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APRIL 2019

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American Taxation…A Walk Through History

Hopefully you are ready to file your 2018 taxes by the time you receive this newsletter. Some of you overachievers probably already have your refunds and are planning a summer vacation. In December 2017, Congress passed the Tax Cuts and Jobs Act of 2017 making this the first year under the new tax rules. Changes in the tax code are nothing new, though many of you have shared that doing your taxes seems more complicated than ever. I've known for a long time that taxes are complicated, but my curiosity got the best of me and I thought I'd do a little research on the history of taxation.

For most of American history, there was no income tax. In fact, the US Supreme Court ruled income tax unconstitutional in 1895. Wow. I didn't think I'd ever want to go back to the 19th century, but once I learned this fact, I might reconsider. Before the income tax was implemented, the bulk of our national revenue came from tariffs and more specialized taxes on "sin" items of liquor, tobacco, and a few other goods.

That all changed with the Revenue Act of 1861 when the Civil War began to take its toll on the national treasury. The 1861 Act provided for a temporary flat tax of 3% of all income, rents, and dividends on every American making more than $800 per year. Depending on how you calculate inflation that comes to between $37,000 and $55,000 today. This was before Social Security (FICA), Medicare, and other payroll taxes.

The 1861 Act didn't generate as much revenue as was hoped, so Congress—unusually quickly—passed the Revenue Acts of 1862 and 1864. Three tax acts in four years…sheesh. The 1862 Act expanded taxation to include "luxury items" like playing cards, pianos, yachts…and feathers. I guess pillows were luxuries back then? (Now I know why I haven't wanted to go back to the 19th century). Of particular interest in the 1862 Act was a provision that these taxes would terminate in 1866 when there would be no need for tax revenue to support the war.

The 1864 Act established "stamp taxes" (I think King George tried that in 1765) on things like photographs (a major luxury back in 1864) and matches. Congress—perhaps realizing they were pressing their luck–stopped short of taxing tea this time around. I guess they remembered what happened in America the last time that was tried.

All three of these Acts would expire in 1873 only to be resurrected again in 1893 and the ultimate passing of the Wilson-Gorman Tariff Act of 1894. The Supreme Court ruled the income tax unconstitutional in 1895 under the Pollock decision. Whew.

And then, like a hockey-mask-wearing-creature-from-a-70s-camp-movie, the income tax took the form of the 16th Amendment to the Constitution. It was ratified by the requisite number of states in 1913 and then, feeling emboldened by the power of a constitutional amendment, Congress passed the Revenue Act of 1913, the great-great-great grandfather of what we have now.

(American Taxation, continued to page 3)

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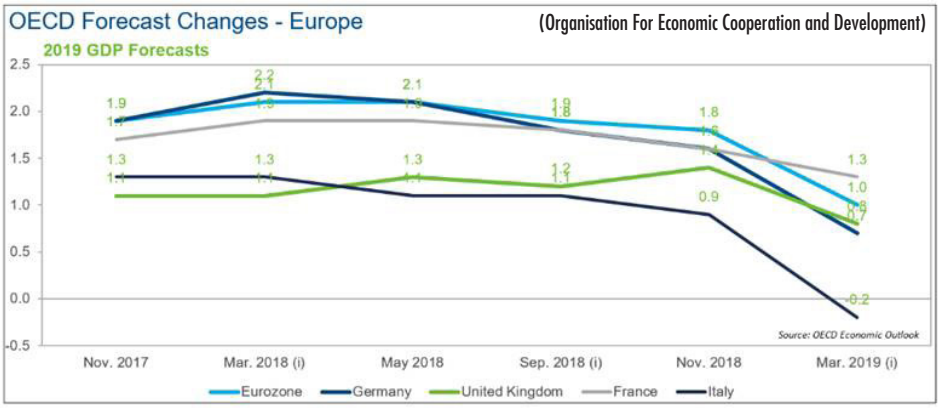
Market Commentary: Markets up, profit margins down

Written March 20, 2019

This has been a fascinating six months in the market and global economy to say the least. We've seen investor greed turn to fear and then back into greed. The Federal Reserve has flip-flopped from raising rates to halting those rate hikes due to a visibly slowing US economy, and the two-step that is the China-US trade talks. The European Union is experiencing their own history in the making with the UK on course to leave at the end of this month with no extension and no plan. According to the UK government's assessment, such an outcome could result in the UK economic decline of 6.3% to 9% in fifteen years compared to what it would have been. That would likely cause a ripple effect throughout Europe and the rest of the world at a time when the Eurozone's GDP forecast has been reduced to 1.1% for 2019.

But you wouldn't know that anything is amiss in the global economy by looking at the US stock market. After being down nearly 20% from its high, the S&P 500 has regained considerable ground in 2019, up 13.5% year-to-date. At this rate, the S&P would be up over 50% by the end of 2019.

With deteriorating fundamentals, is now a good time to buy? According to CNBC's headlines, the answer is yes. After all, a slowing economy means lower interest rates, which is a positive. If President Trump can get a deal done with China, that will be good news. The European Central Bank will step in if things get too rough over in the Eurozone, right? So let the good times roll.



Are headlines a good indicator of where the stock market is headed? Calendar year 2009 saw the S&P 500 soar over 26% and kicked off a nine year stock market winning streak. For fun, look below to see what was being printed March 2009.

So during the absolute best month to buy in the last two decades, everyone said to sell. And when everyone says to buy? Well, I think that's usually a good time to take a look around to see what's really happening outside instead of letting other people tell us what to do.

And what we see are increasing risks of a slowing economy. Earnings growth peaked in the 3rd quarter of 2018 and slowed in the 4th quarter of last year. Profit margins also fell sharply. We haven't seen an abrupt slowdown like this since 2007.

(Market Commentary, cont. to page 3)

March 2009 Headlines:

Rally, Yes; Bottom, No
Forbes.com – 3/10/09

Is This A Real Rally Or Dead Cat Bounce?
Investors Business Daily – 3/16/09

Roubini Says Rally is a "Dead Cat Bounce"
The Business Insider – 3/16/09

Enjoy the Sucker's Rally, Says Merrill's Rosenburg
Yahoo! Finance – 3/19/09

Bear Rallies Turn Market Into a Circus
Wall Street Journal – 3/23/09

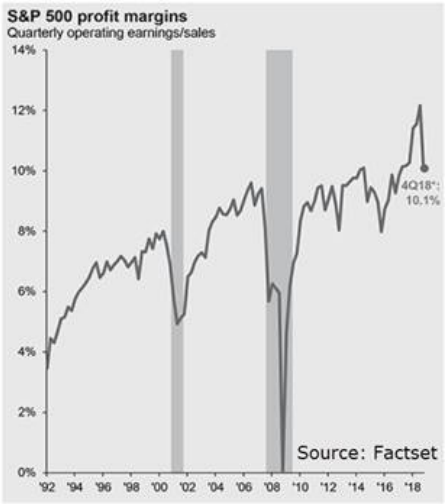
Don't Buy the Chirpy Forecasts
The history of banking crises indicates this one may be far from over.
Newsweek – 3/30/09

Market Commentary

(continued from page 2)

Does that mean a recession is eminent? It's too early to tell, but even so, we think this rally is unsustainable in the current economic environment and have become more defensive in our clients' managed accounts. If 1st quarter earnings and other economic fundamentals continue to show signs of slowing, we may see a recession as early as 2020. We're keeping a close eye on these indicators and how they develop over the next few months.**

- Victoria Bogner, CFP®, CFA, AIF®



KU recently announced an early buyout program called the Voluntary Separation Incentive Program (VSIP). If you've decided to take the VSIP or know someone who has, we can help. There are significant time-sensitive planning opportunities we can employ to maximize your overall benefit from the VSIP.

American Taxation

(continued from page 1)

There were six tax brackets back in 1913. By the end of Wilson's second term in 1921 there were 56. See the table below, but talk about confusing. Look at how much tax rates changed in less than ten years. In 1913, if you made $20,000 you paid zero tax. In 1921, you paid 21%. In 1913 if you earned $500,000 (you were probably a Rockefeller or a Vanderbilt) you paid 6% (7% if you were subject to the "super tax" in that year). In 1921 if you earned $500,000 you paid a staggering 76% tax rate.

I bring this history lesson to you today for a couple reasons. Mostly it's because I love history in general, and American history in particular. I'm fascinated to learn how we got to where we are today. The Tax Act of 2017 was a modest change when viewed through the lens of history. If you were alive in 1912, and earned $25,000 per year, your annual tax rates from 1912 through 1921 were as follows: 0%, 1%, 2%, 2%, 3%, 12%, 23%, 19% (from 1919 – 1921). Talk about confusing. And, again, this was all before FICA, Medicare, and other payroll taxes, to say nothing of state income and local property taxes.

Source: www.taxfoundation.org

	Tax Year 1913	Tax Year 1921
Number of Brackets	6	56
Min. Tax Rate/Income	0% up to $20,000 per year	4% up to $4,000 per year
Tax Rate on $100,000 per year	4%	60%
Max. Tax Rate/Income	6% on income > $500,000	73% on income > $1,000,000

Disclaimers and Notes

Thanks for walking down Taxation Memory Lane. Spring brings flowers and baseball. Hope you are able to get outside and enjoy the warmer weather. We've certainly earned it this winter.

- Peter Knutson, CFP®, CLTC, AIF®

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Thank you to the 158 clients and friends who showed up at our 17th annual MK Night At Theatre Lawrence. We hope you had a great time and we are already planning our 2020 sponsorship. Thanks also to Theatre Lawrence for taking such good care of us and for putting on such a great show…as always.

We're scheduled to move April 12th, so please plan accordingly. We're excited to move into our new office and we look forward to seeing you there.

Our new address is 3705 Clinton Parkway.