DID THE PASSAGE OF FEDERAL TAX LAWS IN 1909 AND 1913 DRIVE GROWTH OF STATE CPA SOCIETIES?

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ABSTRACT

Throughout this past decade, numerous CPA state societies have announced their "Celebratory Century Mark" of founding. This paper looks historically at some of the factors that would cause such an acceleration in the need for accounting societies to come into existence across the United States (US), particularly after the 1913 passage of the 16th amendment.
This paper acknowledges that many states already had CPA societies before 1913. In addition, other new federal laws, such as the implementation of a nationwide corporate tax in 1909, the Federal Reserve System in 1913 and Clayton Antitrust Act in 1914, created additional need for accountants.

With that in mind, the new Federal laws (including the 1909 Corporate Tax Act and the 16th amendment) do seems to create a need in almost all states for accounting societies. Whereas pre-1913 most state societies were founded either in coastal states or states with waterways or large industries, immediately post-1913 societal foundings were in many smaller states in the interior of the US. There was also a great deal of uncertainty and confusion about accounting and tax measurements in general in the years before and after 1913. This uncertainty would certainly have led to the need for accountants to have avenues for debate and discussion on ambiguous areas. Some of these areas of ambiguity are highlighted.

INTRODUCTION

Each year, particularly since the turn of the 21st century, it seems that one of more state CPA societies are celebrating their "100th anniversary." These century celebrations do not seem to be limited to just state CPA societies either. The American Association of University Instructors in Accounting (now the American Accounting Association - the association comprised of mostly accounting professors) started in 1916. Beta Gamma Sigma (the business student honor society) was in 1913. The IMA – the Institute of Management Accountants and administrator of the Certified Management Accountant's exam – is celebrating its 100th anniversary founding in 2019. Even the "official" Uniform Certified Public Accounting Exam started in 1917 (King, et al., 2017).
This paper discusses some of the historical business and accounting context of the decades of the 1900s and 1910s while attempting to answer the particular question of "Did the 1909 corporate and 1913 individual income tax law passage drive the acceleration of the creation of these societies?"

It should first be acknowledged that not all of these state organizations or societies were started in 1913 or after. New York was the first, in 1896. The first exams were given and licenses were issued later that year. The actual state society – the New York State Society of Certified Public Accountants – came along in 1897 (Anonymous, 1997). That one-year (or multi-year) difference sometimes occurs in other states as well, but sometimes not. Pennsylvania was second in establishing its state society in 1899. Maryland was 1900. California and Michigan began in 1901. Illinois and Washington 1903. New Jersey 1904. Florida 1905. Connecticut was 1908.

But did the 16th amendment accelerate more state societies to be founded afterwards? There does seemed to be increase in state societies being established on or after 1913. For example, Montana was 1913. Indiana, Iowa, South Carolina and Texas were 1915. Idaho and Oklahoma were 1918. West Virginia is in 1919. Mississippi is 1920. Eventually New Mexico and Wyoming was in 1921, Maine in 1924 and Nebraska 1928.

What also seems to be noticeable is that professional societies arose from coastal states (Northeast, Florida, California) much earlier than most of the "inland" state (Oklahoma, Texas, Nebraska). The exception to this was when the state had a city connected to a major inland waterways and significant population growth after the turn of the 20th century – such as Detroit, St. Louis or Chicago.

What is obvious is that some external force or forces sped up the process of forming state-wide professional accounting society – and in states that did not have large industrial bases or widespread population – like Indiana, Iowa and Oklahoma. This "acceleration" was apparently brought on by two forces on a national level: a variety of new federal laws (including tax laws) and agencies and the large uncertainty about accounting rules that still existed in 1913.

This paper is organized as follows. Section two describes the advent, evolution and purpose of accountants and their professional accounting societies in Europe beginning in the early 1800s and in the US in the late 1800s. Section three presents some of the uncertainty that existed in the accounting and taxation even in the early part of the 1900s, which led to the creation of more and more collaboration between accountants both in the US and Europe and in state societies within the US. Section four concludes.

INCREASE IN NUMBER OF ACCOUNTANTS IN THE 1800s

Accounting as a profession grew slowly, beginning in the 1700s in England and Scotland. By the 18th century, the double-entry system of bookkeeping began to replace the "discharge and charge" system of feudal days. The number of accountants to rise, as businesses began to become bigger and require greater detail on the financial performance. Littleton (1942) documented this growth through scanning address books in Scotland and England in various years in late 18th and early 19th century in table 1.

Table 1:
Accountants Listed in 1700 and 1800s in Scotland and England

Edinburgh	1773 – 6 accountants
	1774 – 14
	1821 – 58
	1834 – 80
Glasgow	1783 – 5 accountants
	1821 – 16
London	1776 – 1 accountant
	1799 – 1
	1840 – 107
	1870 – 464
Liverpool	1783 – 1 accountant
	1796 – 10
	1860 – 91
	1870 – 1139

By the middle of the 19th century, accounting began to establish itself as a profession. Guilds of accountants were established in Edinburgh and Glasgow in 1853 and in Aberdeen in 1867. Later in England, institutes of accountants appeared in Liverpool and London in 1873, in Manchester in 1873 and in Sheffield in 1877 (Tinsley, 1983). These professions were copying the English legal profession. Apprentices in common law received instructions from practitioners, rather than at universities. These guilds then became the recognized agency which admitted new members. Accountants began with the same apprenticeship system. The chartered accountant's ability to analyze business affairs created a demand for those same accountants to be sent to the US.

Some attributed this to the Jefferson-Jackson view of limited government, which allowed capital to flow to entrepreneurial ideas, creating small businesses which we able to offer a wider range of goods and services (Hamill, 1999). Other factors in the increase in business activity included general laws for incorporating a business (New York, 1811), creation of markets for stocks and bonds (Philadelphia in 1790, New York in 1792 and Boston 1834) and the growing widespread availability of state banks (there were 834 by 1840) (Rosseau and Sylla, 2005).

By the mid-nineteenth century, however, it was would be difficult to ascertain whether the evolution of accounting standards was driving the tax system towards an income tax system – or whether the practice of taxing income was creating a better system of accounting. In an argument for the latter, Lister (1983) argues that the implementation of the British income tax in the early part of the 19th century was one of the four driving factors in the development of accounting in Europe (in a footnote, he cites the others as progression in the number of large organizations, usage by companies of limited liability and high rates of companies unable to meet current obligations with cash.)

The demand for accountants and training in accounting in the US began to accelerate with the investments in railroads by the mid-1800s. Union Pacific and Central Pacific Railroads build the first transcontinental railroad. By 1880, railroad systems had accumulated $4.6 billion of investment. In 1869, 38 railroad securities were trading on the NYSE (King, 2006).

This increase in the demand for accounting information created additional demand for accounting in the US. There were less than 250 CPAs in the US in 1900, but by 1920 over 5000

CPA certificates had been issued, with New York, New Jersey and Pennsylvania accounting for over 1000 of those (Previts, 1973). Anyon (1925) showed the increase in the late 1800s in combined NY, Chicago and Philadelphia accountants from address books as shown in table 2.

TABLE 2:

Total number of accountants in New York, Chicago and Philadelphia (by year)

1870 – 28

1880 – 49

1890 – 125

1899 – 332

Other significant changes were taking place in the late 19th century in the US which was increasing accounting knowledge as well as the number of accountants. These changes included the creation of more societies of accountants (mostly on a nationwide basis) and the usage of colleges and universities to begin teaching the codified standards of accounting. In 1882, the first public accounting organization – the Institute of Accountants and Bookkeepers of the City of New York is established. It remains an active organization for about 25 years (Edwards, 1961). The AAPA – American Association of Public Accountants – incorporated in New York in 1887 with 31 members – tried to replicate the model of professionalism developed in England by the Institute of Chartered Accountants, and eventually became the predecessor of the American Institute of Certified Public Accountants (Dennis, 2000).

More formal education in accounting (as opposed to apprenticeships) also began. New York University started a degree program led by Charles Waldo Haskins in 1900. Also, around 1900 T. Edward Ross, one of the original founders of Lybrand, Ross Brothers and Montgomery, began offering classes in Philadelphia, teaching 10-15 college students at a time. Allen (1927) showed the very large increase in number of universities in the US offering accounting courses (see table 3).

TABLE 3:
Number of universities offering at least one accounting course by year

1900	13
1910	52
1916	116
1926	335

Demand for more accountants was experienced before the 1913 and the 16th amendment. For example, when addressing the 1907 Annual Dinner for students at New York University School of Commerce, E.W. Sells pointed out that the American Association of Public Accountants had 80 to 100 members in 1897. By 1907, it had 700 members and perhaps nearly 1000 when considering associated organizations. If the trend continues, Sells said he expected 10,000 by 1917. Sells also pointed out the demand for accountants should grow dramatically by the need required in growing railroads and banks (Sells, 1907).

The demand, though, was increased not just by the 16th amendment, but also by the passage of other national laws, as discussed in the next section. Furthermore, the passage of the 16th amendment also created many unanticipated problems, mostly from lawmakers and taxpayers in the US not having enough institutional knowledge of accounting.

THE LACK OF CLARITY IN TAX LAW IN THE 1910's AND STATE SOCIETIES ROLES

What is now known as the federal individual tax law began with the passage of the 16th Amendment to the US Constitution on March 3, 1913. The US Revenue Act of 1913, named the Underwood Tariff Act, was passed on October 3, 1913. A variety of federal mandates which required accounting knowledge began in 1909, with the passage of the corporation income tax in the US. It became the foundation of our current corporate tax system and provided CPAs with an early foothold into the tax preparation business. Other changes affecting CPAs soon followed besides the 16th amendment. The Federal Reserve System was created in 1913, requiring additional nationwide accountability and documentation for banks. The Clayton Antitrust Act passed in 1914, adding additional rules on price discrimination and predatory pricing. Lastly, in 1916, cost-plus contracts were implemented by the US government for supplying the World War 1 efforts. Obviously more and more accounting work was needed, on a consistent based and with standards and rules that were widely agreed upon and accepted within the profession.

Of course, the income tax implementation for both corporate and individuals was a large driving factor for the expansion of the accounting sector, as numerous researchers have previously shown. Lemke (1957) cited the passage of the income tax laws as the single most important moment since it brought professional accountants into contact with new clients. It also tested accountants (and legislators) on the adequacy of accounting measurements, particularly as they related to measuring revenue and expenses (Pace, 1920)

Accounting societies – both at the state and national level, it seemed, functioned as formal mechanism to codify the new laws. On the other hand, it is also interesting to note what state societies at the time were *not* doing. In the United States, accounting was still being questioned as whether or not it should be considered a “profession” – and the national and state societies were participating in this debate. As such, accountants were much slower in adopting rules on ethical behavior and subsequent enforcement - at least more hesitant than attorneys. The setting of standards for this new accounting “profession” was also slow to come to fruition. For example, the idea that accountants should be independent of their clients was not widely agreed, and in fact was not enforced until the Securities and Exchange Acts of 1933 and 1934 (Casler, 1964). Accountants were also much cautious in adopting rules on ethical behavior and subsequent enforcement. Until 1916, there were no prohibition of solicitation of another CPA’s clients and no minimum level of knowledge that an accountant needed to have to accept an engagement (Backof and Martin, 1991).

While attorneys and their state bar associations were much quicker to adopt codes of ethics and enforcement mechanisms at the state level, those same attorneys all but ignored the passage of nationwide income tax laws in 1909 and 1913. A subcommittee of the American Bar Association dedicated to tax issues at the state and local level disbanded from 1916 to 1921, and no committee existed for many years on federal tax laws. It was only by the late 1930s that attorneys realized their mistake in anticipating the scope and reach of federal tax laws and attempted, unsuccessfully, to limit accountants' work in taxation under the "illegal practice of law" argument (Weaver, 1956).

CPAs quickly became much more specialized in the areas of taxation, as demonstrated by the quickly publishing in 1913 of a variety of tax "how-to" books. Lybrand, Ross Bros. and Montgomery (now PricewaterhouseCoopers) published a 60-page guide in 1913 of "Income Tax Guide: An Guide on Obligations Imposed on Individuals, Firms and Corporations." That same year, one of the founders of Touche, Niven and Co. (now Deloitte) began a tax column in the Journal of Accounting (Murray, et al., 2012).

This growth in tax laws in the decade following the 1909 and 1913 Acts also created much more need for clarification of the accounting details of the mandates. In the late 1800s, the set of rules of accounting were still under debate in the US, and the need for an avenue of debate and reflection among accounting professionals became necessary by the growth in large corporations and trusts. The new income tax laws created more urgency. Two areas of debate: depreciation and revenue recognition – dominated the years before and after 1913, and the state and national societies at the time became an avenue for creating clearer rules.

The accounting treatment of depreciation was debated for decades before 1913 – when should the depreciation expense be recognized – at purchase, at sale or abandonment, or ratably over the life of the asset? Consider, for example, Teichmann (1906) who argued several reasons why depreciation was not an expense, including

> "…1) repairs and maintenance have already been expensed, and for many assets, its value and effectiveness remain the same as the time of the purchase; 2) when an asset is replaced, the new asset can decrease profits in that year by recognizing the entire asset purchase price as an expense; 3) the cost of the asset has increased, so the loss is replaced by inflation if a used asset would need to be purchased." (pg. 123)

While depreciation was debated specifically, there was a larger and more general question of when revenues and other expenses should be realized and recognized. When the 1909 Corporate Tax Act was implemented, accountants calculated revenue when the cash was received, not when the revenue was earned. Similarly, expenses (not including depreciation) were also recognized on a cash basis. Carey (1969) pointed out the need for more understanding of accounting in the 1909 Corporate Tax Act:

> "Few of the creators of the income tax law had any conception of the difficulty of measuring business income for short time period. Most people thought of income in terms of cash receipts and cash disbursements. The accrual concept of accounting was not readily grasped, even by most lawyers. The blind spot was clearly evident in the 1909 Corporation Excise Tax Law and it has persisted...." (pg. 68).

The 16th amendment certainly accelerated the process, and accountants began nationwide to address these uncertainties – nationwide because it was now facing a "nationwide mandate" – the new income tax laws. The need for accounting societies, even in states formerly with relatively little large-scale commerce, became more pressing. One remarkable story (Grady, 1962) was relayed in 1913 by George O. May, a British accountant and long-time leader of Price Waterhouse, on his meeting with Cordell Hull, then a member of the House Ways and Means Committee, after the 16th amendment passage:

> "After the amendment became effective, I was a member of the Committee on Federal Legislation of the American Association of Public Accountants. The Committee communicated with Representative Cordell Hull who was in charge of the income tax bill, and with two other members, I called upon him in the Spring of 1913. I recall that after the first meeting with Mr. Hull, we adjourned to our hotel where the Chairman of the Committee sat down to write an income tax bill. Having had some experience with income taxation in England, I was surprised and amused at his hardihood. I discussed the English practice at some length with Mr. Hull and lent him a volume containing the text of English laws for 1842 forward." (pg. 62)

Apparently this confusion about defining net income on a consistent basis across the US did not end with May's conversation with Hull, either. By 1916, there was already a movement to start taxing gross rather than net income – at least then those expenses would not need to be properly classified, defined and recognized (Commissioner of the Internal Revenue, 1916):

> "The Bureau has heretofore recommended the shifting of the requirements of individual returns on a net income basis to that of gross income. … on the present basis of net income….there exists the anomalous condition that taxpayers are allowed in some degree to pass upon their own liability for a tax based on their own interpretation of the laws…The Revenue Act of 1913 permitted a reasonable allowance for exhaustion, wear and tear of property arising out of its use in a business."

Inventory – not clarified until 1918 Act - the 1913 and 1916 Acts were essentially cash receipts and cash expenditures. By 1917, the heavy tax on income caused more taxpayers to find expenses. Haig (1921) found that the 1918 Act tried to clarify the inventory/cost of goods sold expense issue by passing a law empowering the Commissioner of the Internal Revenue to define it:

> "That whenever in the option of the Commissioner the use of inventories is necessary in order to clearly determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe… as most clearly reflecting income."

CONCLUSION

Every year numerous state societies of CPAs are celebrating the founding's 100th anniversary. While numerous states celebrated before 2013, it seems the pace has accelerated post 2013 - at least in states where commercial activity would have been at a lower level in 1913 than their contemporary states. This paper asks the question "Did the passage of the 16th amendment accelerate the demand for accountants in every state to codify and understate an agreed upon set of accounting rules?"

The answer is a "definitely, probably yes." Before 1913 (and the 1909 Corporate Tax Act), accounting in the US still had many unclear and ambiguous rules. These includes how to measure net income on an accrual basis and how to recognize depreciation. Beginning in 1909 and continuing into 1913, the urgency to resolve these issues, and to educate accountants nationwide, not just in heavily industrial areas or port cities, became much more important.

The topics in this paper could be expanded to look at the conversations that took place in formulating CPA societies in states beginning in 1913, and how the implementation of a nationwide tax system created urgency among those acting in the accounting role. For example, the Texas Society of CPAs (founded in 1915) first met in Fort Worth with 16 members at its initial meeting: what conversations took place then or afterwards and what place the new income tax laws have on those members (Texas Society of CPAs, 2019).

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