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THE HISTORY OF FEDERAL INCOME TAX RATES

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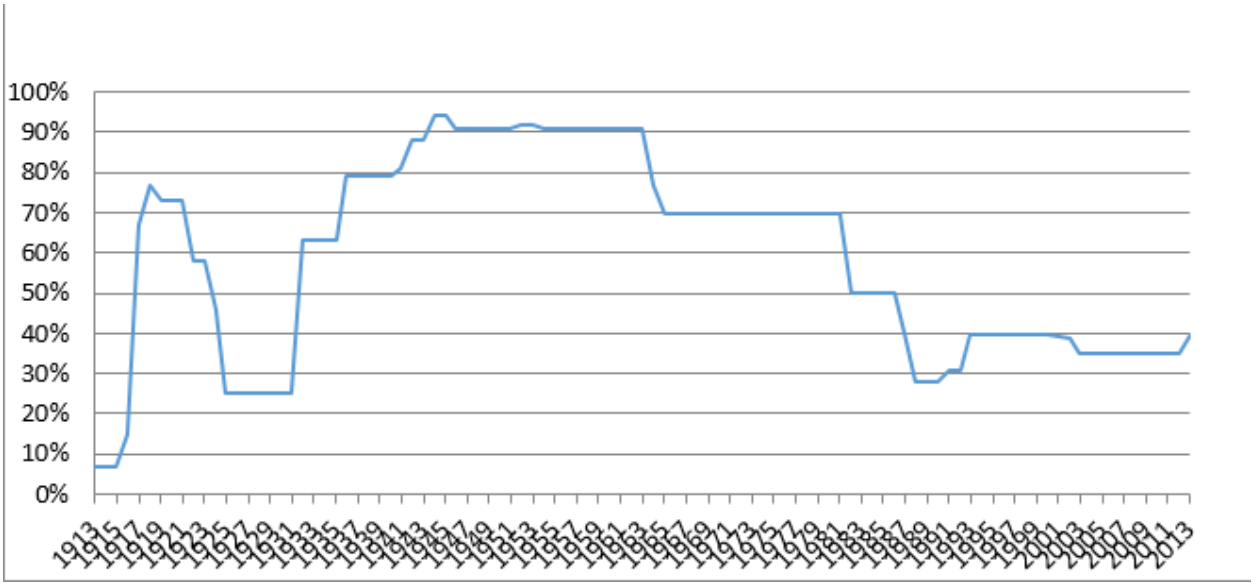
The following chart is not the pattern of an irregular heartbeat, although it may cause cardiac arrhythmias. It is a chart of the federal tax rate in the maximum statutory income bracket for married filing jointly taxpayers, for the years 1913 through 2013.



A LITTLE HISTORY ABOUT ON INCOME

In Pollock v. Farmers' Loan & Trust Co., the US Supreme Court's 1895 ruling declared certain taxes on income … to be unconstitutionally apportioned direct taxes. This decision was effectively overturned on February 3, 1913 with the passage of the 16th Amendment to the Constitution which gave Congress the legal authority to tax both individuals and corporations. Starting in 1913, there were seven different tax brackets with a maximum rate of 7%; by 1918 there were 56 tax brackets with a maximum rate of 77%! (Author's note: remember this the next time you hear Congress proposing a national sales or value-added tax.)

During periods of war, federal income tax rates have soared. For example, during 1941 through 1963, the married filing jointly federal tax rate in the maximum statutory bracket ranged from 81% to 94%. Such maximum bracket tax rates were decreased under President Johnson in 1964 and 1965 to 77% and 70%, respectively. Such maximum bracket tax rates were again decreased, to 50%, 38.5% and 28% during 1981, 1987 and 1988, respectively. Since 1991, the maximum bracket tax rate has ranged from 31% to 39.6%.

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WHAT ARE THE IMPLICATIONS OF TAX RATE VOLATILITY?

Here are some things to think about:

1. Tax rates in the maximum bracket are highly volatile, as are the number of income brackets and range of income in each bracket.
2. There are fewer income brackets today than there were during the first half of the twentieth century, subjecting more individuals to the higher rate brackets.
3. In times of economic need, Congress raises tax rates – often substantially.
4. Today's income tax rates, although high in relation to recent years, are quite low in relation to the past century.
5. When tax rates increase, after-tax cash flows to business owners tend to decrease (thereby impacting business value).
6. Short and long-term tax planning should take into consideration the reality of tax rate volatility, so leave room for flexibility.

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