer paid taxes in the form of grain, which were

stored in the pharaoh's warehouses. The taxes were payable at least once a year with payment made in the form of labor or grain. This grain was used to feed the people in the event of a famine. At the time, Egypt was without coined money, so grain represented a tangible store of value that could easily be collected, traded, and redistributed throughout society. The Greek civilization took the idea of taxation to a higher level and spread it throughout the developed world, as they expanded their realm and civilization evolved. Greek city states imposed taxes on commodities when wars were fought or when there was an emergency, but (where some form of democracy applied) usually direct taxation only applied to the part of the population entitled to vote. In times of peace, the state governors sometimes paid back revenue no longer required for military conflict. Then came ancient Rome. In ancient Rome, the second Caesar, Augustus, acclaimed for his ability as a strategist and financial expert, introduced a wealth tax on Roman citizens. Under later emperors the reliance on taxes ebbed and flowed: there was always some expense involved in defending the empire's borders but additional funding might be needed for military campaigns (against invaders, or, for example, when Claudius decided to conquer Britain). International trade and the imposition of tariffs on imports were crucial and tended to produce a steady source of income, even more than the taxes paid by Roman citizens. In the Dark Ages, after the Roman Empire collapsed in Europe, Europe returned to less sophisticated tax systems that varied from kingdom to kingdom. Karl Marx saw the feudal network as he understood it as muddled and uncoordinated, taking a toll on the development of European economies. Feudal taxation was highly indirect: large classes were expected to give their labor and its fruits to the overlord and monarchs occasionally brought in levies to cover military engagements (or extravagance), which were resented by the populace. These were generally on assets, like the famous Window Tax introduced under William and Mary and only repealed 150 years

later. By the 18th century, the intelligentsia began to discuss the purpose of government. Industrialization led to calls for political and economic reform and for the tax system to tackle the accompanying expansion and growth: rich merchants reaped extensive profits from colonies in Africa, Asia and elsewhere. In Europe, income tax was introduced in the eighteenth century, as in ancient times, to cover foreign wars. Monarchs' ruthless demands on their taxpayers sometimes led to revolutions.

1.2 History of the American Tax System

Originally, America was without its largest source of modern revenue: the income tax. Additionally, many original colonists and traders in the 17th century were exempt from tax collection from their parent countries for a few years, and some for up to 20 years.

American colonies levied property taxes, excise taxes, poll taxes, and some early forms of income taxes, though tax rates and burdens were far less than their counterparts in Great Britain. While American governments were faring well financially, the British government faced debt from many wars worldwide.

This led to the British government turning to the American colonies for additional revenue, and the beginning of the tax struggle we are familiar with that led to the American Revolution. These included:

- Sugar Act of 1764: tax on molasses, sugar, and wine
- Stamp Act of 1765: taxes on important printed material like legal documents, newspapers, and pamphlets
- Townshend Acts of 1767: taxes on 72 items, including the tax on tea that led to the Boston Tea Party

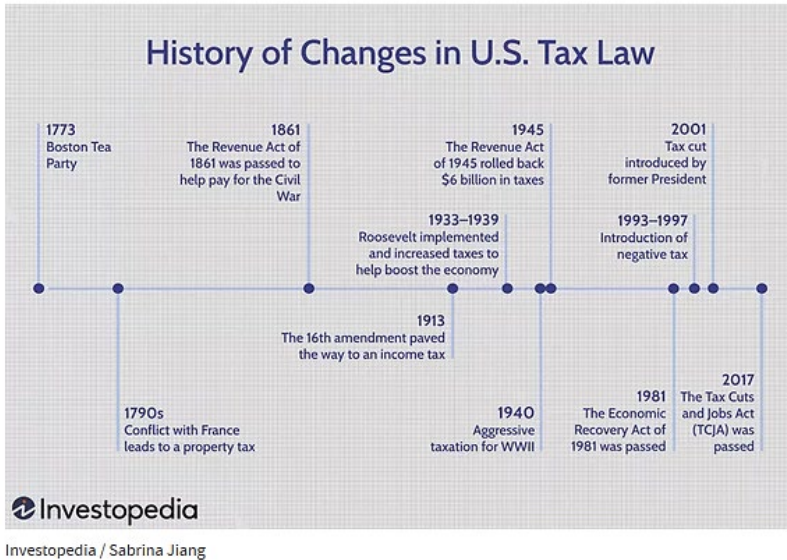


Figure 1.1: History of Changes in US Tax Laws

The federal income tax came into being after the ratification of the 16th Amendment in 1913. The story of the 16th Amendment itself begins in early 1909 when President William Howard Taft called upon Congress to revise the existing tariff schedule of the United States¹. Before the income tax, import taxes actually provided the largest share of the federal government's revenue stream. In 1913, the 16th Amendment authorized an income tax—a policy that began the following year.

- Taxes and Revolution

¹ Phillip W. Magness (2019): The Real History of the American Income Tax, American Institute for Economic Research, <https://www.aier.org/article/the-real-history-of-the-american-income-tax/>

Tax was the handmaiden of the Revolution, in particular in the conflict over whether the British Parliament or the American colonies had the power and right to tax². That is, taxation without representation was the seed of the American Revolution. The 'thuggish barons' of the US in the 1760s and 1770s were eventually forced to fight for control of the state that was taxing them, or more precisely replace that state with a state of and for national capital³. The cry of "no taxation without representation" was inspired by John Locke's maxim of just taxation, which stated that "[legislators] must not raise taxes on the property of the people without the consent of the people, given by themselves or their deputies."⁴ Colonists rebelled against Britain's punitive taxes because they had no voice in parliament. The Declaration of Independence cited the fact that King George had 'imposed taxes on us without our consent' as one of the Revolution's main causes⁵. On July 4, 1776, the Declaration of Independence severed ties with England. The Revolutionary War ended in 1783, and a new nation was born.

- Evolution of Taxation

On February 21, 1787, Congress approved a Constitutional Convention to revise the Articles of Confederation: "... the Congress shall have the power to lay and collect taxes, duties, imposts, and

²Countryman, E. (2003). *The American Revolution*, Macmillan Franklin, J.H. (1947). *From Slavery to Freedom*, McGraw-Hill, New York.

³ John Passant (2017): *Taxation and the American Revolution*, AABFJ | Volume 11, no. 3, pp. 1-10

⁴ William B. Barker (2006): *The Three Faces of Equality: Constitutional Requirements in Taxation*, 57 Case W. Reserve Law Rev. 1 (2006). Available at: <https://scholarlycommons.law.case.edu/caselrev/vol57/iss1/3>.

⁵ Ross, M.L. (2004). 'Does Taxation Lead to Representation?' *British Journal of Political Science* vol. 34 no 2 (April) 229. <https://doi.org/10.1017/S0007123404000031>.

excesses, to pay the debts and provide for the common defense and general welfare of the United States.”

On September 2, 1789, Congress established the Department of the Treasury and appointed Alexander Hamilton as the first Secretary. To pay for the War of 1812, Congress passed new internal taxes on refined sugar, carriages, distillers and auction sales and reinstated the Commissioner of the Revenue to collect them. On August 24, 1814, the British burned the Treasury building in Washington, D.C. On December 23, 1817, Congress repealed these and all remaining internal taxes and abolished the position of the Commissioner of the Revenue and all offices to collect them.

On July 1, 1862, President Lincoln signed the second revenue measure of the Civil War Law. This law levied internal taxes and established a permanent internal tax system. Congress established the Office of the Commissioner of Internal Revenue under the Department of the Treasury. On July 17, 1862, George S. Boutwell became its first commissioner.

- First Federal Income Tax

On February 25, 1913, the 16th Amendment officially became part of the Constitution, granting Congress constitutional authority to levy taxes on corporate and individual income. The Bureau of Internal Revenue established a Personal Income Tax Division and Correspondence Unit to answer a flood of questions about its enforcement, and a special division within General Counsel to prepare opinions interpreting internal revenue laws. On January 5, 1914, the Treasury Department unveiled the four-page form (including instructions) for the new income tax. The form was numbered 1040 in the ordinary stream of numbering forms in sequential order. In the first year, no money was to be returned with

the forms. Instead, each taxpayer's calculations were verified by field agents, who sent out bills on June 1. Tax payments were due by June 30.

- Payroll Withholding

On August 14, 1935, Franklin D. Roosevelt signed the Social Security Act. Employees originally paid one percent of the first \$3,000 of their salaries to finance the benefits. The law required a new system of tax withholding, which the Bureau of Internal Revenue had to collect and turn over to the Social Security Trust Fund. It also created an unemployment compensation program and laid the foundation for modern payroll withholding. The 1942 Revenue Act sharply increased most existing taxes, introduced the Victory tax (a 5 percent surcharge on all net income over \$624 with a postwar credit), lowered exemptions and began provisions for medical and dental expenses and investors' expense deductions.

- IRS Modernizes Data Processing

In 1959, Congress and the Secretary of the Treasury approved IRS plans to install a nationwide automatic data processing system. By January 1962, automated data processing entered full operation, processing up to 680,000 characters per second. The toll-free telephone network system, piloted in 1966, eventually allowed the IRS to handle most taxpayer inquiries by phone. On January 1, 1967, the IRS launched a nationwide, automated federal tax system. That same year, the IRS established a long-range study to determine automated data processing requirements through 1970 and beyond. In 1972, the IRS began to offer tax information in Spanish. Over time, translations expanded to include additional languages in print and on IRS.gov. In 1976, the Service offered toll-free telephone and teletypewriter service to the deaf and hard of hearing. Today, the IRS provides support

through social media channels, relay services, American Sign Language YouTube videos, and at Volunteer Individual Tax Assistance Centers.

- The Tax Reform Act of 1986

U.S. Congress passed the Tax Reform Act to “simplify the income tax code.” The Service marked a pivotal change in the way it interacted with taxpayers by beginning the progression from paper-based filing to electronic filing. The Tax Reform Act of 1986 was considered as the most significant change in our nation’s tax law since the income tax was extended to the masses during World War II.⁶ It is viewed by many scholar as mere rearrangement of the tax code, in which marginal tax rates were reduced and the tax base was broadened by limiting or eliminating various loopholes, deductions, and exemptions. The TRA was designed to be neutral in its overall effect on revenue over the period 1987-91⁷. The over- reaching character of the TRA affected both the individual and the tax corporate taxes. The TRA altered the previous tax structure, which comprised 14 personal income brackets, with statutory tax rates ranging from 11 percent to 50 percent. It replaced that structure with a two-bracket system, with tax rates of 15 percent and 28 percent effective January 1988. The TRA revised the basic tax rate structure for corporations by replacing the previous system of five brackets (from 15 percent to 46 percent) with a system of three brackets (from 15 percent to 34 percent)⁸. With regard to tax shelters and real estate, the TRA created a new income category, “passive income,” from which losses are not, in general,

⁶ Michael J. Graetz (2007): Tax Reform Unraveling, *Journal of Economic Perspectives*—Volume 21, Number 1, pp. 69 –90.

⁷ Owen Evans and Lloyd Kenward (1998): *Macroeconomic Effects of Tax Reform in the United States*, IMF, pp. 1-25.

⁸ *Idem*.

deductible against other income⁹. More, three macro-econometric simulation studies conducted by the IMF indicated that the TRA might have a negative effect on real output in the United States over the medium term because the impact of the reduction in the capital stock induced by an increased cost of capital would more than offset the increase in aggregate labor supply that would be generated by increased after-tax wages¹⁰.

- The Restructuring and Reform Act of 1998

In response to the congressional testimony regarding perceived IRS abuse of taxpayers, Congress enacted the 1998 Revenue Reform Act, which was intended to make for a kinder and gentler IRS. Taxpayers became “customers” and tax professionals became “partners. The Act included numerous amendments to the Internal Revenue Code of 1986. The IRS Restructuring and Reform Act of 1998 prompted the most comprehensive reorganization and modernization of the IRS in nearly half a century. The IRS reorganized itself in 2000 to closely resemble the private sector, creating four major business divisions, each aligned to a group of taxpayers with similar needs. The reform amended the Internal Revenue Code to: (1) increase the maximum individual income tax rate to 35 percent; (2) eliminate the phase-out of personal exemptions; and (3) include net capital gain in the calculation of phase-out of the 15-percent rate (thus setting a 28 percent maximum individual long-term capital gains rate).

- Taxpayer Relief Act of 1997

The benefits of the Taxpayer Relief Act were directed mainly to middle- and low-income taxpayers. Many of its provisions, such as

⁹ Idem.

¹⁰ Idem.

the child tax credit and the education credit, were phased out at higher income levels. The Taxpayer Relief Act of 1997 significantly changed the tax treatment of housing capital gains in the United States. Before 1997, homeowners were subject to capital gains taxation when they sold their houses unless they purchased replacement homes of equal or greater value. The act permanently exempted from taxation the capital gains on the sale of a personal residence of up to \$500,000 for married couples filing jointly and \$250,000 for singles. Moreover, it added a tax break for people with long term investments in stocks bonds and other assets; including tax credits for children and deductible educational expenses. It introduced several tax incentives on qualifying student loans.

- The Economic Growth and Tax Relief Reconciliation Act of 2001

With a budget surplus developed during the Bill Clinton administration, and with the Federal Reserve Chairman Alan Greenspan's support, the Bush administration taught that the best use of the surplus was to lower taxes. After Treasury Secretary Paul O'Neill expressed concerns over the tax cut's size and the possibility of future deficits, Vice President Cheney took charge of writing the bill, which the administration proposed to Congress in March 2001. EGTRRA differed from previous reforms in that: (i) most of the major provisions were either directly or indirectly reduced marginal tax rates; (ii) individuals rather than corporations benefited the most, (iii) major provisions were phased in over a longer period¹¹.

¹¹ Donald Kiefer, Robert Carroll, Janet Holtzblatt, Allen Lerman, Janet McCubbin, David Richardson, Jerry Tempalski (2002): The Economic Growth and Tax Relief Reconciliation Act of 2001: Overview and Assessment of Effects on Taxpayers, National Tax Journal, Volume 55, Number 1.

- The Tax Cuts and Jobs Act of 2017

On December 22, 2017, President Donald J. Trump signed into law H.R. 1, known as the Tax Cuts and Jobs Act, the most significant piece of tax reform legislation in decades. Today, the IRS continues its mission to provide America's taxpayers with top quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all. The Tax Cuts and Jobs Act ("TCJA") changed deductions, depreciation, expensing, tax credits and other tax items that affect businesses. TCJA made many large changes across multiple areas of the tax code, including most infamously reducing the corporate tax rate, increasing the standard deduction, and increasing the applicable exclusion amounts for estate taxes. TCJA lowered the top statutory corporate tax rate from 35 percent to 21 percent. The TCJA overwhelmingly benefited the rich and corporations while overlooking working families. Analysts at the International Monetary Fund find that 80 percent of the corporate tax cuts were repurposed into stock buybacks and dividends, which overwhelmingly benefited wealthy shareholders¹². The overall critique is simple: by providing large, regressive, deficit-financed tax cuts to an economy with low unemployment, rising long-term inequality, and high debt, the law was the wrong thing at the wrong time. Congress seems to have intended building improvements to be eligible for 100 percent bonus depreciation, but left them out due to a last-minute drafting error.

- The One Big Beautiful Bill of 2025

¹². Emanuel Kopp and others, "U.S. Investment Since the Tax Cuts and Jobs Act of 2017." Working Paper (International Monetary Fund, 2019), available at <https://www.imf.org/en/Publications/WP/Issues/2019/05/31/U-S-46942>.

The House of Representatives' Fiscal Year 2025 reconciliation bill – titled the One Big Beautiful Bill Act of 2025 (OBBBA) adds \$2.4 trillion to primary deficits over the coming decade, adding \$3.0 trillion to the debt including interest. If its temporary provisions are extended without offsets, it is estimated that, in total, it would add \$5.0 trillion to the debt including interest¹³. On July 4, 2025, the *One Big Beautiful Bill Act (OBBBA)* was signed into law, resulting in changes to federal student aid programs. Some of these changes went into effect immediately, while others will go into effect next year and beyond. The 870 page-bill *covers nearly every sector of the American economy*, and extends many of the taxpayer-friendly provisions of the Tax Cuts and Jobs Act (TCJA).

¹³ <https://www.crfb.org/blogs/breaking-down-one-big-beautiful-bill>.

Chapter 2

The Constitutional Sources of Tax Laws

Income tax is the largest source of revenue for the federal government. The Constitution's Sixteenth Amendment authorizes Congress to lay and collect taxes on income; however, it does not describe how Congress is to go about doing so. The Taxing Clause in Article I, Section 8 of the Constitution allows Congress to "lay and collect Taxes, Duties, Imposts and Excises," but the article also says that "direct" taxes must be apportioned among the states according to their population.

2.1 General

The United States Constitution contains seven references to taxes, which provide the basis for federal tax law. The Constitution's Sixteenth Amendment authorizes Congress to lay and collect taxes on income; however, it does not describe how Congress is to go about doing so. Likewise, Article I, Section 8, Clause 1 of the Constitution—the Taxing and Spending Clause—provides Congress with the power to lay and collect taxes; and Article IV, Section 3, Clause 2 of the Constitution—the Property Clause—provides Congress with the power to make needful rules and regulations concerning federal areas.

2.2 Article I, Section 8, Clause 1 of the Constitution

The issue of "taxation without representation" played a large role in the development of the American legislative system and is seen in Article I, Section 2 of the U.S. Constitution, which granted the elected

representatives in Congress the exclusive power to impose taxes on all citizens.

The Taxing Clause in Article I, Section 8, grants Congress the broad “Power To lay and collect Taxes, Duties, Imposts and Excises,” but Article I also provides (twice) that a “direct” tax must be apportioned among the states on the basis of population. This means that if a tax is a “direct” tax, a state with one-tenth of the national population must bear one-tenth of the total liability. It doesn’t matter whether one state has lots of whatever is being taxed (such as valuable land) and another state has very little—the states have to bear the burden according to population. That requirement makes direct taxation cumbersome, and often impossible.

2.3 The Sixteenth Amendment

The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

The origin of the modern income tax began with ratification of the Sixteenth Amendment to the U.S. Constitution. The amendment authorized Congress to institute a graduated income tax on the earnings of American workers. This power thus enabled the passage of the Revenue Act of 1913. The ratification of the Sixteenth Amendment was the direct consequence of the Court’s 1895 decision in *Pollock v. Farmers’ Loan & Trust Co.* During the years between the *Pollock* decision in 1895 and the ratification of the Sixteenth Amendment in 1913, the Court gave evidence of a greater awareness of the dangerous consequences to national solvency that *Pollock* threatened, and partially circumvented the threat, either by taking refuge in redefinitions of “direct tax” or by emphasizing the history of excise taxation. [T]he Sixteenth Amendment conferred no new power

of taxation but simply prohibited the previous complete and plenary power of income taxation possessed by Congress from the beginning from being taken out of the category of indirect taxation to which it inherently belonged.

Timeline

June 17, 1909	United States Senator Norris Brown of Nebraska proposed the Sixteenth Amendment to the U.S. Constitution.
1909-1913	State legislatures across the U.S. begin to ratify the amendment.
February 3, 1913	Wyoming becomes the last of the three-fourths states needed to ratify the Sixteenth Amendment, which officially enables Congress to legally act on a permanent income tax.
September 23, 1915	Stockholders file a brief in the U.S. Supreme Court, which argues the Sixteenth Amendment covers "many taxes other than on income."
January 24, 1916	The Supreme Court declares the income tax is constitutional by the Sixteenth Amendment.
March 8, 1920	The Supreme Court says stock dividends are "not taxable under the 1916 income tax law".

Figure 2.1: The Sixteenth Amendment Timeline

- Income Subject to Taxation

Building upon definitions formulated in cases construing the Corporation Tax Act of 1909, the Court initially described income as the "gain derived from capital, from labor, or from both combined," inclusive of the "profit gained through a sale or conversion of capital assets"; in the following array of factual situations it subsequently applied this definition to achieve results that have been productive of extended controversy.

Even prior to the Amendment, the Constitution gives the federal government the power to tax pretty much anything, with three caveats: (1) federal duties, imposts, and excises must be uniform throughout the U.S.; (2) no federal direct taxes may be imposed unless it is proportional to population; and (3) no federal taxes can be imposed on exports from a state. In 1894, the Supreme Court ruled that the income tax is a direct tax, and consequently, while the federal