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THE REVENUE BILL OF 1941

SEPTEMBER 2, 1941.—Ordered to be printed

Mr. GEORGE, from the Committee on Finance, submitted the following

REPORT

[To accompany H. R. 5417]

The Committee on Finance, to whom was referred the bill (H. R. 5417) to provide revenue, and for other purposes, having had the same under consideration, report favorably thereon with certain amendments and, as amended, recommend that the bill do pass.

ESTIMATES OF REVENUE

The bill as passed by the House was estimated to produce added tax revenue of $3,216,400,000 annually. The amendments made by your committee add $463,400,000 to this figure, bringing the total additional annual yield to $3,679,800,000.

The additional revenue to be secured by your committee bill over that of the House bill comes principally from the following sources: corporation normal tax $19,000,000, corporation surtax $120,500,000, and individual income tax $332,400,000.

The following table sets out the estimated yields of the House bill and the Finance Committee bill, with the increase or decrease of the Finance Committee bill over the House bill. It should be noted that the figures contemplate a year of full operation.

Estimated revenue effect[1] *of the revenue bill of 1941 (H. R. 5417) as passed by the House of Representatives Aug. 4, 1941, and as reported by the Senate Finance Committee, Sept. 2, 1941*

[In millions of dollars]

	Estimated increase or decrease (−) over yield or present law		Estimated increase (+) or decrease (−) Senate Finance Committee over House bill
	House bill	Senate Finance Committee	
Income taxes:			
Corporation:			
Normal tax	−520.1	−501.1	+19.0
Surtax	644.7	765.2	+120.5
Excess-profits tax	1,198.3	1,130.6	−67.7
Total corporation income taxes	1,322.9	1,394.7	+71.8
Individual	864.8	1,197.2	+332.4
Total income taxes	2,187.7	2,591.9	+404.2
Miscellaneous internal revenue:			
Capital-stock tax	22.3	−16.1	−38.4
Estate tax	135.9	141.6	+5.7
Gift tax	16.0	16.0	0
Total	174.2	141.5	−32.7
Manufacturers' and retailers' excise taxes:			
Distilled spirits	[2] 122.3	[2] 123.0	+.7
Wines	[2] 5.0	[2] 14.4	+9.4
Passenger automobiles, parts, and accessories	72.2	72.2	0
Automobile trucks, busses, and trailers	16.1	16.1	0
Tires and tubes	44.6	44.6	0
Refrigerators, refrigerating apparatus, and air-conditioners	16.6	16.6	0
Matches	[2] 8.2	[2] 8.2	0
Playing cards	1.0	1.0	0
Radio receiving sets and parts	9.4	9.4	0
Phonographs and phonograph records	4.5	4.5	0
Musical instruments	3.6	3.6	0
Sporting goods	8.5	8.2	−.3
Luggage	4.5	4.5	0
Electrical appliances	12.6	12.6	0
Photographic apparatus	10.0	9.9	−.1
Electric signs	2.7	2.7	0
Business and store machines	13.0	13.0	0
Rubber articles	21.3	21.3	0
Washing machines	.4	5.7	+5.3
Optical equipment	.3	.3	0
Soft drinks	22.6	0	−22.6
Gas and oil appliances		19.2	+19.2
Electric-light bulbs		8.0	+8.0
Jewelry, etc	56.2	56.2	0
Furs	20.7	20.7	0
Toilet preparations	19.7	19.7	0
Total manufacturers' and retailers' excise taxes	496.0	515.6	+19.6
Miscellaneous taxes:			
Admissions	60.0	105.9	+45.9
Cabarets, roof gardens, etc	2.0	2.0	0
Club dues	2.8	2.8	0
Safe deposit boxes	1.7	1.7	0
Telephone, telegraph, radio and cable facilities, leased wires, etc	26.6	24.3	−2.3
Telephone bill	43.6	87.2	+43.6
Transportation of persons	36.5	35.5	−1.0
Use of motor vehicles and boats	160.2	160.2	0
Bowling alleys and billiard and pool tables	2.0	1.3	−.7
Coin-operated amusement and gambling devices	8.9	9.9	+1.0
Radio broadcasting	12.5	0	−12.5
Outdoor advertising	1.7	0	−1.7
Total miscellaneous taxes	358.5	430.9	+72.3
Total excise and miscellaneous taxes	854.5	946.4	+91.9
Total miscellaneous internal revenue	1,028.7	1,087.9	+59.2
Total	3,216.4	3,679.8	+463.4

[1] All estimates show full-year effect. Estimates for corporation and individual income taxes and the gift tax are based on levels of income estimated for calendar year 1941; all other estimates are based on income levels estimated for fiscal year 1942.

[2] Excluding nonrecurring floor stocks taxes collectible only in fiscal year 1942—distilled spirits, $38,000,000; wines, $1,000,000 under House bill, $2,900,000 under Senate Finance Committee agreement; matches, $700,000; tires and tubes, $6,700,000.

Treasury Department, Division of Research and Statistics, Aug. 29, 1941.

In order that a more complete summary of the entire revenue may be obtained, the following tables set forth the estimated receipts under present law coupled with those expected under the committee bill. The first table deals with the income and excess-profits taxes and the second sets out the estate, gift, capital stock, and excise taxes.

Income taxes—estimated calendar year 1941 liabilities under present law and estimated increased income tax liabilities under a full year effect of the income tax provisions of the revenue bill of 1941 (H. R. 5417) [1] *at levels of income estimated for calendar year 1941*

[In thousands of dollars]

	Estimated liabilities under present law	Estimated increase or decrease (−) due to revenue bill of 1941	Estimated total income-tax liabilities under revenue bill of 1941
Income taxes:			
Corporation normal tax	2,939,200	−501,100	2,438,100
Corporation surtax		765,200	765,200
Individual	2,223,300	1,197,200	3,420,500
Back taxes	260,000		260,000
Excess-profit tax	1,026,400	1,130,600	2,157,000
Declared value excess-profits tax	37,000		37,000
Unjust enrichment tax	4,000		4,000
Total income taxes	6,489,900	2,591,900	9,081,800

[1] As reported by the Senate Finance Committee, Sept. 2, 1941.

Treasury Department, Division of Research and Statistics, Sept. 2, 1941.

Miscellaneous internal revenue—Estimated fiscal year 1942 receipts under present law [1] *and estimated full year effect of the revenue bill of 1941 (H. R. 5417)* [2] *at levels of income estimated for fiscal year 1942*

[Thousands of dollars]

	Estimated receipts under present law	Estimated increase or decrease (−) due to revenue bill of 1941 [2]	Estimated total receipts under revenue bill of 1941 [2]
		Hypothetical full year effect [3]	Hypothetical fiscal year [3]
Capital-stock tax	193,400	−16,100	177,300
Estate tax	350,700	141,600	492,300
Gift tax	100,000	16,000	116,000
Liquor taxes:			
Distilled spirits (excise tax)	458,800	123,000	581,800
Fermented malt liquors	330,800		330,800
Rectification tax	12,800		12,800
Wines (domestic and imported) (excise tax)	15,200	14,400	29,600
Container stamps	10,400		10,400
Special taxes in connection with liquor occupations	10,200		10,200
All other	1,300		1,300
Total liquor taxes	839,500	137,400	976,900
Tobacco taxes:			
Cigarettes (small)	645,100		645,100
Cigars (large)	13,900		13,900
Tobacco (chewing and smoking)	56,100		56,100
Snuff	6,800		6,800
Cigarette paper and tubes	1,500		1,500
All other	130		130
Total tobacco taxes	723,530		723,530

[1] Detail of estimates released in summary form by the Bureau of the Budget, June 1, 1941.
[2] As reported by the Senate Finance Committee, Sept. 2, 1941.
[3] Assuming that all provisions of the law were fully reflected in receipts for an entire year.

Miscellaneous internal revenue—Estimated fiscal year 1942 receipts under present law and estimated full year effect of the revenue bill of 1941 (H. R. 5417) at levels of income estimated for fiscal year 1942—Continued.

[Thousands of dollars]

	Estimated receipts under present law	Estimated increase or decrease (−) due to revenue bill of 1941	Estimated total receipts under revenue bill of 1941
		Hypothetical full year effect	Hypothetical fiscal year
Stamp taxes:			
Issues of securities, bond transfers, and deeds of conveyance	25,300		25,300
Stock transfers	14,000		14,000
Playing cards	4,800	1,000	5,800
Silver bullion sales or transfers	80		80
Total stamp taxes	44,180	1,000	45,180
Manufacturers' excise taxes:			
Lubricating oils	37,100		37,100
Gasoline	390,800		390,800
Electrical energy	51,400		51,400
Tires and inner tubes	54,200	44,600	98,800
Automobile trucks	12,400	16,100	28,500
Passenger automobiles and motorcycles	73,400	72,200	145,600
Parts and accessories for automobiles	13,300		13,300
Radio sets, etc	7,900	9,400	17,300
Mechanical refrigerators	12,300	16,600	28,900
Firearms, shells, pistols, and revolvers	5,400		5,400
Matches		8,200	8,200
Electrical appliances		12,600	12,600
Phonographs and phonograph records		4,500	4,500
Musical instruments		3,600	3,600
Sporting goods		8,200	8,200
Luggage		4,500	4,500
Photographic apparatus		9,900	9,900
Electric signs		2,700	2,700
Business and store machines		13,000	13,000
Washing machines		5,700	5,700
Rubber articles		21,300	21,300
Optical equipment		300	300
Gas and oil appliances		19,200	19,200
Electric light bulbs		8,000	8,000
Toilet preparations	8,800	−8,800	
Total manufacturers' excise taxes	676,000	271,800	947,800
Retailers' excise taxes:			
Jewelry, etc		56,200	56,200
Furs		20,700	20,700
Toilet preparations		28,500	28,500
Total retailers' excise taxes		105,400	105,400
Miscellaneous taxes:			
Telephone, telegraph, radio, and cable facilities, leased wires, etc	28,000	24,300	52,300
Transportation of oil by pipe lines	13,300		13,300
Leases of safe-deposit boxes	2,200	1,700	3,900
Admissions to theaters, concerts, cabarets, etc	83,100	107,900	191,000
Club dues and initiation fees	7,000	2,800	9,800
Oleomargarine, etc., including special taxes, and adulterated butter	2,300		2,300
Coconut and other vegetable oils processed	4,500		4,500
Bituminous-coal tax	4,900		4,900
Sugar tax	62,400		62,400
Transportation of persons		35,500	35,500
Use of motor vehicles and boats		160,200	160,200
Bowling alleys, and billiard and pool tables		1,300	1,300
Coin-operated amusement and gaming devices		9,900	9,900
Radio broadcasting		0	0
Outdoor advertising		0	0
Telephone bill		87,200	87,200
All other, including repealed taxes	620		620
Total miscellaneous taxes	208,320	430,800	639,120
Total miscellaneous internal revenue (other than capital stock, estate, and gift taxes)	2,491,530	946,400	3,437,930
Total miscellaneous internal revenue	**3,135,630**	**1,087,900**	**4,223,530**

Treasury Department, Division of Research and Statistics, Sept. 2, 1941.

SUMMARY OF PRINCIPAL CHANGES

I. INDIVIDUAL INCOME TAX

1. *Reduced personal exemptions.*—The House bill made no changes in the personal exemptions provided by existing law. The committee bill reduces the personal exemptions in the case of married persons from $2,000 to $1,500 and, in the case of single persons, from $800 to $750. This broadening of the income tax base is thought to be desirable particularly during the present emergency in order that the greatest possible number of persons may contribute directly to the costs of the defense program.

It has been estimated by the Treasury Department that this reduction in the personal exemptions will require the filing of 4,911,000 new income tax returns and will increase the number of income-tax payers by 2,256,000. Under the House bill, it is estimated that 17,107,000 individual income tax returns would have been filed, of which 10,925,000 would have been taxable. Under the Finance Committee bill it is estimated that 22,108,000 individual income tax returns will be filed of which 13,181,000 will be taxable.

The decrease in the personal exemptions has the effect of increasing the tax throughout the bracket structure. This increase is substantial in the lower brackets. The following table sets out the additional burden on single persons and on married persons without dependents caused solely by the reduced exemptions:

Additional tax due to decreased exemptions

Net income	Single man	Married man—No dependents	Net income	Single man	Married man—No dependents
$750			$15,000	$17.60	$159.50
$800	$2.75		$20,000	20.35	203.50
$900	4.95		$25,000	23.65	236.50
$1,000	4.95		$30,000	25.30	253.00
$1,500	4.95		$50,000	29.70	297.00
$2,000	4.95	$40.70	$60,000	31.35	313.50
$2,500	4.95	49.50	$80,000	33.55	335.50
$3,000	6.60	49.50	$100,000	35.75	357.50
$4,000	6.60	66.00	$150,000	29.70	297.00
$5,000	8.25	66.00	$250,000	30.60	306.00
$6,000	8.25	82.50	$500,000	33.30	333.00
$7,000	10.45	82.50	$750,000	33.75	337.50
$8,000	10.45	104.50	$1,000,000	34.20	342.00
$9,000	12.65	104.50	$2,000,000	34.65	346.50
$10,000	12.65	126.50	$5,000,000	35.10	351.00

2. *Integration of defense tax.*—Under the existing law and under the House bill the 10-percent defense tax is added to the tax computed under the rates provided in the normal and surtax schedule. The House bill makes the defense tax permanent. Your committee recommends and the committee bill so provides that the defense tax be integrated into the basic surtax rates. In order to avoid the use of fractional percentages, the surtax rates have been carried to the nearest whole percentage figure.

The following table shows the increase in the surtax rates and cumulative surtax burden caused solely by the integration of the defense tax:

Comparison of surtax rates and cumulative surtax

Surtax net income classes	Surtax rates			Cumulative surtax on higher amount shown in bracket		
	Present law	House bill	Finance Committee bill	Present law	House bill	Finance Committee bill
	Percent	*Percent*	*Percent*			
$0 to $2,000	....	5	6	....	$100	$120
$2,000 to $4,000	....	8	9	....	260	300
$4,000 to $6,000	4	11	13	$80	480	560
$6,000 to $8,000	6	15	17	200	780	900
$8,000 to $10,000	8	19	21	360	1,160	1,320
$10,000 to $12,000	10	22	25	560	1,600	1,820
$12,000 to $14,000	12	25	29	800	2,100	2,400
$14,000 to $16,000	15	28	32	1,100	2,660	3,040
$16,000 to $18,000	18	31	35	1,460	3,280	3,740
$18,000 to $20,000	21	33	38	1,880	3,940	4,500
$20,000 to $22,000	24	36	41	2,360	4,660	5,320
$22,000 to $26,000	27	39	44	3,440	6,220	7,080
$26,000 to $32,000	30	42	47	5,240	8,740	9,900
$32,000 to $38,000	33	45	50	7,220	11,440	12,900
$38,000 to $44,000	36	48	53	9,380	14,320	16,080
$44,000 to $50,000	40	50	55	11,780	17,320	19,380
$50,000 to $60,000	44	53	57	16,180	22,620	25,080
$60,000 to $70,000	47	55	59	20,880	28,120	30,980
$70,000 to $80,000	50	57	61	25,880	33,820	37,080
$80,000 to $90,000	53	59	63	31,180	39,720	43,380
$90,000 to $100,000	56	61	64	36,780	45,820	49,780
$100,000 to $150,000	58	62	65	65,780	76,820	82,280
$150,000 to $200,000	60	63	66	95,780	108,320	115,280
$200,000 to $250,000	62	64	67	126,780	140,320	148,780
$250,000 to $300,000	64	66	69	158,780	173,320	183,280
$300,000 to $400,000	66	68	71	224,780	241,320	254,280
$400,000 to $500,000	68	70	72	292,780	311,320	326,280
$500,000 to $750,000	70	71	73	467,780	488,820	508,780
$750,000 to $1,000,000	72	72	74	647,780	668,820	693,780
$1,000,000 to $2,000,000	73	73	75	1,377,780	1,398,820	1,443,780
$2,000,000 to $5,000,000	74	74	76	3,507,780	3,618,820	3,723,780
Over $5,000,000	75	75	77	....	....	....

The following table sets out the effect of the integration of the defense tax by showing the increases or decreases in tax caused solely thereby:

Net income	Single man	Married man—no dependents	Net income	Single man	Married man—no dependents
$750	....	....	$15,000	$41.60	$34.10
$800	$0.25	....	$20,000	81.85	72.10
$900	.51	....	$25,000	127.35	122.10
$1,000	.65	....	$30,000	152.60	149.60
$1,500	1.35	....	$50,000	136.60	139.60
$2,000	2.05	$1.30	$60,000	−23.65	−10.90
$2,500	2.75	2.00	$80,000	−420.65	−404.90
$3,000	2.70	2.70	$100,000	−900.15	−963.90
$4,000	1.10	2.60	$150,000	−1,335.60	−1,407.60
$5,000	1.25	1.00	$250,000	−1,587.10	−1,660.60
$6,000	6.65	2.90	$500,000	−1,984.10	−2,054.60
$7,000	11.05	8.30	$750,000	−3,234.85	−3,306.10
$8,000	12.45	11.70	$1,000,000	−4,235.60	−4,307.60
$9,000	12.85	13.10	$2,000,000	−7,236.35	−7,309.10
$10,000	10.25	12.50	$5,000,000	−13,237.10	−13,310.60

The following tables compare the tax burdens and the effective rates of the present law, the House bill and the Finance Committee bill on specified net incomes of both married and single persons:

Comparison of individual income tax on specified net incomes (all income earned) under present law, House bill and Finance Committee bill

Net income	Single person			Married person		
	Present law	House bill	Finance Committee bill	Present law	House bill	Finance Committee bill
$750						
$800			$3.00			
$900	$0.44	$5.94	11.40			
$1,000	4.40	15.40	21.00			
$1,500	24.20	62.70	69.00			
$1,600	28.16	72.16	78.60			$6.00
$2,000	44.00	110.00	117.00			42.00
$2,500	63.80	157.30	165.00	$11.00	$38.50	90.00
$3,000	83.60	211.20	220.50	30.80	85.80	128.00
$4,000	123.20	338.80	346.50	70.40	180.40	249.00
$5,000	171.60	473.00	482.50	110.00	308.00	375.00
$6,000	255.20	633.60	648.50	149.60	435.60	521.00
$7,000	343.20	803.00	824.50	233.20	596.20	687.00
$8,000	418.80	1,007.00	1,030.50	316.80	756.80	873.00
$9,000	558.80	1,221.00	1,246.50	422.40	961.40	1,079.00
$10,000	686.40	1,469.60	1,492.50	528.00	1,166.00	1,305.00
$15,000	1,476.20	2,934.80	2,994.00	1,258.40	2,545.40	2,739.00
$20,000	2,666.40	4,826.80	4,929.00	2,336.40	4,338.40	4,614.00
$25,000	4,252.60	7,073.00	7,224.00	3,843.40	6,505.40	6,864.00
$30,000	6,063.20	9,543.60	9,721.50	5,614.40	8,936.40	9,339.00
$50,000	14,709.20	20,715.20	20,881.50	14,128.40	20,002.40	20,439.00
$60,000	19,954.00	26,958.80	26,966.50	19,320.40	26,206.40	26,509.00
$80,000	31,451.20	40,123.60	39,736.50	30,738.40	39,318.40	39,249.00
$100,000	44,268.40	54,168.40	53,214.00	43,476.40	53,310.40	52,704.00
$150,000	78,350.80	89,012.40	87,706.50	77,532.40	88,299.60	87,189.00
$250,000	147,578.40	159,748.00	158,191.50	146,863.60	159,013.60	157,659.00
$500,000	330,933.20	347,604.80	345,654.00	330,155.60	346,805.60	345,084.00
$750,000	522,418.80	541,347.60	538,140.50	521,619.60	540,537.60	537,569.00
$1,000,000	718,404.40	737,340.40	733,139.00	717,583.60	736,519.60	732,554.00
$2,000,000	1,511,397.20	1,530,333.20	1,523,131.50	1,510,565.60	1,529,501.60	1,522,539.00
$5,000,000	3,917,390.00	3,936,320.00	3,923,124.00	3,916,547.60	3,935,483.60	3,922,524.00

Comparison of effective rates of individual income tax on specified net incomes (all income earned) under present law, House bill, and Finance Committee bill

Net income	Single person			Married person, no dependents		
	Present law	House bill	Finance Committee bill	Present law	House bill	Finance Committee bill
	Percent	*Percent*	*Percent*	*Percent*	*Percent*	*Percent*
$750						
$800			0.375			
$900	0.048	0.660	1.266			
$1,000	.440	1.540	2.100			
$1,500	1.613	4.180	4.600			
$1,600	1.760	4.510	4.912			0.375
$2,000	2.200	5.500	5.850			2.100
$2,500	2.552	6.292	6.600	0.440	1.540	3.600
$3,000	2.786	7.040	7.350	1.026	2.860	4.600
$4,000	3.080	8.470	8.662	1.760	4.510	6.225
$5,000	3.432	9.460	9.650	2.200	6.160	7.500
$6,000	4.253	10.560	10.808	2.493	7.260	8.683
$7,000	4.902	11.471	11.778	3.331	8.517	9.814
$8,000	5.610	12.595	12.881	3.960	9.460	10.912
$9,000	6.208	13.566	13.850	4.693	10.682	11.988
$10,000	6.864	14.696	14.925	5.280	11.660	13.050
$15,000	9.841	19.565	19.960	8.389	16.969	18.260
$20,000	13.332	24.134	24.645	11.682	21.692	23.070
$25,000	17.010	28.292	28.896	15.373	26.021	27.456
$30,000	20.210	31.812	32.405	18.714	29.788	31.130
$50,000	29.418	41.430	41.763	28.256	40.004	40.878
$60,000	33.256	44.931	44.944	32.200	43.677	44.181
$80,000	39.314	50.154	49.070	38.423	49.148	49.061
$100,000	44.268	54.168	53.214	43.476	53.310	52.704
$150,000	52.233	59.341	58.471	51.688	58.866	58.126
$250,000	59.030	63.899	63.276	58.745	63.605	63.063
$500,000	66.186	69.529	69.130	66.031	69.361	69.016
$750,000	69.665	72.179	71.752	69.549	72.071	71.676
$1,000,000	71.840	73.734	73.313	71.758	73.651	73.255
$2,000,000	75.569	76.516	76.156	75.528	76.475	76.126
$5,000,000	78.347	78.726	78.462	78.330	78.709	78.450

3. *Returns where gross income is $3,000 or less.*—In order that persons in the lower-income tax brackets, particularly those brought in by the reduction of the personal exemptions, may be caused a minimum of difficulty in filling out their returns, the optional use of a simplified return is provided where the gross income of the taxpayer does not exceed $3,000. If the taxpayer elects to use this simplified plan, the amount of the tax may be readily ascertained by reference to a table contained in the bill. This simplified return may be used only where the taxpayer's income is derived solely from salaries, wages, compensation for personal services, dividends, interest, rent, annuities, or royalties. If the taxpayer elects to use this method, no deductions or credits against net income are allowed. In lieu of these deductions and credits, the tax provided in the table represents a reduction of 10 percent of the tax that would otherwise be payable without such deductions or credits. This 10-percent reduction has been found to be the effect of the average amount of deductions taken by persons in the lower-income brackets. One set of rates is provided for married persons or heads of families and another is provided for single persons (not heads of families). In determining the amount payable, the taxpayer in either case reduces his gross income by $400 for each dependent, then by reference to the appropriate table he ascertains the tax set out opposite the amount so determined.

It should be kept in mind that the use of the simplified return is at the option of the taxpayer and he elects each year whether to use this method or to file under the general provisions. However, once the return for any year has been filed under this method, the election shall be irrevocable, and if the taxpayer files under the general provisions for any year he may not thereafter elect for such year to be taxed under the simplified method. Nonresident alien individuals, estates, or trusts are not allowed to use the simplified method.

The following table taken from the bill sets out the amount of tax to be paid on specified amounts of income:

If the gross income is over—	But not over—	The tax shall be—		If the gross income is over—	But not over—	The tax shall be—	
		Single person (not head of a family)	Head of family or married person			Single person (not head of a family)	Head of family or married person
$1	$750	$0	$0	$1,325	1,350	48	0
$750	775	1	0	$1,350	1,375	50	0
$775	800	2	0	$1,375	1,400	52	0
$800	825	3	0	$1,400	1,425	55	0
$825	850	5	0	$1,425	1,450	57	0
$850	875	7	0	$1,450	1,475	59	0
$875	900	9	0	$1,475	1,500	61	0
$900	925	11	0	$1,500	1,525	63	1
$925	950	14	0	$1,525	1,550	65	2
$950	975	16	0	$1,550	1,575	68	3
$975	1,000	18	0	$1,575	1,600	70	5
$1,000	1,025	20	0	$1,600	1,625	72	6
$1,025	1,050	22	0	$1,625	1,650	74	7
$1,050	1,075	24	0	$1,650	1,675	76	9
$1,075	1,100	26	0	$1,675	1,700	78	11
$1,100	1,125	29	0	$1,700	1,725	80	13
$1,125	1,150	31	0	$1,725	1,750	83	15
$1,150	1,175	33	0	$1,750	1,775	85	17
$1,175	1,200	35	0	$1,775	1,800	87	19
$1,200	1,225	37	0	$1,800	1,825	89	22
$1,225	1,250	39	0	$1,825	1,850	91	24
$1,250	1,275	42	0	$1,850	1,875	93	26
$1,275	1,300	44	0	$1,875	1,900	96	28
$1,300	1,325	46	0	$1,900	1,925	98	30

If the gross income is over—	But not over—	The tax shall be—		If the gross income is over—	But not over—	The tax shall be—	
		Single person (not head of a family)	Head of family or married person			Single person (not head of a family)	Head of family or married person
$1,925	1,950	100	32	$2,475	2,500	147	80
$1,950	1,975	102	35	$2,500	2,525	150	82
$1,975	2,000	104	37	$2,525	2,550	152	84
$2,000	2,025	106	39	$2,550	2,575	154	86
$2,025	2,050	109	41	$2,575	2,600	156	89
$2,050	2,075	111	43	$2,600	2,625	158	91
$2,075	2,100	113	45	$2,625	2,650	160	93
$2,100	2,125	115	48	$2,650	2,675	163	95
$2,125	2,150	117	50	$2,675	2,700	165	97
$2,150	2,175	119	52	$2,700	2,725	167	99
$2,175	2,200	122	54	$2,725	2,750	169	102
$2,200	2,225	124	56	$2,750	2,775	172	104
$2,225	2,250	126	58	$2,775	2,800	174	106
$2,250	2,275	128	60	$2,800	2,825	177	108
$2,275	2,300	130	63	$2,825	2,850	180	110
$2,300	2,325	132	65	$2,850	2,875	183	112
$2,325	2,350	134	67	$2,875	2,900	186	114
$2,350	2,375	137	69	$2,900	2,925	189	117
$2,375	2,400	139	71	$2,925	2,950	191	119
$2,400	2,425	141	73	$2,950	2,975	194	121
$2,425	2,450	143	76	$2,975	3,000	197	123
$2,450	2,475	145	78				

4. *Community income.*—Ever since the advent of the income tax, the disparity in the taxation of income in the community-property States as compared with that in the non-community-property States has caused considerable concern. This situation has become more accentuated as the graduated surtax rates have been increased from time to time. Married persons in the community-property States under existing law are able to effect substantial tax savings as compared with married persons in the other States. Remedies for this inequitable situation have been frequently recommended to the Congress by the Treasury Department and by various other tax experts. With the substantial increases in the surtax rates contained in the bill, these inequities become more apparent and their termination more desirable.

Consequently, your committee bill provides a method whereby taxpayers in community-property States are placed on a parity with all other taxpayers and will pay the same amount of tax as do individuals similarly situated in the non-community-property States.

The following table shows the Federal income-tax benefits which accrue to the earner of income in a community-property State as compared with the earner of income in a non-community-property State:

Tax on specified earned net incomes

Earned net incomes	Tax under Finance Committee bill	Tax if equally divided between husband and wife	Tax savings in community-property States	Earned net incomes	Tax under Finance Committee bill	Tax if equally divided between husband and wife	Tax savings in community-property States
$3,500	$186	$186	....	$30,000	$9,339	$5,988	$3,351
$4,000	249	234	$15	$50,000	20,439	14,448	5,991
$5,000	375	330	45	$60,000	26,509	19,443	7,066
$6,000	521	441	80	$80,000	39,294	30,153	9,141
$7,000	687	567	120	$100,000	52,704	41,763	10,941
$8,000	873	693	180	$150,000	87,189	72,973	14,216
$9,000	1,079	819	260	$250,000	157,659	140,913	16,746
$10,000	1,305	965	340	$500,000	345,084	316,383	28,701
$12,000	1,817	1,297	520	$750,000	537,569	501,823	35,746
$15,000	2,739	1,855	884	$1,000,000	732,554	691,308	41,246
$18,000	3,819	2,493	1,326	$2,000,000	1,522,539	1,466,278	56,261
$20,000	4,614	2,985	1,629	$5,000,000	3,922,524	3,846,248	76,276
$25,000	6,864	4,355	2,500				

It will be noted that an individual with a net income of $10,000 saves $340 Federal tax solely by reason of being a resident of a community-property State. An individual with an income of $5,000 saves $45. An individual with an income of $30,000 saves $3,351, and an individual with an income of $500,000 saves $28,701.

There are only a few persons in the community-property States who derive any Federal tax benefit out of the community-property system. This is shown by the following tables:

Returns filed in community-property States in 1938

	Total number of returns	Community-property returns	Percent of total
Arizona	20,447	713	3.49
California	523,696	22,859	4.36
Idaho	13,223	411	3.11
Louisiana	59,019	3,776	6.40
Nevada	8,969	339	3.78
New Mexico	13,690	608	4.44
Texas	205,254	13,375	6.52
Washington [1]	106,472	3,336	3.13
Total	950,770	45,417	4.78

[1] Includes Alaska.

Net income shown on returns filed in community-property States, 1938

State	Total net income, all returns	Net income, community-property returns	Percent of total
Arizona	$56,359,000	$6,832,000	12.12
California	1,569,974,000	274,429,000	17.48
Idaho	34,180,000	3,489,000	10.21
Louisiana	191,541,000	43,137,000	22.52
Nevada	27,989,000	3,712,000	13.26
New Mexico	39,211,000	5,472,000	10.50
Texas	683,096,000	162,973,000	23.86
Washington [1]	275,061,000	30,775,000	11.19
Total	2,877,411,000	530,819,000	18.45

[1] Includes Alaska.

Source: Statistics of Income 1938.

Comparison of number of community-property returns filed in 1938 by net-income classes to total number of returns filed in the 8 community-property States

Net-income class	Total number of returns filed	Community-property returns	Percent community-property returns to total returns
Under $5,000	858,882		0
$5,000 to $10,000	69,789	30,534	43.75
$10,000 to $15,000	10,907	7,384	67.70
$15,000 to $25,000	6,461	4,381	67.81
$25,000 to $50,000	3,487	2,331	66.85
$50,000 to $100,000	969	636	65.63
Over $100,000	275	151	54.91
Total	950,770	45,417	4.78

Source: Statistics of Income, 1938.

Not only does this tax saving benefit only a few individuals in the community-property States, but, as shown by the following table, less than 1 percent of the total returns filed in the country represent community-property returns.

Individual returns with net income (excluding fiduciary returns), 1938, by sex and family relationship: number of returns, net income, and percentages

Family relationship	Returns		Net income	
	Number	Percent of total	Amount (thousands of dollars)	Percent of total
Joint returns of husbands, wives, and dependent children, and returns of either husband or wife when no other return is filed	2,866,026	46.60	10,001,384	53.60
Separate returns of husbands and wives:				
Men	152,654	2.48	1,593,939	8.54
Women	153,143	2.49	693,027	3.71
Heads of families:				
Single men and married men not living with wives	395,073	6.42	1,040,372	5.58
Single women and married women not living with husbands	210,143	3.42	472,994	2.53
Not heads of families:				
Single men and married men not living with wives	1,418,385	23.06	2,611,197	13.99
Single women and married women not living with husbands	909,935	14.79	1,717,196	9.20
Community-property returns	45,417	.74	530,819	2.85
Total, individual returns with net income	6,150,776	100.00	18,660,929	100.00

Source: Statistics of Income, 1938.

5. *Alimony and separate maintenance payments.*—Under the existing law periodic payments of alimony or for separate maintenance are not deductible from the gross income of the spouse making such payments and are not taxable to the spouse receiving them. Thus, for example, a husband is taxed upon his entire income even though a considerable amount thereof may be going periodically to his spouse or to his former spouse under a court decree or under a written instrument incident to a divorce or separation. This situation has resulted in substantial hardship in certain cases. Your committee bill therefore provides that periodic payments of alimony or for separate maintenance shall, in taxable years beginning after December 31, 1941, be includible in the gross income of the recipient and shall be deductible

from the gross income of the payor. Likewise, in the case of trusts for the payment of alimony or separate maintenance, the bill provides that the trust income shall be taxed to the beneficiary, rather than to the grantor.

II. Corporation Income and Excess-Profits Taxes

1. CORPORATION NORMAL TAX

The existing rate of normal tax applicable to corporate incomes generally is equivalent to 24 percent. This percentage is the sum of 22.1 and 1.9, the former being the basic rate applicable to net incomes for taxable years beginning after December 31, 1939, and the latter being the 10 percent increase over the basic rate of 19 percent, which was made applicable by the Revenue Act of 1940 (though subsequently increased to 22.1 by the Second Revenue Act of 1940) to taxable years beginning after December 31, 1939. The integration of the defense-tax rate of 1.9 percent with the basic rate removes considerable confusion and at the same time accomplishes the result of the House bill in making the defense tax permanent.

The existing rates (including the defense-tax rates) applicable to corporate net incomes of $25,000 or under are graduated as follows: 14.85 percent on normal tax net incomes not in excess of $5,000; 16.5 percent on the portion of such net income in excess of $5,000 and not in excess of $20,000; and 18.7 percent on the excess over $20,000. The committee bill integrates the defense tax applicable to such net incomes and at the same time rounds them off to 15, 17, and 19 percent, respectively.

These rate changes require an appropriate rate change in the tax on corporate net incomes somewhat in excess of $25,000. That tax is the lesser of an amount equivalent to 24 percent of the total net income and an amount equivalent to the sum of $4,250 and 37 percent of the net income in excess of $25,000. The amount of net income upon which the tax is the same, under whichever of these two methods it is computed, is $38,461.54. The purpose of this so-called notch provision is, of course, to avoid an abrupt ascent from an effective rate of 17 percent (the tax on a net income of $25,000 is $4,250, or 17 percent) to one of 24 percent.

2. CORPORATION SURTAX

The House bill imposed upon corporations a surtax of 5 percent of the first $25,000 of surtax net income and 6 percent of the balance. Your committee bill increases these rates to 6 and 7 percent, respectively. As stated in the report of the Committee on Ways and Means, the surtax is employed as the only means of reaching income from the large volume of partially tax exempt Federal securities held by corporations. Of the total amount outstanding, nearly $31,000,000,000, over 51 percent is held by banks and nearly 20 percent by insurance companies.

Your committee also made a change in the corporate surtax base, the purpose of this change being to effect the equitable operation of the tax. Under the House bill, corporation surtax net income is defined as the net income minus the credit for dividends received provided for in section 26 (b) of the Internal Revenue Code. The credit allowed is 85 percent of the amount of such dividends but is subject

to the limitation that it may not exceed 85 percent of the adjusted net income. Adjusted net income, for the purposes of the corporate income tax, is defined as the net income minus the credit for interest on obligations of the United States and its instrumentalities which is allowed to an individual as a credit for the purposes of his normal tax. Inasmuch as such interest is included by the bill in surtax net income for the purposes of the corporate surtax, it is thought to be in the interest of the fair operation of the tax to substitute for the limitation under the House bill a limitation based on the amount of the net income.

3. EXCESS-PROFITS TAX

Special 10 percent excess-profits tax.—Your committee bill eliminates the provision of the House bill imposing a special tax of 10 percent upon the excess of the adjusted excess-profits net income computed under the income credit over the adjusted excess-profits net income computed under the invested capital credit.

While in sympathy with the stated objective of the proposed tax—to reach profits which, though substantially in excess of those of the base period, escape excess-profits tax by reason of the allowance of the credit based on invested capital—your committee believes that it is inconsistent with the fundamental policy of Congress as expressed in the existing excess-profits tax law. The inconsistency would be more pronounced, in fact, under both the House and the Finance Committee bills, in view of the fact that both disallow normal tax as a deduction in determining excess profits net income. The effect of the disallowance upon the excess-profits credit, especially in the case of the credit computed on the basis of invested capital, is to improve the effectiveness of the excess-profits tax and, therefore, correspondingly to reduce the effectiveness of the invested capital credit as a relief measure.

The elimination of this special 10-percent tax is also justifiable, in the opinion of your committee, on the ground that in many cases the earnings of the base period do not provide the proper measure for the determination of excess profits in the taxable period. Many circumstances may have existed in the base period as a result of which earnings at that time were quite abnormal. In the case of corporations organized in the first or a subsequent year of the base period, the average-earnings credit would likewise be entirely inadequate.

In the absence of this tax there is no need for the complementary provision of the House bill under which the disclaimer of credit was restricted to the invested capital credit.

Corporations mining strategic metals.—Section 206 of the House bill repeals section 731 of the Internal Revenue Code, a provision exempting from excess-profits tax income derived from the mining of tungsten, quicksilver, manganese, platinum, antimony, chromite, or tin. In striking out this section of the House bill your committee leaves the existing exemption unchanged.

It was felt that the discontinuance of the exemption would operate unfairly to corporations which had proceeded in the establishment and extension of the mining properties affected. These enterprises, moreover, have the character largely of emergency enterprises, and the purpose of the existing provision was mainly to encourage the discovery and production of the metals mentioned. It is conceded that

the production of such metals in normal times is largely in foreign countries and that after the existing emergency is over their importation will be resumed.

Reversal of the deduction for income and excess-profits taxes.—While your committee bill makes no change in this provision of the House bill, it is felt that the following explanation taken from the report of the Committee on Ways and Means relative to this provision may be of value.

Under existing law, the income tax is allowed as a deduction in the computation of the excess-profits tax. It seems unfair to allow that part of the income tax which is computed on income which is not subject to the excess-profits tax to reduce the excess-profits net income. Canada allows only that part of the income tax which is computed upon income subject to the excess-profits tax. Under the World War Act, the excess-profits tax was allowed as a deduction in computing the normal tax, but the normal tax was not allowed as a deduction in computing the excess-profits tax. This is also the rule which is now applied by the British. The tax result in Canada is practically the same as the British rule and our 1918 rule. However, it is believed that the World War rule is much simpler in its application. Your committee has, therefore, deemed it advisable to return to the 1918 rule, and has disallowed the deduction of income taxes, both in the base period and in the taxable year, in computing the excess-profits tax. The deduction is allowed in computing both the normal tax and the surtax. The effect of the reversal of the deduction is that the 8-percent credit on invested capital provided in the bill is equivalent to a credit on invested capital of 5.6 percent after deduction of the normal tax and surtax, and the 7-percent credit on invested capital is equivalent to a credit on invested capital of 4.9 percent after deduction of the normal tax and surtax.

In lieu, however, of the example contained in the Ways and Means Committee report showing the effect of this provision, the following example is substituted so as to reflect the changes in surtax rates made by your committee bill:

Corporation with an excess-profits credit of $10,000,000, either under the average-earnings or invested-capital method, and a taxable year's net income of $12,000,000, or $2,000,000 in excess of its excess-profits credit which it made from defense contracts.

WITHOUT REVERSAL OF CREDIT

Net income		$12,000,000
Less normal and surtax:		
Normal tax at 24 percent	$2,880,000	
Surtax 6 percent on first $25,000	1,500	
7 percent on balance	838,250	
Total normal and surtax		3,719,750
Net income less normal and surtax		8,280,250
Excess-profits credit		10,000,000
Excess-profits carry-over		1,719,750

WITH REVERSAL OF CREDIT

Net income		12,000,000
Excess-profits credit		10,000,000
Adjusted excess-profits net income		2,000,000
TAX		
First $500,000	254,000	
Balance at 60 percent	900,000	
Total excess-profits tax		1,154,000

NORMAL AND SURTAX

Net income		12,000,000
Less excess-profits tax		1,154,000
Normal tax net income		10,846,000
Normal tax at 24 percent	$2,603,040	
Surtax 6 percent first $25,000	1,500	
Balance at 7 percent	757,470	
Total normal and surtax		3,362,010
Plus excess-profits tax		1,154,000
Total tax with reversal of credit		4,516,010
Total tax without reversal of credit		3,719,750
Increased amount of tax		796,260

In the above case, it will be noted that without the reversal of credit this corporation, although it made an excess profit of $2,000,000 out of defense contracts, pays no excess-profits tax and would have a carry-over credit of $1,719,750 to apply against its excess profits in the following year, whereas under the reversal of credit it would pay $1,154,000 excess-profits tax, plus $3,362,101 normal and surtax, or a total of $4,516,010, or $796,260 more than it would pay without the reversal of credit.

4. EXCHANGES AND DISTRIBUTIONS IN OBEDIENCE TO ORDERS OF SECURITIES AND EXCHANGE COMMISSION

Supplement R of chapter 1 of the Internal Revenue Code contains provisions governing the nonrecognition of gain or loss and the basis for determining gain or loss upon exchanges and distributions in obedience to orders of the Securities and Exchange Commission. Section 373 of the code contains a definition of such orders, and one of the limitations under that definition is that the order must be issued after May 28, 1938, and prior to January 1, 1941. The committee bill contains a new provision under which the existing period of issuance is extended to January 1, 1943. The amendment is designed to extend the advantages of the supplement to exchanges and distributions the order for which by the Securities and Exchange Commission cannot be issued within the limited period provided for in existing law.

III. Capital Stock Tax and Declared Value Excess Profits Tax

1. CAPITAL-STOCK TAX

The House bill increased the capital-stock tax rate from $1.10 ($1 plus 10 cents defense tax) per $1,000 of adjusted declared value to $1.25, effective for the year ending June 30, 1941. In addition, the Commissioner of Internal Revenue extended the time for filing returns and paying the tax for such year until September 29, 1941. This is the longest extension of time permissible under existing law.

Your committee bill retains the rate provided in the House bill. In addition, it authorizes the Commissioner to extend the time for filing returns and paying the tax for the year ending June 30, 1941, to not more than 90 days. This will permit an extension of 30 days beyond September 29, 1941.

Under existing law corporations must declare this year a capital stock valuation binding upon them for this year and the two subsequent years. Because of the great difficulty under present conditions in estimating future income, particularly in view of the possible restrictions that may result from priorities, your committee deems it equitable to allow an annual declaration of capital stock value.

2. DECLARED VALUE EXCESS-PROFITS TAX

The House bill makes permanent the 10-percent defense tax as applied to the declared value excess-profits tax. Here, as in the income tax, it is felt desirable to integrate the defense tax into the basic declared value excess-profits rates. Thus the basic rate of 6 percent becomes $6\frac{6}{10}$ and the 12 percent rate becomes $13\frac{2}{10}$. No change in the effective rate is accomplished thereby.

IV. ESTATE AND GIFT TAXES

The House bill increased the estate and gift tax rates and made permanent the 10-percent defense tax. The Finance Committee bill retains the rate increases but integrates in these basic rates the 10-percent defense tax instead of having it apply as a separate computation. In adding 10 percent to the estate tax rates in the brackets, fractions of percentages have been avoided.

The following table shows the bracket rates under the House bill and those under the Finance Committee bill along with the cumulative tax on the higher amount shown in the bracket. It should be noted that to the tax as computed under the House bill the defense tax adds 10 percent of the amount of the tax so computed, while under the Finance Committee bill the defense tax is integated into the rates shown.

Net estate	House bill		Finance Committee bill	
	Bracket rate	Cumulative tax on higher amount	Bracket rate	Cumulative tax on higher amount
	Percent		*Percent*	
0 to $5,000	3	$150	3	$150
$5,000 to $10,000	7	500	7	500
$10,000 to $20,000	10	1, 500	11	1, 600
$20,000 to $30,000	13	2, 800	14	3, 000
$30,000 to $40,000	16	4, 400	18	4, 800
$40,000 to $50,000	20	6, 400	22	7, 000
$50,000 to $60,000	23	8, 700	25	9, 500
$60,000 to $100,000	25	18, 700	28	20, 700
$100,000 to $250,000	27	59, 200	30	65, 700
$250,000 to $500,000	29	131, 700	32	145, 700
$500,000 to $750,000	32	211, 700	35	233, 200
$750,000 to $1,000,000	34	296, 700	37	325, 700
$1,000,000 to $1,250,000	36	386, 700	39	423, 200
$1,250,000 to $1,500,000	38	481, 700	42	528, 200
$1,500,000 to $2,000,000	41	680, 700	45	753, 200
$2,000,000 to $2,500,000	45	911, 700	49	998, 200
$2,500,000 to $3,000,000	48	1, 151, 700	53	1, 263, 200
$3,000,000 to $3,500,000	51	1, 406, 700	56	1, 543, 200
$3,500,000 to $4,000,000	54	1, 676, 700	59	1, 838, 200
$4,000,000 to $5,000,000	58	2, 256, 700	63	2, 468, 200
$5,000,000 to $6,000,000	61	2, 866, 700	67	3, 138, 200
$6,000,000 to $7,000,000	64	3, 506, 700	70	3, 838, 200
$7,000,000 to $8,000,000	66	4, 166, 700	73	4, 568, 200
$8,000,000 to $10,000,000	69	5, 546, 700	76	6, 088, 200
Over $10,000,000	70	----------	77	----------

The following table shows a comparison of the Federal estate tax burden (before allowance of credit for State death taxes) under existing law, the House bill, and under the Finance Committee bill upon net estates (before exemption) of selected sizes:

Net estate before exemption	Amount of tax			Effective rate			Increase in tax over present law			
							Amount		Percent	
	Present law [1]	House bill [1]	Finance Committee bill	Present law [1]	House bill [1]	Finance Committee bill	House bill [1]	Finance Committee bill	House bill [1]	Finance Committee bill
				Percent	*Percent*	*Percent*				
$50,000	$220	$550	$500	0.4	1.1	1.0	$330	$280	150.0	127.3
$60,000	660	1,650	1,600	1.1	2.8	2.7	990	940	150.0	142.4
$80,000	2,200	4,840	4,800	2.8	6.1	6.0	2,640	2,600	120.0	118.2
$100,000	4,620	9,570	9,500	4.6	9.6	9.5	4,950	4,880	107.1	105.6
$200,000	21,660	38,270	38,700	10.8	19.1	19.4	16,610	17,040	76.7	78.7
$400,000	63,780	99,530	100,900	15.9	24.9	25.2	35,750	37,120	56.1	58.2
$600,000	112,340	164,590	166,700	18.7	27.4	27.8	52,250	54,360	46.5	48.4
$800,000	167,340	234,330	236,900	20.9	29.3	29.6	66,990	69,560	40.0	41.6
$1,000,000	228,780	308,090	310,900	22.9	30.8	31.1	79,310	82,120	34.7	35.9
$2,000,000	588,000	727,370	735,200	29.4	36.3	36.8	139,370	147,200	23.7	25.0
$4,000,000	1,499,640	1,792,570	1,814,600	37.5	44.8	45.4	292,930	314,960	19.5	21.0
$6,000,000	2,655,140	3,075,450	3,111,400	44.3	51.3	51.9	420,310	456,260	15.8	17.2
$10,000,000	5,323,500	5,964,250	6,057,800	53.2	59.6	60.6	640,750	734,300	12.0	13.8
$20,000,000	12,532,700	13,503,890	13,757,400	62.7	67.5	68.8	971,190	1,224,700	7.7	9.8
$40,000,000	27,391,820	28,583,890	29,157,400	68.5	71.4	72.9	1,192,070	1,765,580	4.4	6.4
$60,000,000	42,361,380	43,663,890	44,557,400	70.6	72.8	74.3	1,302,510	2,196,020	3.1	5.2
$100,000,000	72,521,380	73,823,890	75,357,400	72.5	73.8	75.4	1,302,510	2,836,020	1.8	3.9

[1] Includes the defense tax which is equal to 10 percent of the Federal tax after allowance of the credit for State death taxes (the credit for State death taxes is assumed to be 80 percent of the tax imposed under the 1926 act).

As under both the existing law and the House bill, the gift tax rates are fixed at three-fourths of the comparable bracket rates of the estate tax. The following table compares the gift tax rates under the House bill with those under the Finance Committee bill and shows the cumulative tax on the higher amount shown in the brackets. As under the estate tax, it should be noted here also that the 10 percent defense tax is added to the tax as computed under the rates of the House bill, while under the Finance Committee bill the defense tax is integrated into the rates shown.

Net gift	House bill		Finance Committee bill	
	Bracket rate	Cumulative tax on higher amount	Bracket rate	Cumulative tax on higher amount
	Percent		*Percent*	
$0 to $5,000	2.25	$112.5	2.25	$112.5
$5,000 to $10,000	5.25	375	5.25	375
$10,000 to $20,000	7.50	1,125	8.25	1,200
$20,000 to $30,000	9.75	2,100	10.50	2,250
$30,000 to $40,000	12.00	3,300	13.50	3,600
$40,000 to $50,000	15.00	4,800	16.50	5,250
$50,000 to $60,000	17.25	6,525	18.75	7,125
$60,000 to $100,000	18.75	14,025	21.00	15,525
$100,000 to $250,000	20.25	44,400	22.50	49,275
$250,000 to $500,000	21.75	98,775	24.00	109,275
$500,000 to $750,000	24.00	158,775	26.25	174,900
$750,000 to $1,000,000	25.50	222,525	27.75	244,275
$1,000,000 to $1,250,000	27.00	290,025	29.25	317,400
$1,250,000 to $1,500,000	28.50	361,275	31.50	396,150
$1,500,000 to $2,000,000	30.75	515,025	33.75	564,900
$2,000,000 to $2,500,000	33.75	683,775	36.75	748,650
$2,500,000 to $3,000,000	36.00	863,775	39.75	947,400
$3,000,000 to $3,500,000	38.25	1,055,025	42.00	1,157,400
$3,500,000 to $4,000,000	40.50	1,257,525	44.25	1,378,650
$4,000,000 to $5,000,000	43.50	1,692,525	47.25	1,851,150
$5,000,000 to $6,000,000	45.75	2,150,025	50.25	2,353,650
$6,000,000 to $7,000,000	48.00	2,630,025	52.50	2,878,650
$7,000,000 to $8,000,000	49.50	3,125,025	54.75	3,426,150
$8,000,000 to $10,000,000	51.75	4,160,025	57.00	4,566,150
Over $10,000,000	52.50		57.75	

V. Excise Taxes

1. DISTILLED SPIRITS

Under existing law the tax on distilled spirits (other than brandy) is $3 per proof gallon and on brandy $2.75. The House bill increased these taxes by $1, making the distilled spirits tax $4 and that on brandy $3.75. Your committee bill eliminates this differential between brandy and other distilled spirits and applies the $4 rate to brandy as well as other distilled spirits.

2. WINES

The House bill increased the tax on wines containing not more than 14 percent of alcohol from 6 cents per gallon to 8 cents; on wines containing more than 14 percent but not more than 21 percent of alcohol, from 18 cents to 24 cents; and on wines containing more than 21 percent but not more than 24 percent of alcohol, from 30 cents to 50 cents. Wines containing more than 24 percent of alcohol are taxed as distilled spirits.

It was pointed out by the Treasury Department that even these increases were not sufficient to bring the tax on wines to a comparable basis with the taxes on other alcoholic beverages. Consequently, your committee recommends that the 8-cent rate be increased to 10 cents, the 24-cent rate increased to 35 cents, and the 50-cent rate increased to 65 cents. Likewise, the rate of 4 cents for each one-half pint of champagne and sparkling wine, provided in the House bill, is increased to 7 cents, and the rate on artificially carbonated wine and on liqueurs and cordials is increased from 2¼ cents to 3½ cents per one-half pint.

3. ADMISSIONS TAX

Under existing law amounts paid for admissions of less than 21 cents are exempt from the tax on admissions. The House bill reduced the exemption to amounts of less than 10 cents. Your committee bill eliminates this exemption entirely. In addition, the tax rate provided in the House bill of 1 cent for each 10 cents or fraction thereof of the amounts paid for admission has been replaced by the following schedule of rates:

If the amount charged is—	The tax shall be—
Not over 10 cents	1 cent.
Over 10 cents and not over 15 cents	2 cents.
Over 15 cents and not over 20 cents	3 cents.
Over 20 cents and not over 25 cents	4 cents.
Over 25 cents and not over 35 cents	5 cents.
Over 35 cents and not over 40 cents	6 cents.
Over 40 cents and not over 45 cents	7 cents.
Over 45 cents and not over 50 cents	8 cents.
Over 50 cents	15 percent of the amount charged; fractions of ½ cent or more shall be increased to 1 cent; smaller fractions shall be disregarded.

Under existing law in the case of persons admitted free or at reduced rates, a tax based on the established charge applies, except when the person admitted is a bona fide employee, municipal officer on official business, or a child of less than 12 years of age. The House bill extends this category to include members of the armed forces of the United States and of the Civilian Conservation Corps when in uniform.

Because of the practice now generally followed by many motion-picture theaters of admitting high-school-age boys and girls at reduced rates, the above limitation of 12 years of age has been increased to 18 years by your committee bill. Thus, with respect to persons under 18 years of age, as well as the other persons above described, the tax is based upon the amount actually paid and not upon the established price.

The House bill strikes from existing law all classes of exemptions from the admissions tax except that based only upon the amount paid. Your committee bill restores the exemption of admissions to agricultural fairs and to certain concerts conducted by civic or community membership associations.

4. CABARET, ROOF GARDEN, ETC., TAX

While your committee has made no change in the House bill with respect to this tax, it feels that it may be desirable to clear up a misunderstanding which has arisen regarding the right of the operator of a cabaret, roof garden, or similar establishment to pass on to the patrons the amount of the tax paid. As is the case with respect to all other excise taxes imposed by the Federal Government, the law imposes no restriction upon the extent to which such taxes may be passed on in the price of the goods sold or in the payment for services rendered.

5. TAX ON TELEPHONE, TELEGRAPH, AND CABLE MESSAGES AND SERVICES

Under existing law, telephone, telegraph, and radio or cable messages are taxed in separate categories and at separate rates. The House bill consolidates these items and applies to the charge for such messages a tax of 5 cents for each 50 cents or fraction thereof where the charge is more than 24 cents.

Your committee bill leaves the tax on telephone and radio-telephone conversations as above described, but on telegraph, cable, or radio messages imposes, in lieu of the above rates, a tax of 10 percent of the amount charged.

The House bill continued the present rate of 5 percent upon leased wire or talking circuit special service but added to this category certain wire and equipment services such as teletypewriter service, burglar-alarm service, news-ticker service, stock-quotation and information services. Your committee bill places leased wire, teletypewriters, or talking circuit special service in one category and increases the tax on the amounts paid therefor from 5 to 10 percent. It leaves in effect the 5-percent rate with respect to other wire and equipment services such as stock-quotation and information services, but specifically excludes news-ticker services where a general news service similar to that contained in the public press is furnished. Likewise, amounts paid for burglar- or fire-alarm services are exempted.

The House bill imposed a tax of 5 percent upon amounts paid by subscribers for local telephone service. The committee bill increases this rate to 10 percent.

6. TAX ON SOFT DRINKS

The House bill contains a tax on bottled soft drinks of one-sixth of a cent per bottle on bottles to be sold at retail for less than 10 cents per bottle and at corresponding rates on bottles to sell for more than 10 cents. Similarly, taxes were imposed upon finished or fountain sirups and upon carbonic-acid gas. It was demonstrated to your committee that these taxes would prove a serious hardship upon bottlers, particularly the smaller ones, and that the margin of profit in many cases was less than the tax which would have to be absorbed.

A tax reduced to a point where it could be absorbed safely would produce very little revenue but would impose the same administrative burden as the tax at the higher rate. Consequently, your committee has stricken this tax from the bill.

7. TAX ON ELECTRIC, GAS, AND OIL APPLIANCES

The House bill imposes a tax of 10 percent upon the manufacturer's sale of electric appliances. It was pointed out that the exclusion of gas and oil water heaters and cooking appliances created an unfair competitive situation. Consequently, these gas and oil appliances are included in the taxable category and are taxed at the 10-percent rate.

8. WASHING MACHINES

The House bill lays a 10-percent tax upon the manufacturer's sale of washing machines of the kind used in commercial laundries. Your committee bill applies this tax with respect to all washing machines.

9. ELECTRIC LIGHT BULBS

Your committee has placed a tax of 10 percent upon the manufacturer's sale of electric light bulbs.

10. RETAILERS' EXCISE TAXES

In connection with the consideration of these taxes, it was brought to the attention of your committee that serious competitive situations might arise where some sellers of toilet preparations, furs, or jewelry might advertise or otherwise represent that the price for which these articles are to be sold does not include the tax. Consequently, a provision has been inserted imposing a penalty of not more than $1,000 upon any person who in connection with the sale or lease of furs, jewelry, or cosmetics makes any statement intended or calculated to lead any person to believe that the price of such article does not include the tax.

11. TAX ON THE TRANSPORTATION OF PERSONS

No change is made in this tax as contained in the House bill except to exempt amounts paid for transportation of not more than 1¼ cents per mile applicable to round-trip tickets sold to soldiers, sailors, marines, and members of the Coast Guard when in uniform and traveling at their own expense.

12. TAX ON COIN-OPERATED AMUSEMENT AND GAMING DEVICES

The House bill places a special tax of $25 per year upon each coin-operated amusement or gaming device maintained for use on any premises.

Your committee divides these devices into two categories. Upon so-called pinball or other amusement devices operated by the insertion of a coin or token, the tax is reduced to $10 per year. Upon so-called slot machines, however, the tax is placed at $200 per year.

13. INSTALLMENT SALES

Where any article subject to a manufacturers' excise tax is sold under an installment sale contract before the effective date of part IV of this bill, and delivery is made before such date, the tax applicable to the installments after such date shall be at the rate in force prior to such date. As a result, the new taxes imposed by this bill or the increases in existing taxes are not applicable to such installments.

A similar rule is made applicable with respect to the new retail taxes imposed by the bill.

14. OUTDOOR ADVERTISING

The committee eliminated from the House bill the section imposing a special tax on persons maintaining or controlling the use of billboards for outdoor advertising. The tax, an annual levy, was graduated on the basis of the advertising space area of the billboard.

In the opinion of the committee this tax would entail administrative expense and difficulties incommensurate with its value as a revenue producer. It is believed also that if such a tax were to be

imposed it would be desirable to provide for an exemption of billboards the use of which is donated to the Federal Government for the purpose of aiding it in recruiting for the military and naval forces and in the sale of its securities. It is regarded also as a tax regulatory in some degree of a matter which might preferably be left in the hands of State and local authorities.

15. RADIO BROADCASTING STATIONS AND NETWORKS

The tax imposed by the House bill on persons operating radio broadcasting stations or engaging in net work broadcasting has been stricken out. The reasons in consideration of which the Ways and Means Committee recommended and the House adopted the tax are recognized as having considerable force, but it is believed that the peculiar characteristics of this possible source of revenue require careful study before either the proper basis or rate of tax can be satisfactorily determined. It is the opinion of the committee also that the tax imposed by the House bill would operate with some unjustified discrimination against this particular form of advertising.

16. COCONUT OIL

The committee added to the House bill a section amending chapter 21 of the Internal Revenue Code by adding at the end thereof a new section, numbered 2483, which provides, under certain limitations, that the processing tax provided for in that chapter collected with respect to coconut oil wholly of the production of Guam or American Samoa or produced from materials wholly of the growth or production of those islands shall be held as separate funds and paid into their respective treasuries. The collections affected are those made after the date of the enactment of the bill.

The provision is similar to an existing provision, section 2476 of the Internal Revenue Code, governing the disposition of collections from the processing tax on coconut oil wholly of Philippine production or produced from materials wholly of Philippine growth or production.

VI. NONESSENTIAL FEDERAL EXPENDITURES

This amendment establishes a committee to investigate nonessential Federal expenditures. The committee is to be composed of (*a*) three members of the Senate Committee on Finance and three members of the Senate Committee on Appropriations, to be appointed by the President of the Senate; (*b*) three members of the House Committee on Ways and Means, and three members of the House Committee on Appropriations, to be appointed by the Speaker of the House of Representatives; and (*c*) the Secretary of the Treasury and the Director of the Bureau of the Budget. It shall be the duty of such committee to make a complete study and investigation of all expenditures of the Federal Government with a view to recommending the elimination or reduction of all such expenditures deemed to be nonessential. The committee shall report to the President and to the Congress the result of its study together with its recommendations at the earliest practicable date. It is given the authority and powers

commonly given to similar committees of the Senate and will operate under an appropriation not to exceed $10,000.

Paralleling this action, your committee also adopted a committee resolution calling upon the Director of the Budget, under the Budget and Accounting Act of 1920, to submit to the chairman of your committee a report showing how nondefense and nonessential budget items may be reduced by alternative totals of (1) $1,000,000,000; (2) $1,500,000,000; (3) $2,000,000,000. Such report would be available not only to the appropriate committees of the House and Senate but to the committee established under this amendment. The action of your committee in this respect is in line with repeated recommendations of the Secretary of the Treasury before both the Committee on Ways and Means of the House and your committee.

Detailed Discussion of the Provisions of the Bill

TITLE I—INDIVIDUAL AND CORPORATION INCOME TAXES

SECTION 101. SURTAX ON INDIVIDUALS

Under the House bill, the surtaxes apply upon the entire surtax net income and hence the exemption from surtax of the first $4,000 of surtax net income found in existing law is abolished. The lowest surtax bracket rate is 5 percent as compared with 4 percent under existing law. The surtaxes are increased in all brackets up to $750,000 and from that point the rates of existing law are retained. While the rates attributable to surtax net income in excess of $750,000 are not increased, surtaxes payable by taxpayers in these upper brackets are increased by reason of the higher rates in the lower brackets.

Under the bill as reported by your committee, further increases in the surtax rates are made as the result of the integration of the defense tax and the surtax rates. The lowest surtax bracket rate is therefore 6 percent as compared with 5 percent under the House bill and the rates on income in excess of $750,000 are likewise increased, the highest rate being 77 percent as compared with the 75 percent contained in existing law and in the House bill.

SECTION 102. OPTIONAL TAX ON INDIVIDUALS WITH CERTAIN GROSS INCOME OF $3,000 OR LESS

Section 102 of the bill adds to the Internal Revenue Code a new supplement designated "Supplement T" and comprising sections 400 to 404, inclusive. No comparable provisions are contained in the House bill.

Section 400 of Supplement T imposes a tax upon individuals whose gross income is $3,000 or less and consists wholly of salary, wages, compensation for personal services, dividends, interest, rents, annuities, or royalties. The tax is imposed at the election of the taxpayer and is in lieu of the tax imposed by sections 11 and 12. If the taxpayer's gross income exceeds $3,000 or if he has income from any source, or of any class, other than those specified in section 400, he may not avail himself of the election. For instance, the section is not available to a taxpayer who has income from the conduct of a business, or from a partnership or trust, or who has realized gain from the sale or exchange of property. If a husband and wife file

separate returns under the section, the limitation of $3,000 applies to the gross income of each; if they file a joint return, the limitation applies to the combined gross income of the spouses.

The amount of the tax imposed on specified amounts of gross income is determined by reference to the schedule set forth in section 400, a duplicate of which will be printed on the reverse of the form prescribed for making a return of the tax under such section. Gross incomes are grouped in blocks of $25 with the same tax payable for all incomes falling within the particular block. The tax imposed is the amount appearing in column 3 or 4 opposite the particular block. If the taxpayer is a single person who is not the head of a family, the tax imposed is the amount set forth in column 3. If the taxpayer is the head of a family or a married person, the tax imposed is the amount set forth in column 4. If a taxpayer has one or more dependents, he merely subtracts from his gross income $400 for each such dependent and finds the block in which falls the reduced amount.

The amount of the tax imposed in the various blocks is the average of the tax imposed by sections 11 and 12 on the lower and upper limits of the blocks, reduced by 10 percent as an allowance in lieu of deductions from gross income. The schedule takes into account a personal exemption of $750 for a single person and $1,500 for a married person or the head of a family, the same as allowed by section 25 in respect of the tax imposed by sections 11 and 12.

Section 401 prescribes certain rules to be observed in the application of the schedule set forth in section 400. The section states that only a married person living with husband or wife is to be deemed a "married person" for the purposes of Supplement T, and specifically defines a "dependent." For the purposes of this Supplement, the status of a taxpayer as a "married person," "head of a family," or "dependent" is to be determined as of the last day of the taxable year. Consequently, the provisions of section 25 (b) (3) relating to the apportionment of the personal exemption and credit for dependents by reason of a change of status during the taxable year have no application in ascertaining the amount of the tax under section 400. Thus, if a taxpayer has on the last day of the taxable year a dependent within the meaning of the definition contained in section 401, he is entitled to reduce his gross income by $400 in order to ascertain the amount of tax, and it is immaterial that the dependent may have occupied such status for only a portion of the taxable year.

Section 401 provides that if a husband and wife living together file separate returns under section 400, each shall be treated as a single person. Thus, in effect, each receives the benefit of one-half the personal exemption allowed a husband and wife. If they file separate returns and one spouse elects to be taxed under section 400, such spouse is taxed as a single person and in effect receives the benefit of one-half the personal exemption allowed a married person. The personal exemption and credit for dependents of the spouse who does not elect to be taxed under section 400 is determined under the provisions of section 25 (b) and is not governed by his status on the last day of the taxable year. Under the provisions of section 25 (b), as amended by section 111 of the bill, such spouse will be allowed for that portion of the taxable year during which he occupied the status of a married person living with husband or wife one-half of the personal

exemption allowed a married person for such portion of the taxable year.

For example, H, a widower having two dependents, marries W, a single person, on July 1, 1941. For the calendar year 1941, they filed separate returns and W elects to be taxed under section 400. W is taxed as a single person and, since she receives the benefit of a $750 exemption, she in effect receives the benefit of half the marital exemption of $750 for the second half of the year by reason of her status on the last day of the taxable year. H, who is taxed under sections 11 and 12, is subject to the provisions of section 25 (b) (3) requiring an apportionment of the personal exemption and credit for dependents by reason of a change of status during the taxable year. H qualifies as the head of a family for the first 6 months of the taxable year and as a married person living with husband or wife for the last 6 months. Accordingly, his personal exemption is six-twelfths of $1,500 for the first half of the year plus six-twelfths of $750 for the second half, or $1,125. Inasmuch as his status as the head of a family arises from the fact that he maintained a home for two dependent children, the credit for one of such dependents for the first 6 months of the taxable year is disallowed. He is therefore entitled to a credit for one dependent for the first 6 months and a credit for two dependents for the last 6 months. His credit for dependents is therefore $600.

Section 401 also provides that a married person who is not the head of a family and is not living with husband or wife on the last day of the taxable year shall be subject to the tax imposed upon a single person.

An election to be taxed under section 400 can be made only by affirmative action of the taxpayer. Section 402 provides that the election to be taxed under section 400 shall be made by filing a return for the taxable year on the form prescribed for making a return of the tax under this section. Such an election once made is irrevocable. Consequently, such election may not be changed by an amended return. Moreover, if for any taxable year the taxpayer makes a return without regard to this supplement he may not thereafter elect for such taxable year to have his tax computed under this supplement. If the taxpayer fails to file a return for the taxable year and the Commissioner or the collector makes a return under the authority of section 3612, such return shall be made without regard to the provisions of this supplement and the taxpayer shall be deemed to have lost his right to make an election for the taxable year under this supplement.

Section 403 provides that the provisions of section 31 (relating to foreign tax credit) and section 32 (relating to taxes withheld at source) shall not apply with respect to the tax imposed by Supplement T. This provision is necessary in the interest of simplicity. If substantial amounts of either such credit are involved, the taxpayer should make his return under the general provisions of the statute.

Section 404 provides that Supplement T shall not apply to a nonresident alien individual, or an estate or trust. This provision is also necessitated in the interest of simplicity. Such taxpayers are subject to special provisions of the statute that are not readily adaptable to the method of taxation employed in Supplement T.

Section 102 (b) of the bill amends sections 11 and 12 of the code to include cross-references to section 400.

Section 102 (c) of the bill amends section 4 of the code to insert references to Supplements S and T.

SECTION 103. CORPORATION DEFENSE-TAX RATES INCORPORATED IN RATE SCHEDULE

Section 103 of the House bill makes permanent the defense tax imposed by section 15 of the Internal Revenue Code as added by section 201 of the Revenue Act of 1940.

Section 103 of the bill as reported by your committee integrates the defense-tax rates with the rates provided in sections 13 (b) (1) and (2) of the code. Under the bill the permanent normal tax rate applicable to corporations not entitled to the special treatment provided for small corporations is 24 percent, and is thus the same as under existing law including the defense tax. The rates of tax applicable to corporations having normal tax net income of $25,000 or less are as follows:

	Percent
First $5,000	15
Next $15,000	17
Next $5,000	19

The alternative tax in the case of corporations the normal tax net income of which is slightly in excess of $25,000 is $4,250 plus 37 percent of the normal tax net income in excess of $25,000. Under this provision the full tax rate of 24 percent does not become effective until the normal tax net income of the corporation reaches $38,461.54. Integration of the defense-tax rates and the normal tax rates causes the double notch provision found in existing law to disappear.

There is a corresponding integration of the defense tax with the normal taxes on resident foreign corporations and on mutual investment companies, and with the surtax on corporations improperly accumulating surplus.

SECTION 104. SURTAX ON CORPORATIONS AND TERMINATION OF DEFENSE TAX

Section 102 of the House bill, adding section 16 to the Internal Revenue Code, imposes upon all corporations (including insurance companies), except nonresident foreign corporations and mutual investment companies (the latter being later dealt with in the section), a surtax of 5 percent upon the first $25,000 of corporation surtax net income and 6 percent upon the excess of such income over $25,000. Complementary amendments are made to sections 104 (b), 231 (b), 251 (c) (1), and 261 (a). Corporation surtax net income is defined as net income minus the credit for dividends received provided in section 26 (b) and thus includes interest on partially tax-exempt securities in the tax base. Such section also imposes upon mutual investment companies a surtax upon supplement Q surtax net income of such companies at rates corresponding to those imposed upon corporations generally.

Section 104 of the bill as reported by your committee corresponds to section 102 of the House bill and, in addition, terminates the defense tax, the defense-tax rates being integrated with the other income taxes in other sections of the bill.

In lieu of the surtax rates contained in the House bill, the bill as reported by your committee provides a surtax of 6 percent on the first $25,000 of surtax net income and 7 percent on the remainder. Since the credit for interest on partially tax-exempt Government securities is not allowable in computing surtax net income, the bill as reported by your committee also provides that, for the purposes of the surtax, the dividends-received credit shall be limited to 85 percent of the net income rather than 85 percent of the adjusted net income.

SECTION 105. TAX ON NONRESIDENT ALIEN INDIVIDUALS

This section corresponds to section 104 of the House bill, which increases the rate of tax on nonresident alien individuals to 25 percent. Such rate has been increased to 27½ percent, thereby integrating the 10-percent defense tax with such tax. This section also amends section 211 (c) of the Internal Revenue Code by changing to $23,000 the figure at which a nonresident alien individual becomes subject to the full normal and surtax rates. Such figure represents the approximate point at which, under the provisions of the bill, an effective rate of 27½ percent is reached.

SECTION 106. TAX ON FOREIGN CORPORATIONS

Section 231 (a) of the Internal Revenue Code, amended by section 105 of the House bill so as to increase the rate of tax on nonresident foreign corporations from 15 to 25 percent, is further amended so as to integrate the defense tax by increasing such rate to 27½ percent.

SECTION 107. WITHHOLDING OF TAX AT SOURCE

This section is the same as section 106 of the House bill, which provides for withholding of the tax at the source (by means of which the tax in the case of nonresident aliens is very largely collected) at the rate of 27½ percent instead of 16½ percent under existing law. The rate of 27½ percent represents the rate of tax imposed by section 211 (a) (1) (A) after its amendment by section 105 of the bill. The increased rates of withholding will not go into effect until the tenth day after the enactment of the act in order to afford a reasonable period within which withholding agents will be informed of the higher rates applicable to payments made to nonresident aliens or nonresident foreign corporations.

SECTION 108 (TREATY OBLIGATIONS) AND SECTION 109 (REDUCTION IN PURSUANCE OF TREATIES OF RATES OF TAX AND WITHHOLDING ON NONRESIDENT ALIEN INDIVIDUALS RESIDENT IN, AND CORPORATIONS ORGANIZED UNDER LAWS OF, WESTERN HEMISPHERE COUNTRIES)

These sections are the same as sections 108 and 109 of the House bill. Section 108 provides that no amendment made by this title shall apply in any case where its application would be contrary to any treaty obligation of the United States. Section 109 authorizes reduction by treaty in the rate of taxation and of withholding with respect to dividends derived from sources within the United States

by nonresident foreign corporations organized under the laws of any country in North, Central, or South America, or in the West Indies, or of Newfoundland.

SECTION 110. DEFENSE TAX RATES ON PERSONAL HOLDING COMPANIES AND TRANSFERS TO AVOID INCOME TAX INCORPORATED IN RATE SCHEDULES

This section corresponds to section 109 of the House bill, which amends section 500 (b) and section 1250 (b) of the Internal Revenue Code in order to make permanent the defense taxes imposed by such sections on personal holding companies and on transfers to avoid income tax. The bill as reported by your committee repeals these sections, and the taxes imposed by them are integrated with the tax on personal holding companies and the tax on transfers to avoid income tax.

SECTION 111. PERSONAL EXEMPTION

This section, for which there is no corresponding provision in the House bill, amends section 25 (b) (1) by lowering the personal exemption of married persons from $2,000 to $1,500 and the personal exemption of single persons from $800 to $750. The section also amends section 214 of the Internal Revenue Code (relating to personal exemption of nonresident alien individuals) and section 251 (f) of the Internal Revenue Code (relating to personal exemption of citizens entitled to the benefits of section 251) by striking out $800 and inserting in lieu thereof $750 in conformity with the changes made in section 25 (b).

This section further amends section 25 (b) (1) relative to the personal exemption of a married person whose spouse files a separate return under Supplement T, added by section 102 of the bill.

SECTION 112. RETURNS OF INCOME TAX

In accordance with the change in the personal exemption made by section 111 of the bill, this section amends section 51 (a) of the Internal Revenue Code to require a return in the case of any individual whose gross income is equal to or in excess of the personal exemption as reduced by section 111. Thus, a return is required from any individual who is single or married but not living with husband or wife if his gross income is $750 or over, and from a married individual living with husband or wife if having a gross income of $1,500 or over if the other spouse has no gross income, or having a gross income together with the other spouse of $1,500 or over.

A similar change has been made with respect to fiduciary returns and with respect to the amount of payments to individuals which requires an information return from the payor of the income.

SECTION 113. CREDIT FOR DEPENDENTS

This section is the same as section 110 of the House bill which amends section 25 (b) (2) of the Internal Revenue Code relative to the credit for dependents.

In the case of the head of a family or a married person living with husband or wife, the existing law provides as a credit against net

income a personal exemption plus $400 for each dependent other than husband or wife. Under these provisions, a married person living with husband or wife and having no dependents receives as a maximum credit the personal exemption. On the other hand, an unmarried person maintaining a home for a person who also qualifies as a dependent may receive in addition to the same personal exemption a credit for $400 for such dependent. The proposed legislation disallows the credit for one dependent in cases where the taxpayer's status as head of a family is occasioned solely by the existence of one or more of such dependents. The amendment will not affect any case except one in which the taxpayer occupies the status as head of a family solely by reason of the existence of a person for whom he is also entitled to the credit for a dependent. For instance, it will not operate to reduce the credit in the case where a widower is maintaining a home for two children, only one of whom qualifies as a dependent. In such case, the status as head of a family is not occasioned solely by existence of the child in respect of whom the credit of $400 is allowed and consequently the taxpayer may be entitled to the personal exemption allowed the head of a family plus the $400 credit, the same as under existing law.

SECTION 114. NON-INTEREST-BEARING OBLIGATIONS ISSUED AT DISCOUNT

This is the same as section 111 of the House bill and provides that any taxpayer who owns any non-interest-bearing obligations issued at a discount and redeemable for fixed amounts increasing at stated intervals and who, under the method of accounting used by him in computing his net income, is not permitted to report the increment in value of such obligations as it accrues, may, at his election, treat such increment in value as constituting income to him in the year in which it accrues rather than in the year in which the obligations are disposed of, redeemed, or paid at maturity. Under existing law a taxpayer on the accrual basis who owns, for example, non-interest-bearing United States defense bonds is required to report the increment as it accrues, whereas a taxpayer on the cash basis who owns such defense bonds is required to treat the entire increment in value as being income received in the year of redemption or maturity. Therefore, with respect to such non-interest-bearing United States defense bonds, the effect of this section is to extend, at the election of the taxpayer, the accrual method to a taxpayer on the cash basis, but only for the limited purpose of reporting the increment in value of such bonds as it accrues.

The election provided for in this section must be made in the taxpayer's return, and may be made for any taxable year beginning after December 31, 1940. When so made with respect to any obligation, the election shall apply also to all obligations of the type described in this section owned by the taxpayer or thereafter acquired by him. The election applies to the taxable year for which such return is filed and is binding for all subsequent taxable years unless the Commissioner permits the taxpayer, subject to such conditions as the Commissioner deems necessary, to change to a different method of reporting income from such bonds. Although the election, once made, is binding upon the taxpayer, it would not apply to a transferee of such

taxpayer. For example, A, on the cash basis, buys non-interest-bearing United States defense bonds in 1942 and elects in his return for 1942 to treat the increment in value as being income to him as it accrues. In 1943 A dies and bequeaths such bonds to B, who is also on the cash basis. B is not bound by A's election, but he may, if he so desires make an election under this section with respect to the increment in value accruing after the acquisition of such bonds by him. If B had previously made an election under this section, such election would apply to the bonds acquired from A.

In any case in which an election is made under this section, the amount considered to accrue in any taxable year to which the election applies is measured by the actual increases in the redemption price occurring in that year. Such amount shall not be considered to accrue ratably between the dates on which the redemption price changes. Thus, if two dates on which the redemption price increases fall within the taxable year and if the redemption price increases in the amount of 50 cents on each such date, the amount deemed to accrue in that year would be $1. The preceding sentence, however, is subject to an exception in the case of the first taxable year to which the election applies. If at the beginning of the first taxable year to which the election applies the taxpayer owns non-interest-bearing bonds of the prescribed character acquired prior thereto, he is required to report in such year, in addition to the increases in the redemption price actually falling within that year, the total of the increases in such price occurring between the date of acquisition and the beginning of such year. Accordingly, if a taxpayer on the calendar year basis makes an election under this section for 1944 and if the bonds have been issued to the taxpayer on June 1, 1941, he would be required to include in his gross income for the taxable year 1944 the total of the increases in the redemption price of such bonds occurring between the acquisition on June 1, 1941, and December 31, 1944.

SECTION 115. SHORT-TERM OBLIGATIONS ISSUED ON DISCOUNT BASIS

This section, which was not contained in the House bill, provides that the issuing discount on certain short-term Federal, State, and local government obligations issued on a discount basis on or after March 1, 1941, shall not be deemed to accrue until such obligations are paid at maturity, sold, or otherwise disposed of, and that such obligations shall not be treated as capital assets. An obligation may be issued on a discount basis even though the price paid exceeds the face amount. Thus, although the Second Liberty Bond Act provides that Treasury bills of the United States shall be issued on a discount basis, the issuing price paid for a particular bill may, by reason of competitive bidding, actually exceed the face amount of the bill. This section eliminates the necessity for making an allocation between interest and capital gain or loss and will have particular application in the case of Treasury bills of the United States issued after March 1, 1941, which are made taxable by section 4 of the Public Debt Act of 1941.

The requirements of existing law with respect to Treasury bills issued on or after March 1, 1941, impose on taxpayers the duty of making burdensome computations. The portion of the gain attribu-

table to the original discount on such bills is considered as interest and the remainder is treated as a capital gain. Thus, where such a bill is sold by the original holder for an amount in excess of the purchase price plus the issuing discount accrued to the date of sale, allocation to interest and capital gain is required. In the case of a loss resulting from the sale of such a Treasury bill, the loss is treated as a capital loss and must be segregated as such. Being a short-term capital loss, it is allowable only to the extent of short-term capital gains. Moreover, the existing rule that the original discount on Treasury bills accrues ratably over the entire life of the bills requires each successive taxpayer holding a particular bill to ascertain the issuing discount in order that he may determine the amount of such discount which is treated as accruing during the period for which he held the bill.

Under this section a person who sells a Treasury bill issued on or after March 1, 1941, or has it paid at maturity, would need only to compare the sales price, or the amount paid at maturity, with the purchase price or other basis and account for the net gain or loss. In such case there would be two different elements, that is, interest (original discount) and ordinary gain or loss, but since no special treatment is accorded such gain or loss, allocation would be unnecessary. Only the net gain or the net loss need be taken into account. For example, if a $1,000 90-day bill is issued for $994 and the original purchaser sells it at the end of 60 days for $997, he need report only $3 as ordinary income, although there are $4 of accrued discount and a $1 loss. Under existing law he would be required to report the $4 discount as interest and the $1 loss as a short-term capital loss.

Inasmuch as the gross income of life-insurance companies is limited to interest, dividends, and rents, these companies will still be required to make an allocation in respect of obligations of the prescribed character any part of the discount on which is considered as interest. But, as most of the funds of life-insurance companies is invested in long-term obligations, the problem of allocation in this field is not serious.

This section is applicable to taxable years ending after February 28, 1941.

SECTION 116. INFORMATION RETURNS WITH RESPECT TO FEDERAL OBLIGATIONS

This is the same as section 112 of the House bill.

As a consequence of the elimination of tax exemption with respect to Federal obligations brought about by the Public Debt Act of 1941, section 116 of the bill repeals, prospectively, section 147 (d) of the Internal Revenue Code, which made inapplicable to interest on obligations of the United States those provisions of law relating to securing information at the source. Section 116 also makes a complementary amendment to section 147 (b). Such amendments will enable the Commissioner to prescribe regulations requiring such information with respect to interest on United States obligations as he may deem necessary in the interest of good administration of the income-tax laws. Section 116 is to take effect on the day following the enactment of the bill.

SECTION 117. ALIMONY AND SEPARATE MAINTENANCE PAYMENTS

This section amends sections 22, 23, and 25 of the Internal Revenue Code and adds a new section to Supplement E of chapter 1 in order to provide in certain cases a new income-tax treatment for payments in the nature of or in lieu of alimony and allowance for support as between divorced or legally separated spouses. These amendments are intended to distribute the income-tax burden between such spouses by treating such payments as income to the spouse actually receiving or actually entitled to receive such payments and by relieving the other spouse from the tax burden upon whatever part of the amount of such payments is under the present law includible in his gross income. In addition, the amended sections will produce uniformity in the treatment of amounts paid in the nature of or in lieu of alimony regardless of the variance in the laws of different States concerning the existence and continuance of any obligation to pay alimony. In this respect the amendments are designed to remove the uncertainty as to the tax consequences of payments made to a divorced spouse out of the net income of so-called irrevocable alimony trusts, arising from the recent Supreme Court decisions in *Helvering* v. *Fitch* ((1940) 309 U. S. 149), *Helvering* v. *Fuller* ((1940) 310 U. S. 69), and *Helvering* v. *Leonard* ((1940) 310 U. S. 80), which decisions make the test of whether such income is taxable to the husband the existence of a continuing legal obligation under State law.

Section 22, relating to the definition of gross income, is amended by inserting at the end thereof a new subsection designated (k). This subsection applies only to an individual who is divorced or legally separated under a decree of divorce or of separate maintenance and to such individual's spouse or former spouse from whom such individual was divorced or legally separated by such decree. Periodic payments received (other than as beneficiary or assignee of a beneficiary of a trust) by such individual, subsequent to the decree, in discharge of, or attributable to property transferred in discharge of, a legal obligation imposed upon or incurred by such individual's spouse or former spouse under such decree or under a written instrument incident to such divorce or separation are defined by section 22 (k) as gross income to such individual and are includible as such in her income. Installment payments discharging a part of an obligation the principal sum of which is, in terms of money or property, specified in the decree or instrument, are not considered periodic payments for the purposes of section 22 (k), and are, therefore, not gross income to the recipient under that section.

Section 22 (k) also provides that, in the case of a divorce or legal separation, periodic payments which are attributable to property transferred in discharge of the legal obligation of a spouse or former spouse shall not be includible in the gross income of such spouse or former spouse. As a complement to section 22 (k), section 23, relating to deductions from gross income, is amended by adding a new subsection, designated (u), which allows a deduction by the spouse or former spouse described in section 22 (k) in his taxable year in which are paid the amounts includible under section 22 (k) in the gross income of the individual described in section 22 (k). However, such spouse or former spouse is not allowed a deduction under

section 23 (u) for any periodic payments attributable to property transferred in discharge of his legal obligation which under section 22 (k) or section 171 are excluded from his gross income.

Sections 22 (k) and 23 (u), being based upon the terms "received" and "payment of which is made," place the spouses on the cash receipts and disbursements basis with respect to their treatment of the amounts described in sections 22 (k) and 23 (u) for any taxable year. The provisions of section 22 (k) and section 23 (u) are applicable only with respect to taxable years of the spouses beginning after December 31, 1941.

The operation of sections 22 (k) and 23 (u) may be illustrated by the following examples (in which it is assumed that all payments are made and received within taxable years of the spouses beginning after December 31, 1941):

(1) Under the terms of a decree of separate maintenance entered by a State court, Mr. A is to pay Mrs. A $200 a month as alimony for her life. During 1942, Mr. A, pursuant to the decree, pays Mrs. A $200 a month. In computing their income taxes for 1942, Mrs. A will include in her gross income the $2,400 thus received, and Mr. A is entitled to a deduction of $2,400 from his gross income.

(2) Mrs. B files suit for divorce from Mr. B. In consideration of Mrs. B not requesting alimony and not making public his financial affairs, Mr. B makes a legally binding promise in writing to Mrs. B to pay to her $200 a month if a final decree of divorce is granted without any provision for alimony. Accordingly, Mrs. B does not request alimony and no provision for alimony is made under the final decree of divorce. During 1942 Mr. B pays Mrs. B $200 a month, pursuant to the promise. The $2,400 thus received by Mrs. B is includible in her gross income under the provisions of section 22 (k), and Mr. B is entitled to a deduction of $2,400 from his gross income.

(3) Under the provisions of a divorce decree, Mr. C is to pay $200,000 to his divorced spouse, Mrs. C, in installments of $10,000 a year. No part of the $200,000 or the installments thereof is income to Mrs. C under section 22 (k) or deductible by Mr. C under section 23 (u).

(4) A divorce decree requires Mr. D to pay to Mrs. D, his former wife, $500 a month. To meet this obligation, Mr. D purchases an annuity for the life of his divorced wife which will pay her $500 a month. Under the provisions of section 22 (k) and notwithstanding the provisions of section 22 (b) (2), the full $500 a month received by Mrs. D is includible in her gross income and no part of such amount is includible in the gross income of Mr. D or deductible by him from his gross income.

Supplement E is amended by adding a new section, section 171, to state the rule applicable to trust income after a decree of divorce or of separate maintenance. Section 171 is designed to include in the gross income of an individual who is divorced or legally separated under a decree of divorce or separate maintenance the amount of the income of any trust such individual is entitled to receive which, except for the provisions of section 171, would be includible in the gross income of such individual, spouse, or former spouse and to exclude such amount from the gross income of such spouse or former spouse,

regardless of section 166, section 167, or any other provision of chapter 1. The taxable year for which such income is to be accounted for is to be determined under the provisions of section 164. Section 171 is applicable only with respect to taxable years beginning after December 31, 1941.

The operation of this section (and its relation to section 22 (k) and section 23 (u)) may be illustrated by the following examples (in which it is assumed that all payments are made and received within taxable years beginning after December 31, 1941):

(1) As part of a separation agreement, Mr. X transfers property to a trust, the net income of which is estimated by the parties to be sufficient to provide for Mrs. X's support. A few years later Mrs. X obtains a divorce from Mr. X. The final decree refers to the trust created previously under the separation agreement and provides that the transfer in trust and the income therefrom receivable by Mrs. X shall be in lieu of alimony. The court, however, retains, as is allowed under the law of the State in which the divorce is obtained, jurisdiction to provide for further payments to Mrs. X by Mr. X should the income of the trust be insufficient for her support. Under section 171 the net income of the trust is income to Mrs. X and is not income to Mr. X.

(2) Under the same facts as in the previous example the decree of the court provides that in all events Mrs. X shall receive $10,000 a year as alimony. In the first taxable year beginning after December 31, 1942, the net income of the trust is only $8,000. The trustees, therefore, pay an additional $2,000 from the corpus of the trust to Mrs. X. In such a case only $8,000 is includible in the income of Mrs. X under the provisions of section 171. No part of the trust income is includible in the gross income of Mr. X nor is he allowed any deduction for any part of the $10,000 paid to Mrs. X. However, if the additional $2,000 is not payable out of the corpus of the trust but is payable by Mr. X to Mrs. X, then the $2,000 paid by Mr. X to Mrs. X is income to her under section 22 (k). Therefore, for 1942 Mrs. X includes $10,000 in her income, Mr. X does not include in his income the $8,000 paid to Mrs. X by the trust but is entitled to deduct the $2,000 paid by him to Mrs. X.

(3) Mr. Y is the beneficiary of a trust established under the will of his father. Under the terms of the trust, the trustees are to pay to Mr. Y $10,000 a year from the net income of the trust, but if the net income of the trust for any year does not equal $10,000, to pay the net income and so much more from the corpus of the trust as will total $10,000. In 1942 Mrs. Y obtains a divorce from Mr. Y. Under the divorce decree Mr. Y is to pay Mrs. Y $5,000 a year for his life. To meet this obligation under the divorce decree, Mr. Y assigns to Mrs. Y for 5 years one-half of the amount he is otherwise entitled to receive from the trust, promising to make another such assignment or to provide another method of payment of the $5,000 a year to her at the expiration of that period. In 1942 the net income of the trust is $8,000. Under the terms of the trust instrument and of the assignment by Mr. Y to Mrs. Y the trustees pay $5,000 to Mr. Y and $5,000 to Mrs. Y. Since only eight-tenths of the amount thus distributed represents the net income of the trust, only $4,000 of the amount received by Mrs. Y is income to her. Mr. Y will include in

his income only $4,000 and will not include any amount on account of the $5,000 paid to Mrs. Y.

Section 22 (k) and section 171 do not apply to that part of such periodic payments under section 22 (k) and to that part of such trust income under section 171 which by the terms of the decree, or of the written instrument under section 22 (k), or of the trust instrument under section 171, is specifically designated as a sum payable for the support of minor children of the spouses. If, however, the periodic payments and the trust income are received by the wife for the support and maintenance of herself and of minor children of the spouses without such specific designation of the portion for the support of such children, then the whole of such amounts are includible in the income of the wife as provided in section 22 (k) and in section 171. As a necessary complement to these provisions, section 25 (b) (2), relating to credit for dependents, is amended so as to provide that payments to an individual's spouse or former spouse which are includible under section 22 (k) or section 171 in the gross income of such spouse or former spouse shall not be considered payments by such individual for the support of the minor children of such persons. Thus where the portion of such payments for the support of the minor children is not specifically designated, the wife, if actually contributing to the support of the children, is entitled to the credit for dependents, unless it is established that independently of such amounts paid to the wife the husband (or some other person upon whom the children are financially dependent) is actually contributing a greater amount for the support of such children than is the wife.

These rules may be illustrated by the following examples:

(1) Under a decree of divorce which awards to Mrs. Z the custody of the two minor children of herself and Mr. Z, Mr. Z is obligated to pay $500 per month for the maintenance and support of Mrs. Z and their two children. In the calendar year 1942 Mr. Z makes such payments. The $6,000 received by Mrs. Z is to be included in her gross income, and Mr. Z is entitled to a deduction of $6,000. If such payments constitute the children's chief support, Mrs. Z is entitled to the exemption applicable to the head of a family and to a credit for one dependent.

(2) If, in the previous example, the decree had provided that Mr. Z should pay Mrs. Z $300 per month for her maintenance and support and an additional $200 per month for the maintenance and support of their children, only $3,600 would be includible in the gross income of Mrs. Z and deductible from the gross income of Mr. Z; $2,400 would be considered as payments by Mr. Z and not by Mrs. Z for the purpose of determining which of them is entitled to exemption for the head of a family and the credit for dependents.

SECTION 118. EXTENSION OF TIME OF ORDERS OF SECURITIES AND EXCHANGE COMMISSION

Under Supplement R of the Internal Revenue Code certain transactions arising out of the simplification or geographical integration of public-utility holding-company systems may be treated as tax-free exchanges and various adjustments of the basis of property are made. Under Supplement R, as amended by the Revenue Act of 1939,

such transactions must be in conformity with orders of the Securities and Exchange Commission issued before January 1, 1941 (instead of January 1, 1940, the date originally provided), or orders supplementary to such orders. The amendment made by section 118 extends from January 1, 1941, to January 1, 1943, the time during which such an order may be made.

SECTION 119. COMMUNITY INCOME

This section amends the Internal Revenue Code by inserting a new section 29, applicable to taxable years beginning after December 31, 1940, and relating to the taxation of community income.

Subsection (a) provides that, in the case of earned income, the income shall be taxed to the spouse who earned the income. This rule shall apply regardless of the fact that such earnings may be treated as community property under the State law.

Subsection (b) is applicable to income derived from community property. It is provided that such income shall be taxed to the spouse who has the management and control thereof under the law of the jurisdiction in which the marital community exists.

This provision shall not be applicable to income derived from property that is considered the separate property of one of the spouses under the law of the jurisdiction in which the marital community exists, even though such income is considered community property; nor is it applicable to income derived from property which is acquired with funds which constituted income from separate property. The exception is intended to apply to all income derived from property the source of which can be traced to income from separate property, regardless of how many times such income may have been invested or reinvested, i. e., income from separate property A will not be affected by this section even though such income is community property, and if such income is invested in property B the income from such property will also not be subject to this section, nor will any income from property in which such income is in turn invested, etc. In the case of such income, it will continue to be taxed as it was prior to this amendment.

Subsection (c) provides that if spouses elect to file separate returns, only the spouse who is required to treat the income covered by the section as his individual income will be entitled to the deductions and credits allowed under the internal-revenue laws which are properly allocable to such income.

SECTION 120. TAXABLE YEARS TO WHICH AMENDMENTS APPLICABLE

This section corresponds to section 114 of the House bill and makes the amendments relative to individual and corporation income taxes contained in this title, except the amendments made by section 107 (withholding tax at source), section 115 (short-term obligations issued on discount basis), section 116 (information returns with respect to Federal obligations), and section 117 (alimony and separate maintenance payments), applicable only with respect to taxable years beginning after December 31, 1940.

TITLE II—EXCESS-PROFITS TAX

SECTION 201. EXCESS-PROFITS TAX RATES AND CREDITS

Section 201 (a) of the House bill amends section 710 (a) of existing law, relating to the imposition of the excess-profits tax, to provide for increased rates of tax, which are set forth in the table in section 710 (a) (1). These rates begin at 35 percent upon adjusted excess-profits net income of not more than $20,000 and increase upon a graduated scale to 60 percent upon the amount of adjusted excess-profits net income in excess of $500,000. The rates of tax set forth in section 710 (a) (1) represent an increase of 10 percentage points in each rate bracket as compared with the rates under the present law, which run from 25 to 50 percent. Section 201 (a) of the House bill also provides a special tax in certain cases where the invested capital credit is used, amounting to 10 percent of the excess of the adjusted excess-profits net income computed under the income credit over the adjusted excess-profits net income computed under the invested capital credit.

Section 201 (b) of the House bill amends section 714 of existing law by reducing the credit with respect to corporations using the invested capital method in cases where the invested capital exceeds $5,000,000. In such cases, the invested capital credit is reduced from 8 to 7 percent upon so much of the invested capital as exceeds $5,000,000.

In the bill as reported by your committee the increase in excess-profits tax rates and the reduction in the percentage applicable to invested capital in excess of $5,000,000 have been retained, but for reasons set forth elsewhere in this report the special 10-percent tax in certain cases where the invested capital credit is used has been eliminated.

SECTION 202. DEDUCTION OF EXCESS-PROFITS TAX

Except for the elimination of subsection (i), which is no longer necessary in view of section 301 (c) of the bill, providing for an annual declaration of value for capital-stock-tax purposes, this section is the same as section 204 of the House bill. It provides that the income tax imposed by chapter 1 of the Internal Revenue Code and by corresponding provisions of prior revenue acts shall not constitute an adjustment in determining excess-profits net income for current and base period taxable years. Section 23 (c) is amended to provide for the deduction of the excess-profits tax in determining income subject to chapter 1 tax. Furthermore, the taxpayer, if using the income method, has its excess-profits credit increased by the corresponding nondeduction of income taxes in determining its average base period net income.

It is provided that the deduction shall be allowed only in computing the income tax imposed for the taxable year for which the excess-profits tax is levied. By providing that any excess-profits tax paid after the taxable year shall be deemed to have been paid within the taxable year, the same treatment is accorded to taxpayers on the cash basis as is accorded to taxpayers on the accrual basis. It is also provided that the excess-profits tax shall be computed, for the purposes

of this deduction, without reduction by the foreign tax credit, and without regard to the adjustments provided for in section 734.

Since the excess-profits net income for a taxable year is primarily the normal-tax net income with certain adjustments, it is necessary to amend section 711 (a) to require an adjustment to normal-tax net income in the form of a disallowance of the deduction of the excess-profits tax. A further adjustment is added to this section in the form of a provision stating that, for the purpose of computing any deduction or credit which is limited to a certain percentage of the taxpayer's net income—e. g., the deduction for charitable contributions or for percentage depletion—such net income (or, in the case of percentage depletion, such net income from the property) shall be computed without regard to the deduction on account of the excess-profits tax. It is also provided under section 718 (c) (3) with reference to taxpayers on the invested-capital basis, that in determining whether distributions were out of earnings and profits of any excess-profits-tax taxable year, the income tax shall be disregarded in the computation. Finally, in determining the presence and extent of the taxpayer's right to the benefits of section 722, dealing with abnormalities, it is provided that the excess-profits tax shall be disregarded.

Section 602 of the Internal Revenue Code, dealing with the computation of net income for the purposes of the declared value excess-profits tax, is amended to provide that the net income shall be determined without regard to the deduction on account of the excess-profits tax imposed by subchapter E of chapter 2.

It is also provided that, in computing the excess-profits credit carry-over, the excess-profits credit and excess-profits net income for taxable years beginning in 1940 shall be computed as if the amendments made by this bill were applicable.

SECTION 203. NEW CAPITAL

This section is the same as section 205 in the House bill except for certain changes of a technical nature made in subparagraph (A) intended to carry out more completely the provisions of the House bill.

This section amends section 718 (a) of the Internal Revenue Code, defining equity invested capital, by adding a new paragraph designated as (6). The effect of the amendment is to increase by 25 percent the amount includible in equity invested capital on account of new capital. The term "new capital" is defined to mean the aggregate of the amount of money and property paid in for stock or as paid-in surplus, or as a contribution to capital, and the amount of taxable stock dividends made, during a taxable year beginning after December 31, 1940, subject to certain limitations. These limitations are intended, in general, to prevent a taxpayer from treating as new capital amounts resulting from mere adjustments in the existing capital, including borrowed capital, of the taxpayer, or of a controlled group of corporations.

The limitations provided by subparagraphs (A), (B), and (C) bar from the concept of new capital the amount of any equity invested capital acquired in an exchange occurring during a taxable year be-

ginning after December 31, 1940, to which section 112 (b) (3), (4), or (5), or so much of section 112 (c), (d), or (e) as refers to section 112 (b) (3), (4), or (5) is applicable, or would be applicable if the term "control" had been defined in section 112 (h) to mean the ownership of stock possessing more than 50 percent of the total combined voting power of all classes of stock entitled to vote or more than 50 percent of the total value of all classes of stock. In order to take care of exchanges under Supplement R of the Internal Revenue Code, which relates to exchanges and distributions in obedience to orders of the Securities and Exchange Commission, and to which section 112 (b), (3), (4), or (5) is made inapplicable by section 371 (g), that portion of subparagraph (A) of the House bill reading:

There shall not be included money or property paid in by a corporation in an exchange to which section 112 (b) (3), (4), or (5), or so much of section 112 (c), (d), or (e) as refers to section 112 (b) (3), (4), or (5) is applicable—

has been changed to read:

There shall not be included money or property paid in by a corporation in an exchange to which section 112 (b) (3), (4), or (5), or so much of section 112 (c), (d), or (e) as refers to section 112 (b) (3), (4), or (5) is applicable (or would be applicable except for section 371 (g)).

These limitations also bar from the concept of new capital any equity invested capital acquired in a transaction between members of a controlled group of corporations as that term is defined in subparagraph (B).

The limitations provided by subparagraph (D) have the effect of reducing the amount of new capital as of any day by the excess of the amount of inadmissible assets held on that day over the amount of such assets held on the first day of the taxpayer's first taxable year beginning after December 31, 1940. This treatment is comparable to the treatment of excluded assets in the computation of daily capital additions under section 713 (g) of the existing law.

The limitations under subparagraph (E) prevent new capital as of any day from exceeding the amount by which the total equity invested capital and borrowed capital as of such day, computed without including the 25-percent increase, exceeds the sum of the equity invested capital and borrowed capital as of the first day of the taxpayer's first taxable year beginning after December 31, 1940. Any increase in new capital is thus prevented where the amount of borrowed capital is reduced by the same amount as that by which the equity invested capital is increased, and no increase in new capital will result from a distribution by a stock dividend of earnings and profits accumulated prior to the first day of a taxable year beginning after December 31, 1940. Subparagraph (E), however, is so worded that there is no reduction to the extent that the sum of the equity invested capital and borrowed capital as of any day is less than the sum of the equity invested capital and borrowed capital as of the first day of a taxable year beginning after December 31, 1940, due to an operating deficit occurring in any taxable year during the intervening period.

The limitations contained in subparagraphs (A) to (E) may be illustrated by the following examples:

EXAMPLE (1), SUBPARAGRAPH (A)

Corporation A issues stock during a taxable year beginning after December 31, 1940, to corporation B in exchange for the transfer of certain property by corporation B. Immediately after the transfer the stock acquired by corporation B has a value of $10,000, the total value of all classes of stock of corporation A then outstanding amounting to $18,000. Corporation A obtains no new capital, since the property for which the new stock was issued was obtained in an exchange to which section 112 (b) (5) would be applicable if the term "control" had been defined in section 112 (h) so as to include either the ownership of stock possessing more than 50 percent of the total combined voting power of all classes of stock entitled to vote or more than 50 percent of the total value of all classes of stock outstanding.

EXAMPLE (2), SUBPARAGRAPH (B)

Corporation A owns stock in corporation B, and corporation B owns stock in corporation C. Corporation A transfers property to corporation C in exchange for stock of corporation C. Immediately after the transfer the stock owned by corporation A in corporation B possesses more than 50 percent of the total combined voting power of all classes of stock entitled to vote. Also immediately after such transfer the stock owned by corporation B in corporation C has a value equal to more than 50 percent of the total value of all classes of stock of corporation C.

Corporation C obtains no new capital through the acquisition of the property from corporation A in exchange for its stock, since immediately after the transfer corporation A, the transferor, and corporation C, the transferee, are members of the same controlled group.

EXAMPLE (3), SUBPARAGRAPH (C)

Corporation A makes a distribution in taxable stock dividends to corporation B and C during a taxable year, beginning after December 31, 1940. Immediately after the distribution corporations B and C own stock in corporation A which has a voting power of more than 50 percent of the combined voting power of all classes of stock entitled to vote. Also immediately after the transfer corporation B owns stock in corporation C, which has a value of more than 50 percent of the total value of all classes of stock of corporation A. The distribution made by corporation A in the taxable stock dividend does not constitute new capital to corporation A.

EXAMPLE (4), SUBPARAGRAPH (D)

Corporation X makes its excess-profits tax return on the calendar-year basis. On July 1, 1941, cash in the amount of $100,000 is paid in for stock. There are no other changes made in either the amount of equity invested capital or borrowed capital at any time during the year 1941. The adjusted basis of inadmissible assets as of January 1, 1941, amounts to $5,000. The adjusted basis of such assets as of July 2, 1941, is increased to $15,000. The new capital of $100,000 is reduced

to $90,000 as of July 2, 1941, by subparagraph (D), as shown by the following computation:

$100,000, new capital, minus $10,000 ($15,000, amount of inadmissibles as of July 2, 1941, minus $5,000, amount of inadmissibles as of July 1, 1941) =$90,000.

EXAMPLE (5), SUBPARAGRAPH (E)

Corporation Y makes its return on the calendar-year basis. Its equity invested capital as of January 1, 1941, amounts to $30,000, consisting of money paid in for stock, $20,000, and accumulated earnings and profits, $10,000. Its borrowed capital as of January 1, 1941, consists of bonds outstanding amounting to $15,000, making the total of its equity invested capital and borrowed capital as of January 1, 1941, $45,000. The corporation has no inadmissible assets at any time during the year 1941. On January 2, 1941, the corporation makes a distribution in taxable stock dividends amounting to $5,000. On July 1, 1941, money is paid in for stock amounting to $15,000, and on July 2, 1941, bonds are retired in the amount of $10,000.

The new capital of $20,000 acquired during the year 1941 represented by a distribution in a taxable stock dividend amounting to $5,000 and by money paid in for stock amounting to $15,000 is reduced to $5,000 on July 3, 1941, due to the retirement of $10,000 of bonds on July 2, 1941, and the fact that the stock dividend is paid out of earnings accumulated before January 1, 1941, under the application of subparagraph (E), shown as follows:

The sum of the equity invested capital and borrowed capital on July 3, 1941 (computed without regard to the 25-percent increase for new capital), amounts to $50,000. This sum exceeds the total equity invested capital and borrowed capital on January 1, 1941, amounting to $45,000, by $5,000. Under subparagraph (E) the new capital shall not be more than such excess. The new capital is thus reduced from $20,000 to $5,000.

If the accumulated earnings and profits of corporation Y as of January 1, 1942, are reduced to zero due to the stock dividend distribution of $5,000 made on January 2, 1941, and an operating deficit of $5,000 during the taxable year 1941, the new capital includible in equity invested capital as of January 1, 1942, would be $10,000 instead of $5,000 under the application of subparagraph (E), as shown by the following computation:

New capital as of January 1, 1942, before application of subparagraph (E), $20,000, shall not be more than the excess of $50,000 (total capital on January 1, 1942, before adding 25 percent under section 718 (a) (6)) over $45,000 (total capital on January 1, 1941) less $5,000 (amount by which the accumulated earnings and profits as of January 1, 1941, exceed the accumulated earnings and profits (computed without regard to distributions as of January 1, 1942)), or the new capital cannot exceed $50,000 minus ($45,000 minus $5,000), or $10,000.

SECTION 204. TAXABLE YEARS TO WHICH AMENDMENTS APPLICABLE

This is the same as section 207 of the House bill and provides that the amendments relative to the excess-profits tax made by this title are applicable only with respect to taxable years beginning after December 31, 1940.

TITLE III—CAPITAL-STOCK TAX AND DECLARED VALUE EXCESS-PROFITS TAX

SECTION 301. CAPITAL-STOCK TAX

The House bill increased the capital-stock tax from the defense rate of $1.10 per $1,000 to $1.25 per $1,000 of the value of the capital stock as declared by the corporation. This provision is retained in the bill as reported by your committee. In addition, your committee has revised this section to provide for an annual declaration of capital-stock value. Certain technical amendments necessitated by such provision have also been made.

Section 1203 (a) (2) of the Internal Revenue Code is also amended to permit a 90-day extension of time, in lieu of the 60-day extension authorized by existing law, for filing of capital-stock returns for this year. However, if a return has already been filed, the filing of an amended return is not made compulsory, it being provided that the value declaration on a return filed in accordance with the statute shall constitute the declared value for purposes of the statute as amended unless another return is filed within the time prescribed by law, which includes the period of any extension granted by the Commissioner.

SECTION 302. DECLARED VALUE EXCESS-PROFITS TAX—DEFENSE-TAX RATES INCORPORATED IN RATE SCHEDULE

The House bill made permanent the defense-tax rates of the excess-profits tax. The amendment accomplishes the same result by integrating the defense-tax rates with the basic tax.

Other technical amendments are made to accord with the amendments made by section 301 relative to the capital-stock tax.

TITLE IV—ESTATE AND GIFT TAXES

SECTION 401. ESTATE-TAX RATES

This section of the House bill increases the rates applicable to the additional estate tax with respect to decedents dying after the date of enactment of the act and make permanent the defense tax on net estates imposed by section 951. In the bill as reported by your committee these increases have been retained, but the rates have been further increased by reason of the integration of the defense tax and the additional estate tax.

SECTION 402. GIFT-TAX RATES

This section of the House bill increased the rates for computing the gift tax for the calendar year 1942 and each calendar year thereafter. The 75-percent ratio previously existing between the gift-tax rates and the aggregate of the estate tax and additional estate-tax rates was preserved. The House bill also made permanent the defense tax imposed for 5 years by section 1001 (d) of the Internal Revenue Code. In the bill as reported by your committee these increases have been retained, but the rates have been further increased by reason of the integration of the defense-tax and the gift-tax rates.

TITLE V.—EXCISE TAXES

PART I. 1932 EXCISE TAXES MADE PERMANENT

SECTION 501. 1932 EXCISE TAXES MADE PERMANENT

This section repeals section 3452 of the Internal Revenue Code, which now provides that the manufacturers' excise taxes imposed by chapter 29 shall terminate as of July 1, 1945. It thus makes permanent law the provisions imposing such taxes.

SECTION 502. PIPE-LINE TAX

This section strikes out the termination date (July 1, 1945) applicable to the tax on the transportation of oil by pipe line.

SECTION 503. TECHNICAL AMENDMENT

This section revises the title language of subtitle C of the Internal Revenue Code to make it more descriptive of the taxes included within subtitle C.

SECTION 504. BOND TAX

This section makes permanent the tax on the transfer of bonds.

SECTION 505. CONVEYANCE TAX

The two sections strike out the termination date (July 1, 1945) applicable to the bond transfer and conveyance taxes.

PART II. DEFENSE-TAX RATES MADE PERMANENT (NO INCREASE IN TAX AND NO CHANGE OF BASE)

SECTION 521. DEFENSE EXCISE-TAX RATES MADE PERMANENT WHICH ARE NOT INCREASED BY THIS ACT

With respect to the taxes listed hereinafter section 521 incorporates, without change, in the applicable provisions of the Internal Revenue Code the defense-tax rates imposed by the First Revenue Act of 1940 and makes such rates permanent. These tax rates were originally pre-

scribed by the First Revenue Act of 1940 to be effective for the period prior to July 1, 1945. The particular taxes are those with respect to—

- Corporate securities.
- Capital-stock issues.
- Capital-stock transfers.
- Insurance policies.
- Passage tickets.
- Cigarettes.
- Pistols and revolvers.
- Fermented malt liquors.
- Wholesalers of liquors.
- Retailers of liquors.
- Brewers.
- Wholesalers of malt liquors.
- Retailers of malt liquors.
- Rectifiers.
- Stills.
- Firearms, etc.
- Electrical energy.
- Gasoline.
- Lubricating oils.
- Transportation of oil by pipe line.
- Transfer of bonds.
- Conveyances.

Section 521 of the House bill covered also "box seats" and "sales outside box offices," but under the committee amendment these are covered by section 541 (b) and (c) which increases the tax in each case to 15 percent.

Part III. Increases in Rates of Existing Excise Taxes

SECTION 531. PLAYING CARDS

This section increases the rate of tax on the manufacture of playing cards from 11 cents per pack to 13 cents per pack.

SECTION 532. SAFE-DEPOSIT BOXES

This section increases the rate of tax on the rental of safe-deposit boxes from 11 percent of the amount paid to 20 percent.

SECTIONS 533, 534, LIQUOR

Section 533 amends section 2800 (a) (1) of the Internal Revenue Code, which imposes an excise tax upon distilled spirits and imported perfumes containing distilled spirits at the rate of $4 (and on brandy at the rate of $3.75).

The existing rate of tax upon distilled spirits other than brandy, and upon imported perfumes containing distilled spirits, is $3 per proof gallon, and upon brandy $2.75 per proof gallon. These are the defense-tax rates imposed by section 213 of the Revenue Act of 1940, effective July 1, 1940. The rates proposed by the bill, therefore, represent an increase of $1 per proof gallon over the defense-tax rates. The defense-tax rates are 75 cents per proof gallon over and above the rates in effect prior to July 1, 1940.

Subsection (c) of section 533 makes a complementary amendment to section 2887 of the Internal Revenue Code, which provides for the allowance of drawback of internal-revenue tax upon the exportation of distilled spirits in distillers' original packages.

Subsection (d) will amend section 2800 of the Internal Revenue Code by adding a new subsection "(i)" to provide a floor-stocks tax of $1 per proof gallon on all distilled spirits upon which the tax has been paid and which on the effective date of the new rates are held and intended for sale or for use in the manufacture or production of any article intended for sale. This subsection will have the effect of placing all distilled spirits tax-paid at the old rates and held for the purposes specified on an equal tax basis

with other distilled spirits withdrawn and tax-paid at the new rates. It will preclude loss of revenue through the withdrawal and tax payment of large stocks before the new rates become effective. As in prior floor-stocks tax statutes, provision is made for the filing of returns and for deferring payment of the tax upon the submission of satisfactory surety bonds.

This subsection also provides that for the purposes thereof the term "distilled spirits" shall include products produced in such manner that the person producing them is a rectifier within the meaning of section 3254 (g) of the Internal Revenue Code. The object of this provision is to subject to the floor-stocks tax liqueurs, cordials, and similar compounds in the manufacture of which distilled spirits are a constituent.

The existing rates on still wines are as follows: Not more than 14 percent of absolute alcohol, 6 cents per wine gallon; more than 14 percent and not exceeding 21 percent of absolute alcohol, 18 cents per wine gallon; and more than 21 percent and not exceeding 24 percent of absolute alcohol, 30 cents per wine gallon. Section 534 (a) of the bill imposes rates of 8, 24, and 50 cents respectively. The proposed rates represent an increase of 2 cents, 6 cents, and 20 cents per gallon over existing rates.

The existing tax rates on other wines are as follows: Sparkling wines, 3 cents on each one-half pint or fraction thereof; artificially carbonated wines, 1½ cents on each one-half pint or fraction thereof; liqueurs, cordials, and similar compounds, 1½ cents on each one-half pint or fraction thereof. Section 534 (b) of the bill imposes rates of 4 and 2¼ cents respectively. The proposed rates represent an increase of 1 cent on sparkling wines and three-fourths of 1 cent on artificially carbonated wines, and liqueurs, cordials, and similar compounds, over the tax rates on such products.

Subsection (c) of section 534 will amend subchapter F of chapter 26 of the Internal Revenue Code by inserting at the end thereof a new section imposing a floor-stocks tax on all wines on which the tax has been paid and which are held and intended for sale or for use in the manufacture or production of any article intended for sale on the effective date of the new rates. This subsection, like subsection (d) of section 533 in the case of distilled spirits, will have the effect of placing all wines tax-paid at the old rates and held for the purposes specified on a basis of equality, insofar as taxation is concerned, with other wines withdrawn and tax-paid at the new rates.

Your committee made the following changes: The differential in favor of brandy was eliminated, and brandy made subject to the same $4 rate as other distilled spirits. The rates on still wines of 8 cents, 24 cents, and 50 cents have been changed to 10 cents, 35 cents, and 65 cents, respectively. The rate of 4 cents on sparkling wines has been changed to 7 cents and the rate of 2¼ cents on artificially carbonated wines and on liqueurs, cordials, and similar compounds has been changed to 3½ cents.

SECTION 535. TIRES AND TUBES

This section increases the rate of the manufacturers' excise tax (defense tax rates) on tires from 2½ cents per pound to 5 cents per pound and the rate of tax on inner tubes from 4½ cents per pound to

9 cents. It imposes a floor-stocks tax on tires and inner tubes held for sale by any person other than the manufacturer, producer, or importer on the date the increased manufacturers' excise tax rates take effect. The floor-stocks tax rates are in an amount equal to the increase in the rates of the manufacturers' tax. The floor-stocks tax is restricted in its scope to tires and inner tubes for automobiles, trucks, trailers, motorcycles, etc., and will not be applicable to such miscellaneous items as bicycle tires, baby-buggy tires, etc. The tax is specifically made applicable to tires and tubes held by automobile manufacturers as, or for, equipment on new automobiles. It is not made applicable to tires and tubes actually on automobiles held by new and second-hand car dealers but is applicable to the stocks of unmounted tires and tubes held by such dealers and by any person, including retailers, for sale. The floor-stocks tax does not apply to any tires and tubes held by a person who must pay the increased manufacturers' excise-tax rate on such articles when he sells them.

SECTION 536. EFFECTIVE DATE OF PART III

This section applies to sections 531 to 535, inclusive, and provides, in brief, that the increased tax rates and new taxes imposed by such sections shall take effect on the first day of the first month which begins more than 10 days after the date of the enactment of the bill.

PART IV. CHANGES IN BASIS OF COMPUTING TAX (RATES INCREASED IN CERTAIN CASES)

SECTION 541. ADMISSIONS TAX

The House bill subjected to tax, admissions of 10 cents or more at the rate of 1 cent for each 10 cents or fraction thereof. Under existing law the admissions tax applies only to admissions of 21 cents or more.

Under the committee amendment the tax applies to all amounts paid for admission. In addition to the consideration of the increased revenue resulting from elimination of the exemption, which was strongly urged on the committee, many operators of amusement enterprises would prefer that there be no exemption of amounts less than 10 cents, as this exemption would encourage certain forms of avoidance, such as reducing a 10-cent admission charge to 9 cents.

The committee bill imposes a schedule of rates as follows: A 10-cent admission is taxable at 1 cent, a 15-cent admission at 2 cents, a 20-cent admission at 3 cents, etc. Admissions of more than 50 cents are to be subject to a tax of 15 percent of the amount charged. Fractions of ½ cent or more are to be increased to 1 cent and smaller fractions disregarded. The rates of tax upon sales outside the box office and upon the permanent use or lease of boxes and seats are increased from 10 to 15 percent.

Under the bill as it passed the House, the special treatment under the admissions tax with respect to so-called free or reduced rate admissions now applicable to employees, municipal officers, and children under 12 years of age, is extended to include members of the military or naval forces of the United States and of the Civilian Conservation Corps when in uniform. For example: If the estab-

lished price is 50 cents and a soldier in uniform is charged only 20 cents, the tax basis is 20 cents and not 50 cents. If he is admitted free no tax is payable.

In the case of reduced rates of admission of children under 12 years of age, the present law provides that the tax shall be computed on the amount actually charged such children and not on the regular charge for adults. Your committee recommends that the age limit of 12 years be changed to 18 years.

The bill, as it passed the House, provided that section 1701 of the Internal Revenue Code which allows a number of exemptions from the admissions tax shall not be applicable after the effective date of part III of the bill. The amendment continues the exemptions allowed by sections 1701 (b) and (c) which the committee regards as appropriate. Section 1701 (b) relates to admissions to agricultural fairs, and section 1701 (c) relates to admissions to certain concerts conducted by civic or community membership associations.

SECTION 542. CABARET, ROOF GARDEN, ETC., TAX

This section revises the base of the present "cabaret" tax. It imposes a tax of 5 percent on amounts paid for admission, refreshment, service, and merchandise at any roof garden, cabaret, or other similar place furnishing a public performance for profit. Liability for the tax is imposed on the proprietor. The tax applies to all amounts paid. Under present law the tax is imposed on the patron under a rather complicated rate of 2 cents (including the defense tax) for each 10 cents of 20 percent of the amount paid if 20 percent of the amount paid exceeds 50 cents.

This section also makes certain amendments to administrative provisions of the code applicable to the "cabaret" tax and other admission taxes.

The committee made no change in this section. It was urged before the committee that shifting of liability for the tax from the patron to the proprietor would make it unlawful for the proprietor to add the amount of the tax to the patron's bill. This contention is mistaken. The amendment merely shifts the legal incidence of the tax from the patron to the proprietor and makes the proprietor primarily liable for the payment of the tax to the Government. There is nothing in the section which would prevent the taxpayer, the proprietor, from shifting the tax burden to his customer.

By section 550 of the bill the cabaret tax imposed by section 542 is made applicable to the period beginning 10 a. m. on the effective date of part IV of the bill. The time 10 a. m. means the standard time for the time belt.

SECTION 543. CLUB DUES

This section reduces the amount used as a test for determining liability to the tax on club dues from $25 annual dues of an active resident annual member to $10, and redefines the term "dues" specifically to include certain privilege fees and assessments.

This section also makes permanent the defense-tax rates applicable to dues and initiation fees, as imposed by the first Revenue Act of 1940.

The committee made no change in this section. It believes the redefinition of the term "dues" to be very helpful in avoiding litigation. Under existing law a number of privilege fees and assessments are subject to tax as club "dues". Some taxpayers have alleged either that there is an ambiguity in the present law or that it cannot be construed to cover certain types of fees. It is, therefore, desirable, in order to avoid litigation, to define in very direct terms what is intended to be covered by the term "dues."

SECTION 544. AUTOMOBILE, TRUCK, BUS, AND PARTS TAX

This section increases the rates of tax on automobile truck chassis, truck bodies, etc., from 2½ percent to 5 percent and brings trailers and semitrailers for trucks within the scope of the tax. Passenger busses which under present law are subject to the higher rate of tax applicable to passenger automobiles have been included within the "truck" classification, and will be subject to the new 5-percent rate.

The rate of tax on passenger automobile chassis and bodies, motorcycles, etc., is increased from 3½ percent to 7 percent. Trailers and semitrailers for such vehicles are made subject to the tax. Subsection (b) of section 544 increases the rate of tax on automobile parts and accessories from 2½ percent to 5 percent. It excludes automobile radios which have heretofore been subject to tax as automobile "parts or accessories." Automobile radios are by section 545 made subject to the manufacturers' tax on radio sets and parts at the rate of 10 percent.

Subsection (c) of section 544 increases the rates of credit allowable under this section to automobile manufacturers with respect to the tires and inner tubes on such vehicles from 2½ to 5 percent in the case of trucks, busses, etc., and 3½ to 7 percent in the case of other automobiles and motorcycles.

Subsection (d) repeals section 3403 (f) of the Internal Revenue Code which would allow a tax adjustment with respect to floor stocks of passenger automobiles, trucks, etc., held by dealers as of the termination date of the present tax on such vehicles. This is done because the termination date of such tax has been deleted and the tax made of a permanent nature. Section 3403 (f), therefore, becomes unnecessary.

It was urged that this section be amended to specify that repaired, reconditioned, and rebuilt automobile parts and accessories are not subject to the "parts and accessories" tax. Your committee examined the problem very carefully. Repaired and reconditioned parts are not now subject to tax. There are several decisions of the United States circuit courts of appeals holding rebuilt parts and accessories to be subject to the manufacturers' tax. Rebuilt parts compete with new parts, and it appears appropriate that they should be subject to the same tax. Accordingly, no change has been made.

SECTION 545. RADIOS, PHONOGRAPHS, RECORDS, AND MUSICAL INSTRUMENTS

Section 3404 of the Internal Revenue Code now imposes a tax on sales by the manufacturer of certain radio components at the rate of 5½ percent of the sale price. Section 545 amends section 3404 of the code so as to impose a tax at the rate of 10 percent on—

Radio receiving sets.
Automobile radio receiving sets.
Combination radio and phonograph sets.
Phonographs.
Certain principal components of these articles.
Phonograph records.
Musical instruments.

The articles listed have been included within the same section of the code because largely related.

SECTION 546. REFRIGERATORS, AIR CONDITIONERS

Section 3405 of the Internal Revenue Code imposes a tax on sales by the manufacturer of household-type mechanical refrigerators and certain principal components of such articles at the rate of 5½ percent of the sales price. Section 546 amends section 3405 of the code to increase the tax rate to 10 percent and to make the tax applicable to the principal commercial types of refrigerators, including such articles as ice-cream cabinets, food and beverage display cases, water coolers, milk-cooler cabinets, and similar articles. In addition, there are brought within the scope of the tax components of refrigerating apparatus such as compressors, condensers, evaporators, expansion units, absorbers, and controls. However, the tax with respect to such components is not limited to components for the household, commercial, and industrial type of refrigerator units referred to above. Refrigerating components will be subject to tax regardless of their intended use. For example, components for refrigerator ships and refrigerator cars, and for the refrigerating plants of breweries and cold-storage warehouses will be subject to the tax.

Section 546 also imposes a tax at the rate of 10 percent on the sale by the manufacturer of self-contained air-conditioning units and certain principal components of such articles.

SECTION 547. MATCHES

Section 3409 of the Internal Revenue Code now imposes a tax at the rate of 5½ cents per thousand on certain fancy wooden matches. Section 547 amends section 3409 of the code to also impose a tax at 2 cents per thousand on other types of matches. The types of matches subject to the new tax at 2 cents per thousand include the well-known types of wooden and paper matches now in every-day use.

SECTION 548. TELEPHONE, TELEGRAPH, ETC.

Section 548 as it passed the House would impose on telephone conversations, telegraph, cable, and radio dispatches, messages and conversations, for which the charge is more than 24 cents, a tax at the rate of 5 cents for each 50 cents or fraction thereof of the charge. Under existing law, the tax on telephone toll service does not apply

to charges of less than 50 cents. Telegraph dispatches and messages are now subject to tax at the rate of 5 percent of the amount charged, and cable and radio dispatches and messages at the rate of 10 cents per message.

The committee amendment continues the distinction made by the existing law between telephone service and telegraph service and makes the new rates fixed by the House bill applicable only to telephone or radio-telephone messages or conversations. Telegraph, cable, and radio messages, and dispatches are made subject to tax at 10 percent of the amount charged. The 10-percent rate is double the rate provided by existing law. Your committee felt that the tax rates fixed by the House bill would place telegraph, cable, and radio service at a competitive disadvantage.

This section also amends section 3465 (b), which imposes a tax with respect to leased wires and talking-circuit special service, to more clearly specify the types of service subject to tax, to impose the tax where the service is rendered within a local exchange area and to also tax like service furnished by companies other than telegraph and telephone companies. The present tax is restricted to service furnished by a telegraph or telephone company.

The bill as it passed the House continues the present 5-percent rate. The amendment increases the rate to 10 percent in the case of leased-wire service, teletypewriter service, and talking-circuit special service (which competes with telegraph service subject to tax under the amendment at 10 percent). Other wire and equipment service is in a somewhat different category, and as to it no change in the 5-percent rate provided by the House bill is recommended. Burglar- and fire-alarm service is not taxed under the amendment. Similarly, news-ticker service carrying general news has been exempted from the tax to be consistent with the like exemptions allowed in the case of newspapers with respect to the leased-wire tax.

This section also imposes a tax on amounts paid by subscribers for local telephone service and all other telephone service not otherwise within the tax with respect to telephone toll charges and the tax with respect to leased wires. For example, in addition to local subscribers' service, this tax also applies to telephone toll service where the charge is 24 cents or less. As the tax is imposed only on telephone service, special provision is made to insure that charges for installation of instruments, poles, switchboards, apparatus, and equipment are not subject to the tax. Although service through coin-operated telephones is not subject to the tax on local subscribers' service, it is subject to tax in the case of toll charges of more than 24 cents. Coin-operated telephone service cannot be subject to the tax because of the impracticability of charging the patron a percentage of 5 cents, and collecting the 5-percent tax through the instrument. As the tax on telephone toll service is collected in multiples of 5 cents, it can be collected through coin-operated telephones.

The committee bill increases the rate to 10 percent. No other change is made.

SECTION 549. INSTALLMENT, ETC., PAYMENTS

Section 549 makes certain changes in section 3441 (c) of the Internal Revenue Code which relates to articles leased or sold under installment or conditional sales contracts. Under section 3441 (c) the

taxpayer is permitted to pay the tax as payments are made under the lease or conditional or installment sales contract. The provisions of section 1650 (b) of the Internal Revenue Code are revised and included within section 3441 (c).

Under the bill as it passed the House, payments under leases and installment and conditional sales contracts, and existing sales entered into after June 30, 1941, would be subject to tax. If an existing tax rate were increased, payments after the effective date of the increase would be subject to the increased rate of tax. If a new tax were imposed, payments after its effective date would be subject to the new tax. Your committee is opposed to making such increased rates of tax retroactive to the extent that they would cover sales and leases made during the interim period prior to the inception of the tax. Accordingly, the section has been amended so that where the particular type of contract has been entered into before the effective date of part IV of the bill, and delivery made before such date, the increased tax rate, or the new tax, as the case may be, shall not apply.

SECTION 550. EFFECTIVE DATE OF PART IV

Section 550 contains provisions respecting the effective date of new taxes, or increases in existing rates of tax, or changes in tax base, effected by sections 541 to 548. With certain exceptions, the provisions are the same as those described in the discussion of section 536, i. e., the first day of the first month which begins more than 10 days after the date of the enactment of the bill. The changes with respect to the "cabaret" tax become effective at 10 a. m. on the effective date, for considerations peculiar to that tax. Special provision is made for the effective date of the tax imposed by section 548, with respect to local subscribers' telephone service, in order to give telephone companies (who will collect the tax for the Government) an opportunity to adjust their billing practices to the tax. It was also desired to restrict the application of the tax, as far as is reasonably practicable, to service rendered after the date of the enactment of the act. It is recognized, however, that some local service rendered prior to the date the act is enacted (but billed after such date) will be subject to the tax. It is intended to tax such service.

PART V. NEW EXCISE TAXES

SECTION 551. NEW MANUFACTURERS' EXCISE TAX

As passed by the House this section imposes taxes on sales by the manufacturer, producer, or importer, of the articles listed hereinafter at the rate given:

	Percent		Percent
Sporting goods	10	Business and store machines	10
Luggage	10	Rubber products	10
Electrical appliances	10	Washing machines	10
Photographic apparatus	10	Optical equipment	10
Electric signs	10		

In the case of sporting goods, luggage, electrical appliances, photographic apparatus, business and store machines, and optical equipment, the particular articles the sale of which is subject to tax are

named. Uniforms and sport clothing are not within the scope of the tax on sporting goods.

In the case of electric signs, the tax applies to articles falling within the general classifications of neon-tube signs, electric signs, and electric advertising devices.

It is recognized that a number of articles falling within the scope of the excise taxes listed herein may also fall within the scope of the jewelry retail sales tax imposed by section 552. Provision is accordingly made that such articles will be subject to the jewelry retail sales tax and not to the manufacturers' excise taxes imposed by this section.

Your committee has made the following changes:

Sporting goods.—Artificial lures, baits, and flies have been removed from the scope of the sporting-goods tax.

Electrical appliances.—The scope of this tax has been expanded by the inclusion of gas and oil water heaters and gas and oil stoves and cooking apparatus. Such added articles are directly competitive with the electrical articles taxed by this section as it passed the House.

Photographic apparatus.—Unexposed motion-picture film for use in making news reels is exempted from the tax by a provision included in section 553, which provides for appropriate credit or refund to the manufacturer.

Business and store machines.—A clerical change has been made in the provision with respect to these machines. In this section as it passed the House certain machines were included by trade names. The trade names have been deleted, and the particular machines included by appropriate description. Included in the list of business machines are fare registers and fare boxes. Fare registers and fare boxes for use on streetcars, busses, and other vehicles are taxable under this section and not as automobile accessories.

Washing machines.—As passed by the House this section taxed only washing machines of the kind used in commercial laundries. As many other household appliances are subject to tax under the bill, this section was changed to bring within the scope of the tax all washing machines, domestic as well as commercial.

Electric-light bulbs.—Under the committee bill, a 10 percent tax on the sale of electric-light bulbs by the manufacturer, producer, or importer is imposed. This proposed tax has been included as paragraph 10 of new section 3406 to be added to the Internal Revenue Code.

SECTION 552. NEW RETAILERS' EXCISE TAXES

This section adds a new chapter 19 imposing new taxes on retail sales of jewelry, furs, and toilet preparations each at the rate of 10 percent of the price for which the article is sold. The articles falling within the jewelry tax (including clocks, watches, cases, and movements) are articles which have in former jewelry excise taxes been classified as jewelry. There are added flat ware and hollow ware made of gold or silver, or plated. The tax will not apply to religious articles, surgical instruments, or frames or mountings for eyeglasses.

The fur tax is to be imposed on the sale of articles made of fur on the hide or pelt and articles of which such fur is the component

material of chief value. This is a classification which has been used in earlier manufacturers' excise taxes with respect to furs.

A tax on the sale at retail of toilet preparations is imposed in place of the existing tax on sales by the manufacturer (imposed by sec. 3401 of the Internal Revenue Code). Provision is made that beauty parlors and barber shops shall make monthly returns of toilet preparations used in the treatment of patrons and the quantity used during the month shall be considered to have been sold at retail by such establishments.

Section 552 contains, or makes applicable, the administrative provisions necessary to the administration of these retail sales taxes.

This section also provides that the present tax on sales of toilet preparations by the manufacturer (imposed by sec. 3401 of the Internal Revenue Code) shall not apply to articles sold after the effective date of the retail sales tax. Manufacturer's tax previously paid with respect to articles which will also be subject to the retail sales tax will not be refunded.

Your committee made a number of changes with respect to the retail sales taxes.

Fountain pens are excluded from the jewelry tax if the only part thereof which consists of precious metals is the point.

Relative to the tax on toilet preparations, section 552 adds section 2407 (c) to the Internal Revenue Code to permit a barber shop or beauty parlor to take credit for any retail-sales tax imposed by the bill which has already been paid on toilet preparations as to which the barber shop or beauty parlor is subject to tax.

A provision has also been added specifying certain rules for determining the price base on which the tax is to be computed. This provision is similar to that which has been in effect for many years in the case of the manufacturers' excise taxes. Particularly important is the provision that the amount of the retail-sales tax imposed by the bill shall be excluded in determining the price base for tax purposes. Similarly State sales taxes may be excluded provided they are stated by the retailer as a separate charge. If States sales taxes are not separately stated, but are included in the gross selling price, the tax is computed on the gross selling price. The Federal tax is to be excluded whether or not stated as a separate charge.

In the case of leases, conditional sales, and installment contracts, substantially the same treatment is given with respect to the retail sales taxes as is given with respect to the manufacturers' sales taxes, as more fully explained in the discussion of section 549. That is to say, the language of the section as it passed the House has been changed so that where the particular contract was made, delivery was made, and a part of the consideration was paid, before the effective date of the retail-sales taxes, no tax is imposed.

With a view to preventing the retail-sales tax from being used as a means of securing unfair competitive advantages a penalty provision has been included imposing a fine of not more than $1,000 on any person who in connection with the sale of an article represents that the price does not include the retail-sales tax imposed by the bill.

SECTION 553. ADMINISTRATIVE CHANGES IN MANUFACTURERS' EXCISE TITLE OF CODE

This section, added by the committee amendment, contains several administrative provisions believed important in the effective administration of the excise taxes imposed by the bill.

Leases.—A number of the articles subject to manufacturers' sales tax by the bill are articles which are generally leased by the manufacturer and not sold. Section 3440 of the code already defines the term "sale" to include a lease. In clarification of existing language, this section is amended to provide specially that a lease, including a renewal or extension of a lease, or a subsequent lease, of an article shall be considered a taxable sale.

Existing contracts.—This section also adds an existing-contracts section to the Internal Revenue Code. This section is quite similar to the existing-contracts section included in the Revenue Act of 1932 when the last large bloc of manufacturers' sales taxes was imposed. Your committee believes that provision should be made permitting tax liability to be shifted from the manufacturer to the vendee in the case of sales contracts entered into before the effective date of the particular sales tax or increased rate of tax, but consummated after that date, where the contract does not permit the inclusion of the tax in the sales price. This affords relief to those cases where manufacturers have not been able to protect themselves by inserting a tax clause in their sales contracts to provide that taxes, such as those included in the bill, would be passed on to their vendees. The clause in question is, in language, quite close to the text of section 625 of the Revenue Act of 1932, which now appears as section 3447 of the Internal Revenue Code.

Section 553 also includes the refund and credit provisions with respect to news-reel and motion-picture film referred to in the discussion of section 551.

SECTION 554. TRANSPORTATION OF PERSONS, ETC.

This section imposes a tax on the amount paid within the United States for the transportation of persons by rail, motor vehicle, water, or air, within or without the United States. The rate is 5 percent of the amount paid and tax liability is imposed on the person making the payment. Where the amount paid is less than 35 cents the tax does not apply. Round-trip tickets are not subject to tax if the amount payable for a one-way trip is less than 35 cents. In the case of commutation or season tickets the tax does not apply if the particular trips the holder of the commutation or season ticket is entitled to make under the ticket are less than 30 miles. For example, a commutation ticket entitling a person to transportation for a certain number of trips between two points is not subject to tax if the distance between the two points is less than 30 miles. These provisions will exempt local streetcar, bus, and taxi service, including amounts paid for tokens and passes. Amounts paid for commutation tickets for 1 month or less are also exempt from tax.

This section also imposes a tax on amounts paid for seating or sleeping accommodations in connection with taxable transportation.

Provision is made that the time for filing returns may be extended for as much as 90 days in order that carriers may have the necessary time to assemble, from widely scattered points, necessary data for making returns. Provision is also made that the tax shall not apply to transportation facilities furnished the United States, to any State or Territory or political subdivision thereof, or the District of Columbia.

Section 554 (c) provides that the stamp tax on steamship passage tickets imposed by section 3469 of the Internal Revenue Code shall not apply to any tickets the purchase of which is subject to tax under the new transportation tax.

One change has been made in the section as it passed the House. Provision has been made to exempt from the tax, with certain qualifications, amounts paid for transportation of personnel of the Army, Navy, Marine Corps, and Coast Guard, when in uniform and while on leave, and authorized cadets and midshipmen.

SECTION 555. COIN-OPERATED AMUSEMENT AND GAMING DEVICES

This section imposes an occupational tax of $25 per annum per machine on each person who maintains for use, or permits the use of, on premises occupied by him, a coin-operated amusement or gaming device. "Coin-operated amusement or gaming devices" are, briefly, machines which fall within the general classification colloquially referred to as "pinball" machines and "slot machines." A separate liability is incurred with respect to each machine, but if one such machine is replaced by another, such other machine will not be considered an additional machine.

By committee amendment the rate of tax on so-called pinball machines is reduced from $25 to $10 per annum and the rate of tax on so-called slot machines is increased from $25 per annum to $200 per annum.

SECTION 556. BOWLING ALLEYS, ETC.

This section imposes an occupational tax on persons operating bowling alleys, billiardrooms, or poolrooms. The rate of tax is $15 per annum for each bowling alley, billiard table, or pool table. All types of estabishments maintaining such equipment, including clubs or social organizations, etc., are subject to the tax. Maintaining such equipment in a private home is not subject to tax.

As in the case of other occupational taxes, the tax year begins July 1 of each year.

However, if after payment of tax and prior to the end of the tax year, additional bowling alleys, or billiard or pool tables, are placed in operation, a supplemental return must be filed and tax paid with respect to the additional equipment for the period beginning with the day of the month in which operation of the additional equipment commenced.

By committee amendment the rate is changed from $15 per annum to $10 per annum.

SECTION 557. USE OF MOTOR VEHICLES AND BOATS

This section imposes a tax on the use of motor vehicles and boats. In the case of motor vehicles the tax is $5 per annum. In the case of boats the rate of tax ranges from $5 per annum on boats having an over-all length of 16 feet or over but not over 28 feet to $200 per annum on boats over 200 feet in over-all length. In the case of motor vehicles the tax is to be paid by the person in whose name the motor vehicle is, or is required to be, registered. In the case of boats, the tax is to be paid by the owner of the boat. The effective date of the tax is February 1, 1942; that is, the use of motor vehicles and boats before that date is not subject to tax.

Section 3540 (b) (3) of the House bill defines the term "boat" but excludes from the definition boats used "exclusively" for trade or commercial fishing. The committee bill changes "exclusively" to "chiefly." The committee bill also exempts from the tax boats used by the Sea Scouts Department of the Boy Scouts of America chiefly for training scouts in seamanship.

SECTION 558. EFFECTIVE DATE OF PART V

This section provides that the new taxes imposed by sections 551 to 558 will take effect on the first day of the first month which begins more than 10 days after the date of the enactment of the act.

SECTION 561. PAYMENT OF PROCESSING TAX TO GUAM AND AMERICAN SAMOA

This section was added by committee amendment. It provides that the taxes collected with respect to the processing of coconut oil originating in Guam or American Samoa shall be held as separate funds and paid to the treasuries of these possessions. A condition is imposed that such funds shall not be used to subsidize producers of cocoa, coconut oil, and allied products in such possessions.

SECTION 602. SENATE LEGISLATIVE COUNSEL

Section 602 amends section 1303 of the Revenue Act of 1918 so as to provide that certain matters relating to the office of the legislative counsel of the Senate should be under the direction of the President pro tempore of the Senate.

TITLE VII—CREDIT AGAINST FEDERAL UNEMPLOYMENT TAXES

SECTION 701. CREDIT AGAINST FEDERAL UNEMPLOYMENT TAXES

This section, added by your committee to the House bill, allows further time within which a taxpayer may pay contributions into an unemployment fund under a State law and obtain credit therefor against the Federal unemployment tax for 1936, 1937, 1938, 1939, or 1940.

In each of the past 3 years a similar provision of law has been enacted. However, since this tax has been in effect for more than 5 years, a period in which taxpayers have had ample opportunity to familiarize themselves with the time limitation provided in the per-

manent law and to take advantage of prior relief legislation, your committee states that this relief legislation should be the last of its kind to be enacted.

Under subsection (a), paragraph (1), credit is allowable against the tax for 1936, 1937, or 1938, imposed by title IX of the Social Security Act, for contributions paid before the sixtieth day after the date of enactment of this act, if credit is claimed before the expiration of 6 months after such date of enactment. If the contributions are paid on or after December 7, 1940 (the sixtieth day after the date of enactment of the Second Revenue Act of 1940, containing similar relief provisions in section 701 thereof), the credit on account of such contributions is limited to 90 percent of the amount which would have been allowable if they had been paid before the due date of the Federal return. Paragraphs (2) and (3) provide in certain special cases for the allowance of credit, which is not subject to the foregoing limitations. These paragraphs continue without curtailment the relief heretofore granted in these cases by section 902 (a) (2) and (3) of the Social Security Act Amendments of 1939 and section 701 (a) (2) and (3) of the Second Revenue Act of 1940.

Subsection (b) provides similar relief in the case of the tax for 1939 or 1940 imposed by the Federal Unemployment Tax Act (subchapter C, chapter 9, Internal Revenue Code).

Subsection (c) provides for refunds, credits, and abatements, without interest, based on the credit allowable under subsections (a) and (b). It also provides that on and after the date of enactment of this act no refund, credit, or abatement shall be allowed which is based on any credit allowable under certain prior relief legislation, that is, section 810 of the Revenue Act of 1938, section 902 (a) of the Social Security Act amendments of 1939, and section 701 of the Second Revenue Act of 1940. This section does not affect any credit for contributions paid which is allowable solely by reason of the provisions of section 902 of the Social Security Act or section 1601 of the Federal Unemployment Tax Act.

Calendar No. 703

77TH CONGRESS } SENATE { REPT. 673
1st Session } { Part 2

THE REVENUE BILL OF 1941

SEPTEMBER 2, 1941.—Ordered to be printed

Mr. CONNALLY, from the Committee on Finance, submitted the following

INDIVIDUAL VIEWS

[To accompany H. R. 5417]

As the only community-property-State Senator on the Finance Committee I desire to express my vigorous dissent from the committee amendment directed at the community-property system of eight sovereign States and to the manner in which this amendment was adopted without notice or hearing to those whose constitutions and laws governing property ownership are to be set aside or ignored.

This amendment proposes to treat the ownership of the wife in the community property and income as having been devised as a sham and a fraud for Federal income-tax purposes. Yet my own State of Texas came into the Union in 1845 bringing with it the community-property system in effect during its days as an independent republic. The original State constitution and the present one, adopted in 1876, recognized the community-property system and the courts of Texas have enforced and developed the rights of the wife in community property as strongly as those rights in her separate property.

In Louisiana, Arizona, New Mexico, Idaho, Nevada, and Washington, likewise, the community-property system is of equal historical and statutory dignity, and the wife's ownership of community-property income so firmly imbedded that the Treasury, the Attorney General of the United States, and the Supreme Court itself have consistently recognized that the one-half of the community income is that of the wife. To these was added the State of California when its legislature removed a temporary aberration that was engrafted on the community-property system which denied in some important particulars the full rights of the wife.

To treat the rights of the wife under the constitutions and statutes of eight great States as nonexistent flies into the very face of the heretofore well-recognized principle that the States control the ownership of property and income. To condone at the same time the continued reduction and avoidance of surtaxes by divisions and gifts of

property between husbands and wives in common-law States, which as the Secretary of the Treasury pointed out are made expressly for tax purposes, is indeed to add insult to injury. Constitutional and statutory rules of the eight community-property States are to be flouted; the income of the wife is to be "deemed" and "considered" to be that of the husband, but the deliberate transfer of income-producing property in the common-law States is not to be disturbed. The Finance Committee asks the Senate in this amendment to disregard the fundamental law of eight States of the Union, and, at the same time, recognize the local law of all of the other States of the Union as a guide and basis for the application of the Federal income-tax law.

Instead of penalizing the community-property system, as this amendment proposes, the Congress should encourage its spread. By its recognition of the contribution of the wife to the marital partnership earnings, the community-property system is far in advance of any common-law State. Services are recognized to be rendered by the marital community, and income as earned by husband and wife alike. Legal and practical standing is given to the concept of marital partnership which in common-law States remains spiritual only. Recognition is given to the fact that the wife is entitled to something more than food, clothing, and a place to sleep, and it ought to be the law everywhere. If there is any discrimination, that is the way it should be corrected.

The committee amendment attempts to force the husband to report as his own all of the community partnership income, when as a matter of law and fact the husband owns only one-half, and is merely the managing partner of his wife's half. This amendment ignores the fundamental laws of these States by treating as a nullity what is in substance a partnership created by law, while the bill recognizes fully the interests of every partner in purely voluntary partnerships in every common-law State.

Under the community-property system marriage creates a universal partnership. To its capital the husband and wife contribute their separate property and to it they must contribute their full services, and divide the resulting income share and share alike. Whether the husband or the wife is the managing partner, as each may be as to certain classes of property income, is unimportant as long as a real partnership exists. It is terminated by divorce in which event the community property is equally divided, regardless of guilt, or by death in which the deceased husband or wife has full disposition of his half of the community property. If necessary to protect the rights of the wife against fraud or dissipation, receivership and separations of property can be ordered by the courts without divorce. The courts require the use of the property for the benefit of both partners and will restrain its waste or diversion to others.

The community partnership is also terminated if the husband and wife move their domicile to a common-law State; yet under the proposed amendment, since the new State will recognize that the husband and wife each own an undivided one-half interest in the accumulated community property, the income from it can be divided if the spouses move from Louisiana to New York, but must all be reported by the husband if they remain in Louisiana. Surely the

wife's ownership is just as real in one case as the other. Indeed, it would not exist to be recognized by New York laws except for its accumulation under the beneficent laws of a community-property State. If the proposed amendment is adopted, we will have the unfair and illogical situation of Congress recognizing for income-tax purposes the law of common-law States which recognize and enforce the law of the eight community partnership States, but when dealing directly with the citizens of community partnership States the local community partnership law will be ignored and disregarded.

In effect the amendment proposes to tax the one-half of the community income belonging to the wife to the husband, by providing that it shall be "deemed" or "considered" to be that of the spouse who receives it or who has management and control of it.

This proposal to single out the citizens of community-property States to compel them alone to pay tax on income belonging to their spouses is certainly violative of due process under the fifth amendment to the Constitution.

The Supreme Court of the United States in a series of carefully prepared and presented cases held that one-half of the community income belonged to the husband and one-half to the wife, that it was actually owned by them in these proportions, and therefore taxable to them in such proportions (*Poe* v. *Seaborn*, 282 U. S. 101; *Hopkins* v. *Bacon*, 282 U. S. 122; *Bender* v. *Pfaff*, 282 U. S. 127; *Goodell* v. *Koch*, 282 U. S. 118). The sixteenth amendment gives Congress authority to tax income—but it does not give it authority to tax the income belonging to one person to another. Those incidents of ownership, legal and beneficial, established by State law have always been recognized as governing by the Federal courts and by Congress. The very incidents, legal and beneficial, of ownership by husband and wife in community income which the Supreme Court held made one-half of it taxable to the husband and one-half to the wife are also governing as to the power of Congress to tax one spouse with the income of the other.

The Supreme Court held unconstitutional an attempt of a State to tax the husband upon income belonging to his wife in *Hoeper* v. *Tax Commission* (284 U. S. 206), on the ground that it violated the due-process clause of the fourteenth amendment. The same due-process clause is equally applicable to such action by Congress under the due-process clause of the fifth amendment (*Heiner* v. *Donnan*, 285 U. S. 312).

The present action is more directly contrary to the holding in the *Hoeper case* than the universal mandatory joint return proposal for there can be no question of creating a family classification in eight States of the Union, nor is there a question of measuring the tax by a combined income. The proposal is to tax one person on income which the Supreme Court has held legally and beneficially belonged to another. This proposed action falls under the direct condemnation of the *Hoeper case* even as the joint committee counsel interprets it.

On August 4, in considering this same bill, the House rejected decisively a proposal to disregard individual ownership and property rights of husbands and wives in all States by requiring mandatory joint income tax returns. Yet this committee in executive session has adopted an amendment to the tax bill which in substance and practical effect is a mandatory joint returns requirement applicable only

to eight States. Moreover, although several governors of community-property States and many Senators vigorously protested the hasty action of the committee and repeatedly asked for an opportunity for their representatives to be heard, these requests were ignored by the committee. No opportunity whatever was given to the representatives of the eight community-property States to explain the legal and practical meaning of their local laws demonstrating the fairness and equity of separate returns and the gross discrimination that would result from the proposed amendment.

This last-minute action was ill-considered and hasty in view of the fact that it was taken without hearing the facts and law involved, and that substantially the same amendment had been rejected three times in previous years (1921, 1924, and 1934) after full hearings held by the Ways and Means Committee during which an opportunity had been given to representatives of the community-property States to explain the fairness of separate returns under the local community partnership laws, and the unjust discrimination which would result from the proposed legislation.

The proponents of this discriminatory community-property amendment evidently hope that this will be an entering wedge and a step toward reviving and adopting the recently defeated universal mandatory joint returns proposal at a later date. They expect that later on they will have greater support in their attempt to impose this inequitable proposal on the other States by reviving the discredited and House-rejected universal mandatory joint returns amendment.

It should be noted that the universal mandatory returns proposal which was decisively defeated in the House was not rejected by the Senate Finance Committee. Action on the Treasury suggestion for its revival was simply postponed on the theory that it was a matter that properly should be considered in connection with the administrative bill which is to be submitted to the Ways and Means Committee the last part of September. Accordingly, an open hearing, full discussion and renewed consideration of that question can be expected in connection with the administrative bill. It is astonishing and inconsistent, to say the least, that the Finance Committee did not take similar action with reference to any modified proposal, such as the amendment they adopted with reference to the eight community-property States. The action of the Finance Committee is all the more inconsistent and confusing because the mandatory proposal adopted by it aimed only at the eight community-property States, unlike the universal mandatory joint returns proposal, has not been debated either in the Ways and Means Committee or on the floor of the House. On the other hand, when it has been considered in the past, in 1921, 1924, and 1934, after full hearings, it has been rejected.

This action of the committee can only be explained on the theory that the advocates of mandatory joint returns hoped by these tactics to divide those who opposed such returns in the thought that if the new provision is incorporated in the present tax bill, a mandatory joint return provision in the administrative bill will follow as a matter of course.

Calendar No. 703

77TH CONGRESS, 1st Session | SENATE | REPT. 673, Part 3

THE REVENUE BILL OF 1941

SEPTEMBER 2.—Ordered to be printed

Mr. LA FOLLETTE, from the Committee on Finance, submitted the following

INDIVIDUAL VIEWS

[To accompany H. R. 5417]

PART I. INTRODUCTION

The pending revenue bill as reported to the Senate is a vicious assault on the rank-and-file taxpayer. It is inadequate, inequitable, and, in my opinion, indefensible. It conforms to no standards of justice or fairness. It "soaks" the poor while confirming, protecting, and entrenching the corporate wealth and power engendered by the defense program. It levies the major share of the costs of "all-out" defense on those who have the least property to protect and those who have the least ability to pay.

The bill is a hodge-podge of inconsistencies, with no underlying principle of taxation whatsoever, except that like many previous tax bills, it "plucks the goose that squawks the least." Unfortunately, the small individual taxpayer who will dig deep into his pockets to pay these bills has not made himself heard.

TAX YIELD INADEQUATE

Although the committee tax bill is the largest in our history, it is no answer to the present urgent fiscal situation. The 3.6 billions of dollars are hopelessly inadequate in the face of a 50- or 60-billion dollar defense program, a 49-billion-dollar national debt, and a probable deficit this fiscal year, over and above this tax bill, of more than 10 billion dollars.

The proposed patchwork on the present faulty tax structure, and the hiking of present rates, are not a solution to the Government fiscal problems. It is not commonly appreciated that defense spending has created an extraordinary situation which must be met by extraordinary taxation, not only as to degree of taxation, but also as

to kind of taxation. No doubt taxes must be heavier; but, more than that, they must be revised so as to be more equitable and to conform to the present situation.

EXCESS PROFITS

The Government is pumping billions of defense dollars into our industrial structure. Huge profits are accruing to industry. Generally speaking, the initial and primary beneficiaries are the corporations. It is not punitive taxation—it is just good common-sense fiscal policy supported by expert economic, as well as layman, logic—that a lion's share of all excess and defense profits be siphoned back into the Government Treasury. To the extent that such profits are diverted from the general income stream, the dangers of inflation are accordingly reduced.

The excess-profits tax should be a major item in our tax structure. Such a tax in the fiscal year 1920 yielded about 45 percent of total Federal revenues. In the fiscal year 1942, the excess-profits tax will provide less than 7 percent of total Federal revenue. Even with the full-year effect of the changes proposed now, less than 15 percent of total revenues will be derived from the excess-profits tax. Of course, substantial increases have been made and further increases are proposed in the corporate normal tax and surtax rates, but the entire corporate share of taxes is still far below the World War proportion. Furthermore, in periods of abnormal profits the corporate tax burden is not as equitably distributed by normal income taxes and surtaxes as by an excess-profits tax.

LOWERED INCOME-TAX EXEMPTIONS UNJUSTIFIED

There is no justification whatsoever in dipping further into the poor man's income—whether by hidden excise taxes, or lowered income-tax exemptions—if and until adequate excess-profits levies are made by the Government.

During the Senate debate on the Second Revenue Act of 1940, on September 13, I commented as follows:

> Taxation levied without regard to ability to pay and falling heaviest on those with least ability to pay has been increasing constantly. Such was the case when we considered the first tax bill during the present session of Congress. That bill further increased the inequity of our tax structure. It dumped a heavier burden on the backs of the plain people of the country in the form of increased taxes levied without regard to ability to pay. Prior to the enactment of the first revenue bill of the present session of Congress, almost $400,000,000 was collected annually from the manufacturers' excise taxes, which are, in the last analysis, passed on largely to the consuming public. The bill which we passed in June increased these nuisance taxes by more than $140,000,000.
>
> The bill as passed in June increased corporate taxes only 17 percent, as compared with a 35-percent increase in the yield of excise taxes and a 37-percent increase in the yield of individual income taxes.
>
> I have been an advocate of broadening the base of the income tax, in the hope that increased revenue derived from taxation levied in accordance with ability to pay would enable us to shift some of the crushing burden of indirect nuisance taxes, which are levied without regard to the ability of the taxpayer to pay, on to the sound principle of graduated taxes.
>
> But, Mr. President, as I stated during the debate on the revenue bill passed in June, I saw absolutely no justification for a broadening of the income-tax base at the same time excise taxes and direct taxes were increased by such enormous percentages.

On June 19, 1940, I said in debate on the floor of the Senate:

As the chief advocate in this body in past years for broadening the income-tax base, I must now state that I consider it is a gross inequity to the low-income taxpayers to ask them to increase their taxes, and, at the same time fail to ask the corporations, which are going to be vastly enriched by the necessity for national rearmament, to carry their fair share of the load, according to their ability.

Now, 15 months later, the situation is even worse.

Marriner S. Eccles, Chairman of the Board of Governors of the Federal Reserve System, writing in Fortune Magazine for August 1941, states the entire thought well in these words:

During the emergency the excess-profits tax should, in my opinion, be the keystone of a well-balanced tax program. Increased taxes, however, should not be imposed on the great numbers of small business concerns and on millions of individual taxpayers until they have been given every reasonable assurance that the funds they are being asked to provide will not go to swell the profits of wealthy individuals and corporations.

GENEROUS TREATMENT FOR ESTATES AND GIFTS

The singularly harsh treatment accorded the low-income taxpayer under the committee bill is entirely reversed when dealing with the wealthy taxpayer bequeathing huge estates and gifts. Exceptionally generous exemptions of $40,000 are allowed—53 times as great as the exemption for a single man under the income tax recommendation—and only moderate rates are applied. Although the Treasury Department proposed to lower these exemptions to $25,000, neither the House Ways and Means Committee nor the Senate Finance Committee would concur.

ROBERT M. LA FOLLETTE, SR., IN 1917

In August 1917, 24 years ago, when the Senate of the United States was debating the first real World War revenue bill, my father made an energetic and dramatic fight for a fair and adequate tax program. Recently, when rereading the minority report he submitted to the Senate, I was highly impressed by the following excerpts from his remarks. In my opinion, they are noteworthy of attention in connection with the present bill. They are as true now as they were true then.

He was championing a new tax theory—the Federal income tax was only 4 years old—when he said:

Complicated as is the subject of public finance, there are certain principles and certain truths underlying the science that are self-evident. Among these is the principle that the burden of taxation should be apportioned among the taxpayers in accordance with their ability to pay. Another is that income or profits constitute if not the best, at least one of the best standards by which to measure ability to pay * * *. We must look to the income tax and the war-profits tax to maintain the credit of the Nation and make it possible for our people to bear the awful burdens of this war.

In answer to those who would impose but moderate rates on excess profits—and there are some who take the same position on this bill—my father used these words:

To advocate low rates at present on war profits, with a view to leaving a margin for a later day, is to leave out of sight the fact that this prolific source of revenue will automatically disappear with the end of the war and that the opportunity to tax each year's profits passes with the year. Failure to draw on this source to

the fullest possible extent while the war lasts will therefore result in throwing a much larger burden of taxation upon the people and the normal industries of the country at a time when the easily made war profits will no longer be available, and when business of the country will be staggering under the burden of readjustment.

To those apprehensive of the effects of a stiff excess-profits tax he directed these words:

> Neither the war-profits tax nor the income tax is a levy on capital. Both of these taxes are levied upon extraordinary and unusual profits. Even if they absorbed the greater part of the profits of individuals such taxes would not in any way affect the income of the same individual the next year. The capital remains. The tax does not impair the earning power of that capital.

With respect to excise and nuisance taxes, he wrote:

> It is monstrously unfair to tax the everyday necessaries of the average man and woman to pay the expenses of this war, in addition to commanding their services, and the lives of many of them, and of their children, so long as the above-mentioned swollen and abnormal profits are not taken—profits which the war has created and which will disappear as soon as the war ends. Every dollar of the above profits can be taken and still the enormous peacetime profits of these and other great corporations will not be touched. * * * Will anyone contend that the necessaries of the poor shall be taxed so long as these enormous war profits remain as a source of revenue?

He added these prophetic words about excise taxes:

> Once we admit that excise taxes of this sort are to be levied at all at this time, we will find them mounting with every increasing tax levy. * * * These taxes will endure after the period of the war. * * * Later, it will be these consumption taxes upon the necessaries of life that will be drawn upon to meet the needs of the Government. It is both unjust and unwise.

Part II. The Tax Structure: Past, Present, and Proposed

PRESENT TAX STRUCTURE COMPARED WITH 1917–20

In many respects the present fiscal situation is directly parallel with the World War tax problems two decades ago. The war then and the defense program now have entailed unprecedented governmental expenditures which in turn require unprecedented general taxation. Production and profits have soared. Just as in World War I, the Government is struggling to bolster the Treasury revenues by imposing new taxes.

Of course, we have grown—about 30 millions in population. Our production has doubled and our national income has almost doubled. But the tax picture is much the same, with perhaps this single exception: Our national debt stood at 1¼ billion dollars in 1917. It is 40 times as great now. This backlog of debt in the present picture more than counterbalances the exigencies of actual war in the past picture.

Most everyone will agree that the Government fiscal policies and tax program in the last World War were shockingly inadequate. The war-tax policies—or lack of policies—permitted the accumulation of unconscionable profits for individuals and corporations. The war-tax policies failed to arrest inflation. Whatever other shortcomings existed, it is clear that the Government erred on the side of insufficient taxation of war profits.

Despite the gross inadequacy of the tax structure in the World War, how does it compare with the present tax structure?

Table 1, below, is an abbreviated statement of internal-revenue receipts for the 1920 and 1942 fiscal years, based on estimates of the Treasury Department. The table shows that the over-all tax load has increased about 70 percent (supported, of course, as previously mentioned, by a larger population, a larger production, and a larger national income).

The most significant facts to note from the table are that excise taxes have almost tripled and individual taxes have more than doubled while corporation taxes are yielding only slightly more revenue than in 1920. It is significant to note, too, that the bulk of present corporate taxes is being derived from the income tax instead of the excess-profits tax as in 1920.

All indications are that the next few years will be banner profit years for most corporations. Yet, in the fiscal year 1942, corporations will bear only about 36.3 percent of the Federal tax load, as against 56.7 percent borne in 1920.

TABLE 1.—*Internal revenue receipts by major categories—Estimated receipts in present fiscal year under present law compared with 1920 tax receipts*

[Millions of dollars]

	1920 [1]	1942 [2]
Total	5,736	9,724
Corporation taxes	3,252	3,535
Income [3]	653	2,627
Excess profits	2,506	679
Other [4]	93	229
Individual taxes	1,232	2,529
Income [3]	1,128	2,078
Estate and gift	104	451
Excise and pay-roll taxes	1,252	3,660
Tobacco and liquor	435	1,563
Manufacturers' excises	268	676
Other miscellaneous taxes	549	429
Social security, etc.	----------	992

[1] Fiscal year reports of the Government for 1918–24 do not show separately the various categories of income-tax collections. Hence, the calendar-year-income basis as reported in the Treasury Department's Statistics of Income is used here.
[2] Treasury Department estimates as revised June 1, 1941.
[3] Includes a relatively small amount collected from back taxes.
[4] Includes the capital-stock tax and the declared-value excess-profits tax.

RECENT TRENDS IN FEDERAL TAXATION

Despite all the vaunted statements in recent years in behalf of taxation based on the principle of ability to pay, it is a hard, cold fact that the Federal tax structure has steadily become more and more regressive and more and more burdensome to the common man. Tables 2 and 3 are clear-cut proof of the trend in the last 15 years.

As shown by table 2, excise taxes have steadily grown. In the fiscal year 1940 the total collected in this manner was almost fivefold that collected from the same source in 1927. Despite the fact that the aggregate tax burden had increased almost 85 percent in 1940 over 1927, corporations in 1940 fiscal year paid a less dollar amount in taxes in 1940 than in 1927.

As shown by table 3, corporation taxes comprised about 46 percent of total revenues in 1927; 40 percent in 1932; 26 percent in 1937; and only 24 percent in 1940. On the other hand, excise and pay-roll taxes constituted about 19 percent of total Federal revenues in 1927; 29 percent in 1932; 44 percent in 1937; and 51 percent in 1940. Even with the exclusion of social-security taxes, the percentages of the latter 2 years are high—38 and 35 percent, respectively.

TABLE 2.—*Internal revenue receipts by major categories—Receipts in fiscal years 1927, 1932, 1937, and 1940*

[Millions of dollars]

	1927	1932	1937	1940
Total	2,866	1,558	4,653	5,303
Corporation taxes	1,317	630	1,219	1,276
Income [1]	1,308	630	1,057	1,117
Other [2]	9		162	159
Individual taxes	1,011	474	1,397	1,346
Income [1]	911	427	1,092	986
Estate and gift	100	47	305	360
Excise and pay-roll taxes	538	454	2,037	2,681
Tobacco and liquor	397	407	1,146	1,232
Manufacturers' excises	67		451	447
Other miscellaneous taxes	74	47	175	170
Social security, etc			265	832

[1] Includes a relatively small amount collected from back taxes.
[2] Includes the capital-stock tax and the declared-value excess-profits tax.

TABLE 3.—*Percentage distribution of internal revenue receipts by major categories, fiscal years 1927, 1932, 1937, and 1940*

	1927	1932	1937	1940
	Percent	*Percent*	*Percent*	*Percent*
Total	100.0	100.0	100.0	100.0
Corporation taxes	46.0	40.4	26.2	24.1
Individual taxes	35.3	30.5	30.0	25.4
Excise and pay-roll taxes	18.7	29.1	43.8	50.5
Excluding social security			38.1	34.9

The preceding tables illustrate well the comparative trends as between corporation taxes and excise taxes. It is somewhat difficult, however, from those tables to discern the comparative trends between individual and corporate taxes because both have become a relatively smaller part of total Federal revenues while excise taxes have skyrocketed.

An interesting comparison on a different basis can be made from a table adapted from the 1940 Annual Report of the Treasury Department, in which Federal tax liabilities are estimated under certain assumed conditions. For one set of estimates (column 1) it is assumed that the tax structure of May 1932 is in effect in the calendar year 1941 (i. e. at that level of income); column 2 is under the assumption the tax structure of July 1932 is in effect; column 3, the tax structure of December 1940.

As can be observed from the following table and the percentages calculated therefrom, Federal taxes on individuals have increased substantially more than on corporations. The Revenue Act of 1932 was especially bad in this respect.

TABLE 4.—*Estimated Federal tax liabilities* [1] *for calendar year 1941, based on the tax structures of (1) May 1932, (2) immediately following the passage of the Revenue Act of 1932, and (3) December 1940 (tax base assumed to be independent of tax structure)*

[In millions of dollars]

Tax group	Under laws—		
	(1)	(2)	(3)
	Of May 1932 immediately preceding the passage of the Revenue Act of 1932	Of July 1932 immediately following passage of Revenue Act of 1932	Of Dec. 31, 1940
Individual income, estates, and gifts	594	1,308	2,230
Corporate income and profits	1,277	1,594	3,723

[1] Source: 1940 Annual Report, Treasury Department, p. 3.

TABLE 5.—*Percentage increases—tax structure after Revenue Act of 1932 compared with structure immediately preceding and tax structure of December 1940 compared with each*

	Percentage increase	
	(2) over (1)	(3) over (1)
	Percent	*Percent*
Individual income, estates, and gifts	+120	+275
Corporate income and profits	+25	+192

YIELDS OF THE PRESENT TAX STRUCTURE COMPARED WITH YIELDS UNDER THE PROPOSED COMMITTEE BILL

To complete this series of comparisons made on the basis of the relative burden on the various kinds of taxpayers, a comparison should be made of the present tax structure and the structure as it will be under the committee bill. Tables 6 and 7 make that comparison on a basis comparable with previous tables.

It should be noted that both sets of estimates on table 6 are based on fiscal year 1942 level of income and that both are hypothetical years in that they represent full-year effects. In such respect, they differ from estimated actual receipts (as shown on table 1). For example, about $679,000,000 will be collected in excess-profits taxes in the fiscal year 1942. However, the full-year tax liability on 1942 levels of income would be $1,026,000,000. Similarly, under the proposed bill, the hypothetical full-year effect is estimated to be $2,156,000,000 from excess-profits taxes, but, according to the Treasury, only about 45 percent of the additional amount under this bill would be collected in the next fiscal year.

An examination of tables 6 and 7 shows that an inordinate increase is proposed in individual income taxes contrasted with corporation taxes; in fact, the corporate share of total Federal taxes is actually reduced from 40.4 percent of the total to 39.6 percent. The share to be borne by individual taxes is increased from 25.7 to 28.5 percent. Excluding the social-security tax (which as yet has not been increased), the share borne by excise taxes is increased from 24.7 to 25.0 percent.

TABLE 6.—*Internal-revenue receipts by major categories—Estimated receipts under present law compared with estimated receipts under Finance Committee bill (hypothetical full-year yields at levels of income estimated for fiscal year 1942)*

[Millions of dollars]

	Present law [1]	Under new bill [2]
Total	10,793	14,486
Corporation taxes	4,359	5,738
Income [3]	3,099	3,363
Excess profits	1,026	2,156
Other [4]	.234	219
Individual taxes	2,774	4,129
Income [3]	2,323	3,520
Estate and gift	451	609
Excise and pay-roll taxes	3,660	4,619
Tobacco and liquor	1,563	1,701
Manufacturers' excises	676	966
Other miscellaneous taxes	429	960
Social security, etc	992	992

[1] Differs from estimates of receipts in 1942 fiscal year insofar as the full effects of the 2 Revenue Acts of 1940 are not reflected in the fiscal year estimates of income and excess-profits taxes, etc. Compare with 1942 fiscal year estimates under present law in table 1.
[2] Assuming that all provisions of the law were fully reflected in receipts for an entire year.
[3] Includes a relatively small amount collected from back taxes.
[4] Includes the capital-stock tax and the declared-value excess-profits tax.

TABLE 7.—*Percentage distribution of estimated internal revenue receipts by major categories—Fiscal years 1920, 1942, and hypothetical full-year yields at 1942 levels of income under present law and under new bill*

	1920 [1]	1942 [1]	Hypothetical years	
			Present law	New bill
	Percent	*Percent*	*Percent*	*Percent*
Total	100.0	100.0	100.0	100.0
Corporation taxes	56.7	36.3	40.4	39.6
Individual taxes	21.5	26.0	25.7	28.5
Excise and pay-roll taxes	21.8	37.6	33.9	31.9
Excluding Social Security	....	27.4	24.7	25.0

[1] See footnote on table 1.

All of these statistics merely go to prove two facts which are almost self-evident without a recital of detailed statistics:

1. The present tax structure is inequitable.
2. The committee bill will make it worse.

PART III. DEFECTS IN THE COMMITTEE BILL IN THE TAXATION OF EXCESS PROFITS

In my opinion, the most serious defect of the committee bill is the failure to tax excess profits adequately or fairly. Despite persistent and cogent recommendations of the Treasury Department that the entire method of taxing excess profits be overhauled, the committee bill makes no fundamental corrections in the present law, nor even recognizes the shortcomings evidenced during the first year of operation.

Corporations prosperous during the base period are still not required to pay taxes commensurate with their ability to pay and commensurate with a fair and reasonable rate of return. Other corporations which have profited very substantially, and directly, from Government spending are not contributing their fair share.

PREVIOUS EFFORTS TO SECURE AN ADEQUATE TAX

Last year, during the consideration of both the First and Second Revenue Acts of 1940, I made a strenuous effort to gain congressional approval of an excess-profits tax based solely on invested capital. Although the Senate approved my plan, 41 to 31, in June 1940, it was eliminated in conference with the declaration that an excess-profits tax would be enacted later. A miserable compromise tax plan was adopted a few months later. In September when the bill was under consideration by the Senate, I submitted a minority report explaining my opposition to the compromise excess-profits tax.

The objections I raised then are applicable now, with greater force. I quote at length from the report because I believe the arguments are unanswerable—in fact, already vindicated in many respects after 1 year's operation under the present law:

> The Finance Committee has reported a highly objectionable tax bill to the Senate. * * * It violates every principle of sound tax theory.
>
> THE BILL IS BASED ON A CONFUSED AND UNSOUND THEORY OF EXCESS PROFITS
>
> The President in his message to Congress on July 1, 1940, urged that Congress enact an excess-profits tax to help pay for the defense program because, "it is our duty to see that the burden is equitably distributed according to ability to pay so that a few do not gain from the sacrifices of the many." Yet this bill is not based on any principle of ability to pay. Apparently it intends to tax merely the extra profits due to the defense expenditures—"defense profits" rather than "excess profits."
>
> The so-called earnings method of the bill is supposed to measure defense profits directly. Earnings in the taxable year are compared with earnings in the base period and the increase, if any, is called excess. Two basic assumptions are involved which are not true in a large percentage of cases: First, that the earnings during the base period are "normal." Second, that the increase is "excess" or due to defense expenditures. Actually, with respect to the former, a base period that is normal for corporations as a whole is almost invariably abnormal in varying degrees for corporations individually. With respect to the latter, there is no reasonable assurance that the increase is "excess," or due to defense expenditures.
>
> Witness after witness testified before the Ways and Means and Finance Committees that their earnings were abnormal during the base period or that increased earnings had nothing whatsoever to do with the defense program. Obviously, the bill exempts large amounts of defense profits and taxes large amounts of nondefense profits without any recognition of the sound principle of ability to pay.
>
> Furthermore, there is no satisfactory way of distinguishing between defense profits and other profits. No chemical test can be applied to make a precise

separation. Dollars lose their identity when flowing through the economic system. Products which have an important use in the defense program may have a simultaneous important use in normal industrial activity. Paint for a battleship is the same as paint for industrial machinery. Shoes for the Army are the same as shoes for the farmer. Even with complex accounting systems no satisfactory separation of profits can be made. Surely no rule-of-thumb method of comparing profits in the taxable year with profits during some previous years affords an adequate separation.

The most serious defect in the bill from the standpoint of tax theory is the attempt to combine two opposing theories of taxation in one bill. The net effect is to include the shortcomings of both without the advantages of either. The loopholes in the bill are doubled. The revenue yield is reduced well below what might be obtained under either method separately. The situation becomes a "heads you win, tails I lose" proposition for the Treasury. In addition, highly inequitable situations are created among competitive corporations which are forced by circumstances to use different methods of tax computation.

(2) THE BILL AFFORDS UNWARRANTED PREFERENTIAL TREATMENT TO CERTAIN CORPORATIONS

The large prosperous corporations with consistent substantial profits are those most able to pay an excess-profits tax. Under this bill, they will pay little or no tax. No matter if they are earning 20, 50, 100, or 1,000 percent on their invested capital, they may continue, under the average earnings method of this bill, to earn those profits without additional tax. A tremendous advantage is accorded the established prosperous corporation against a competitor who suffered a depressed condition during the base period or the newly organized corporation which has not become established.

(3) THE BILL ENCOURAGES MONOPOLY AND DISCRIMINATES AGAINST COMPETITORS OF PROSPEROUS ESTABLISHED CORPORATIONS

If there was ever a tax measure which promised to perpetuate monopolistic corporations in their monopolies, it is this one. Three corporations, A, B, and C, are competitors. Corporation A is a quasi monopolist earning profits of 25 percent on invested capital during the base period. Corporation B, struggling against terrific odds, earned 9 percent. Corporation C is newly organized. In 1940, corporation A continued to earn 25 percent; B earned 15 percent; C, 9 percent. This would be typical experience because it is a well-known fact that a certain development period with low profits is typical of the new corporation.

Under the average earnings method of this tax bill, corporation A would pay no excess-profits tax whatsoever. Corporation B would pay a substantial tax though its earnings were much less. Corporation C would also have to pay an excess-profits tax, unless it were small enough so that the $10,000 flat exemption gave it relief.

This tax would be an insurmountable barrier to fair competition among the corporations. No more powerful club than this could be placed in the hand of corporation A. No other concern could successfully challenge its quasi-monopolistic position. If during any future year corporations B or C did achieve the same level of profits as corporation A, they would pay most of it in additional taxes while corporation A went untaxed. The most likely result would be bankruptcy for B and C; a complete monopoly for A.

This inequity inherent in the committee amendment may be further illustrated by the following example, which shows the excess-profits tax that would be payable under the committee amendment by each of two corporations having the same invested capital and excess-profits net income during the taxable year. One of these corporations—corporation A—is, however, an established company with stabilized earnings and the other, corporation B, is a growing enterprise competing with corporation A.

	Corporation A	Corporation B
Current year:		
Excess-profits net income	$1,000,000	$1,000,000
Invested capital	$5,000,000	$5,000,000
Rate of return ... percent	20	20
Base period:		
Excess-profits net income (average)	$1,000,000	$200,000
Invested capital (average)	$5,000,000	$5,000,000
Rate of return (average) ... percent	20	4
Taxable excess profits:		
Average earnings method	0	$790,000
Invested capital method	$500,000	$590,000
Tax:		
Average earnings method	0	$349,000
Invested capital method	$249,000	$249,000
Tax liability [1]	0	$219,000

[1] Excludes the 3.1 percent increase in normal corporation income tax.

It is a serious charge that this bill should condone and encourage monopoly, but perhaps even more serious is the severe penalty that is placed on the new or growing corporation. Such a corporation probably received little profit during the initial years and is now entering into a period when the work of earlier unprofitable years is beginning to bear fruit. The bill allows no future prosperous years for the new or growing corporation; it envisages an economy with the present inequities "frozen" into the future. The precedent herein set will make it all the more difficult at some later date to tax these "privileged" corporations adequately. The hue and cry then will be raised, just as it has been raised to a certain extent now, that the stockholders who have recently purchased stock at high prices because of anticipated high earnings have a vested interest which should not be disturbed. The idea is fallacious, but to allow it to go unchallenged here in this tax bill would give it a cloak of validity which would be hard later to remove.

Entirely disregarded in H. R. 10413 is one of the cardinal principles of taxation: That the burden should be fairly distributed. The preponderance of testimony during the hearings clearly demonstrates that many taxpayers are more concerned about the equity of the tax than the amount of the tax. Aside from those corporations with high earnings which will be able to take advantage of the average earnings tax method, corporations in general are willing to bear almost any reasonable load provided their competitor is treated similarly. The average earnings method and the hodgepodge of a dual method of computing tax liability precludes equal treatment for all.

It has been said in answer to the above contentions that it is not the function of a tax bill to remove existing competitive disadvantages or advantages. This answer is specious. One can agree that it is not the purpose of a tax bill to equalize competitive conditions. But it is undeniable that tax bills should not distort existing competitive conditions and place unwarranted tax handicaps upon one class of corporations as opposed to another, thereby creating an indefensible competitive advantage in favor of the latter. The objection to the committee amendment is not that it does not equalize existing competitive conditions. Rather the objection is that the committee amendment in and of itself creates new and far-reaching competitive advantages. The invested-capital method, on the other hand, does not create or give rise to either new competitive advantages or new competitive disadvantages. It simply imposes an excess-profits tax which falls alike on corporations regardless of their competitive position and thereby does not disturb existing competitive conditions.

(4) THE RATES OF THE TAX IN THE BILL ARE NOT GRADUATED FAIRLY

The rates in the bill are graduated according to the amount of so-called excess profits. This means that a large corporation may make only a very small percentage of excess profits on its capital and still pay the highest rate of tax. Thus, a corporation with $100,000,000 of invested capital and $1,000,000 of taxable excess profits will pay the same tax as a corporation which has the same amount of taxable profits on an invested capital of only $1,000,000. In other words, the brackets are now graduated without reference at all to the earnings or size of a corporation, and a corporation which had excess profits amounting to a 100-percent return on invested capital would pay no more tax than a corporation having excess

profits amounting to 10 percent on invested capital, providing the absolute amounts of excess profits were the same.

Profits cannot be divided sharply into those that are excessive and those that are not. Excessiveness is a matter of degree and the tax rate should be graduated according to the degrees of excessiveness, not simply according to the amount of excess profits. A proper rate structure for an excess-profits tax would graduate the rate according to the ratio of profit to invested capital. Under the rate structure as it now stands, many corporations with extremely excessive profits will pay much more moderate taxes than other corporations with only moderate excess profits.

ESTIMATED ADDITIONAL REVENUE

The Treasury Department estimates that an additional $1,394,700,000 in corporation taxes will flow into the Treasury in the full-year effect of the committee bill. Proponents of the measure point to an alleged increase in the excess-profits tax yield of $1,130,600,000. The figure is somewhat misleading. The yield is achieved only after reversing the tax-deduction procedure, and at an expense of $501,100,000 in the yield of the normal corporate income tax.

Thus, in order to obtain the same (or slightly more) than present tax revenues from the normal net income of corporations, the committee found it necessary to impose new surtax rates of 6 and 7 percent. The net additional yield in this bill from excess profits, over and above the surtax yield, is only $629,600,000.

With an excess-profits tax based solely on invested capital, and without any increase in the rates in the pending bill, the Treasury estimates that $1,880,000,000 additional yield could be derived from excess profits—about $650,000,000 more than the committee bill. Thus, with a full-year effect, a total of $2,900,000,000 would be derived from excess profits—a figure not unreasonable in view of the $2,500,000,000 collected from excess profits in 1920.

PRESENT AND PROSPECTIVE LEVELS OF CORPORATION PROFITS

The direct and indirect effects of Government defense spending are not yet fully reflected in the level of corporation profits. But already the profits are at record high levels. The National City Bank of New York reports the profits of 360 leading corporations in the first half of 1941 to be 20.9 percent above a year ago—after allowing for prospective taxes. Last year's first half was 58.6 percent above the previous year, again after taxes, depreciation, interest, and other charges, and reserves.

Tables 8 and 9 show the data in detail by major industrial groups.

TABLE 8.—*Profits of leading corporations for the half year*

Net profits are as reported, after depreciation, interest, taxes, and other charges and reserves, but before dividends—net worth includes book value of outstanding preferred and common stock and surplus account at beginning of each year

[In thousands of dollars]

No.	Industrial groups	Net profits, half year		Percent change	Net worth Jan. 1		Annual rate of return (percent)	
		1940	1941		1940	1941	1940	1941
7	Baking	7,970	7,608	−4.5	236,681	237,381	6.7	6.4
14	Food products, miscellaneous	34,974	39,194	+12.1	534,953	541,084	13.1	14.5
7	Beverages	8,132	9,088	+11.8	129,922	136,421	12.5	13.3
17	Textiles and apparel	7,862	10,654	+35.5	176,025	169,854	8.9	12.5
7	Wood products	1,326	4,515	+240.5	59,360	61,281	4.5	14.7
14	Paper products	6,883	7,892	+14.7	159,185	164,248	8.6	9.6
28	Chemicals, drugs, etc	92,082	94,021	+2.1	1,300,054	1,331,138	14.2	14.1
11	Petroleum products	141,070	135,227	−4.1	2,666,501	2,671,664	10.6	10.1
13	Stone, clay, and glass	12,220	14,807	+21.2	221,718	223,378	11.0	13.3
26	Iron and steel	61,915	126,111	+103.7	2,447,002	2,491,210	5.1	10.1
12	Building equipment	7,536	11,519	+52.9	224,738	219,780	6.7	10.5
14	Electrical equipment	42,863	47,662	+11.2	637,133	652,618	13.5	14.6
10	Hardware, tools, etc	4,664	6,373	+36.6	82,764	85,572	11.3	14.9
27	Machinery	16,377	21,204	+29.5	158,471	175,062	20.7	24.2
4	Office equipment	8,232	11,557	+40.4	133,264	136,666	12.4	16.9
19	Railway equipment	9,498	13,051	+37.4	173,403	182,930	11.0	14.3
9	Automobile	116,701	125,860	+7.8	1,149,449	1,190,568	20.3	21.1
19	Auto equipment	10,781	14,293	+32.6	111,478	120,197	19.3	23.8
36	Metal products, miscellaneous	20,254	29,003	+45.4	220,815	246,232	18.4	24.0
19	Miscellaneous manufacturing	9,947	18,119	+82.2	316,898	326,785	6.3	11.1
304	Total manufacturing	621,387	748,358	+20.4	11,139,809	11,364,056	11.2	13.2
10	Coal mining	[1] 880	[1] 2,698	+225.1	301,314	206,617	.8	2.6
9	Metal mining	[1] 8,787	[1] 9,649	+9.8	164,037	167,564	10.7	11.5
9	Mining, quarrying—miscellaneous	[1] 9,276	[1] 9,536	+2.8	124,419	121,208	14.9	15.7
16	Trade (wholesale and retail)	3,459	5,982	+72.9	209,447	211,858	3.3	5.6
12	Service and construction	8,389	8,317	−.9	226,955	229,531	7.4	7.2
360	Total	657,128	784,540	+20.3	12,035,981	12,301,019	10.8	12.8

[1] Before certain charges.
D—Deficit.

Source: Bulletin of National City Bank of New York, August 1941.

TABLE 9.—*Comparisons of profits of leading corporations for the first half year 1939, 1940, and 1941—percentage change in net profits after depreciation, interest, taxes, and other charges and reserves, but before dividends*

	Increase 1940 over 1939	Increase 1941 over 1940
Baking	−3.5	−4.5
Food products, miscellaneous	5.1	12.8
Beverages	21.5	11.3
Textiles and apparel	51.3	35.5
Wood products	1,129.2	240.5
Paper products	137.8	14.7
Chemicals, drugs, etc	38.8	2.1
Petroleum products	209.1	−4.1
Stone, clay, and glass	35.9	21.2
Iron and steel	451.1	103.7
Building equipment	180.2	52.9
Electrical equipment	66.7	11.2
Hardware, tools, etc	78.9	36.6
Machinery	238.8	29.5
Office equipment	28.7	40.4
Railway equipment	492.0	37.4
Automobile	17.6	7.8
Auto equipment	62.7	32.6
Metal products, miscellaneous	107.8	45.4
Miscellaneous manufacturing	−14.5	82.2
Total, manufacturing	66.8	20.4

TABLE 9.—*Comparisons of profits of leading corporations for the first half year 1939, 1940, and 1941—percentage change in net profits after depreciation, interest, taxes, and other charges and reserves, but before dividends*—Continued

	Increase 1940 over 1939	Increase 1941 over 1940
Coal mining	(1)	225.1
Metal mining	41.7	9.8
Mining, quarrying, miscellaneous	24.0	2.8
Trade (wholesale and retail)	10.9	72.9
Service and construction	5.2	—.9
Total, all groups	58.6	20.3
(Total, all groups, increase in first half of 1941 over 1939: 92.6 percent.)		

[1] Data not comparable.

Source: Bulletins of the National City Bank of New York, August 1940 and August 1941.

It is interesting to note, in this connection, that most corporations are laying aside very generous reserves in anticipation of vastly increased taxes. The Wall Street Journal, for example, recently reported:

Tax mystery: United Aircraft recently reported tax reserves of over 78 percent of its current profits.

The top any corporation has to pay is 72 percent, including income, excess profits, and surtaxes. This suggests United, like many another big industrial company, is using ultraconservative bookkeeping to avoid phony profits, must report more liberally to the Government and to its stockholders.

Detailed compilations of corporation profits, for individual corporations, as taken from published financial reports, 1940 compared with 1939, and the first half of 1941 compared with the first half of 1940, have been published in the Economic Outlook for February and July 1941. The compilations are reproduced below in tables 10 and 11.

TABLE 10.—*Corporation profits in 1940 compared with 1939* [1]

Company	1940	1939	Percent increase
Allegheny-Ludlum Steel	$3,700,000	$2,093,518	77.0
American Can	17,440,906	18,284,963	—4.6
American Metal	3,689,957	2,994,740	23.0
American Tobacco	28,311,782	26,427,934	7.0
American Woolen	3,154,464	2,311,887	36.4
Aviation Corporation (year ending Nov. 30)	88,350	—2,238,049	------
Babcock & Wilcox	3,588,199	1,168,782	206.0
Bath Iron Works	2,052,180	660,703	211.0
Bell Aircraft	284,745	9,203	3,000.0
Bethlehem Steel	48,679,524	24,638,384	97.5
Bridgeport Brass	1,258,776	459,058	174.0
Caterpillar Tractor	7,830,117	6,004,890	30.6
Chrysler Motors	37,802,279	36,879,829	2.4
Commercial Solvents Corporation	2,387,321	1,600,389	49.2
Consolidated Coal	402,290	—863,915	------
Container Corporation	2,227,682	1,448,900	54.0
Continental Can	8,953,632	8,635,787	3.7
Crucible Steel	6,230,180	2,803,596	122.0
Douglas Aircraft (year ending Nov. 30, 1940)	10,831,971	2,884,197	275.0
Dupont, E. I	86,945,173	93,218,664	—6.7
Electric Auto Lite	6,001,718	5,653,839	6.1
General Cable	2,455,362	733,166	235.0
General Electric	56,241,000	41,235,644	36.5
General Foods	15,244,077	15,118,063	.8
General Motors	195,500,000	183,290,222	6.7

[1] Most of the profits herein listed are net profits and hence the figures are not directly comparable with figures used elsewhere in this minority report when speaking of net income before taxes.

TABLE 10.—*Corporation profits in 1940 compared with 1939*—Continued

Company	1940	1939	Percent increase
General Steel Casting	$1,106,196	$5,661	19,560.0
Goodrich Tire & Rubber	6,104,993	6,628,746	−7.9
Goodyear Tire & Rubber	10,309,783	9,838,797	4.8
Harbison-Walker Refractories	2,513,936	1,868,999	35.0
Inland Steel	14,450,385	10,931,016	32.2
International Harvester (year ending Oct. 31, 1940)	23,161,110	7,932,810	191.0
Jones & Laughlin Steel	10,277,029	3,188,944	222.0
Lehigh Coal & Navigation	1,101,853	18,674	5,700.0
Libbey-Owens-Ford Glass	9,992,766	8,062,753	24.0
Mack Truck	1,805,821	682,987	166.0
Mesta Machine	3,083,032	2,715,427	13.5
Monarch Machine	1,183,102	529,577	123.0
National Distillers Products Corporation	6,711,962	7,007,124	−4.4
National Gypsum	1,565,196	1,455,237	7.9
National Lead	6,102,702	5,780,500	5.6
New Jersey Zinc	8,236,815	5,299,055	55.5
New York Air Brake	1,046,656	797,858	40.0
New York Ship Building (first 11 months 1940)	2,178,748	928,246	135.0
North American Rayon Corporation	1,781,425	2,010,252	−11.4
Otis Steel	717,007	214,965	234.0
Pittsburgh Coal Co	1,255,893	−1,068,787	....
Pittsburgh Steel Co	1,555,794	564,870	175.0
Pure Oil	8,718,057	8,290,418	5.2
Radio Corporation of America	9,113,158	8,082,810	12.9
Rayonier, Inc. (9 months to Jan. 31)	3,031,953	1,425,193	112.5
Remington Rand (9 months ending Dec. 31, 1940)	2,026,372	1,104,418	83.4
Republic Steel	21,113,507	10,671,343	98.0
Rustless Iron and Steel	1,275,993	1,090,876	16.9
Savage Arms Corporation	1,028,141	349,307	195.0
Shell Union Oil	15,600,000	11,805,713	32.1
Taylor Craft Aviation Corporation	57,069	....	....
Union Bag & Paper Co	2,129,948	965,532	120.0
United States Rubber	11,425,241	10,218,849	12.0
United States Steel	102,181,321	41,119,934	148.0
Vultee Aircraft (year ending Nov. 30, 1940)	374,457	25,488	1,370.0
Walworth Co	1,123,156	205,900	445.0
Warner & Swasey	3,371,283	1,864,553	81.0
Western Union	3,621,581	1,380,114	163.0
Westinghouse Air Brake	5,591,606	2,765,629	102.0
Westinghouse Electric	18,983,428	13,854,365	37.0
Wheeling Steel	5,663,980	5,560,753	1.8
Yellow Truck & Coach Co	5,813,976	3,276,474	77.5
Youngstown Sheet & Tube	10,815,468	5,004,484	116.0

TABLE 11.—*Corporation profits in the first half of 1941 compared with the first half of 1940*

Corporation	Profits		Percent change
	First 6 months 1941	First 6 months 1940	
Air Reduction Co	$4,066,135	$3,106,096	30.8
Allegheny Ludlum Steel	4,169,347	1,893,291	120
Allis Chalmers	2,390,577	2,699,758	−9.2
American Brake Shoe & Foundry	1,479,341	1,226,637	20.5
American Radiator Co	3,271,909	1,535,905	113
American Rolling Mill Co	6,667,976	2,084,590	220
American Slating Co	282,227	100,197	182
American Steel Foundries	2,067,719	1,666,525	24.1
Anaconda Wire & Cable	1,410,519	497,269	184
Atlas Powder	938,110	744,518	26.1
Babcock & Wilcox	1,850,078	1,474,906	26.4
Baldwin Locomotive (12 months—June)	2,466,344	1,734,344	42.3
Bausch & Lomb Optical Co	1,174,528	767,285	53
Bendix Aviation (12 months—June)	11,687,229	6,613,180	77
Blaw-Knox Steel	1,220,496	602,717	102
Bohn Aluminum & Brass	817,087	592,181	38
Bridgeport Brass	867,494	506,167	71.4
Budd Wheel	915,972	394,446	132
Caterpillar Tractor	4,298,540	3,509,514	22.5
Consolidated Coal	317,872	136,257	134
Container Corporation	663,649	509,100	35
Continental Oil	2,642,082	1,007,852	169
Coos Bay Lumber	341,259	95,042	259
Copperweld Steel Co	919,962	521,314	77

TABLE 11.—*Corporation profits in the first half of 1941 compared with the first half of 1940*—Continued

Corporation	Profits		Percent change
	First 6 months 1941	First 6 months 1940	
Crosley Corporation	$708,634	$96,661	725
Crucible Steel	2,924,430	1,817,293	61
Detroit Steel	431,636	209,939	106
E. I. duPont	43,761,797	46,853,695	−7.1
Eaton Manufacturing Co	1,979,764	1,908,348	3.8
Fruehauf Trailer	1,137,977	519,583	119
General Electric	26,003,665	25,981,752	0.09
General Steel Castings	1,690,900	72,958	2,210
General Tire & Rubber	1,004,443	280,663	259
General Motors Corporation	118,177,905	113,575,460	4
Goodrich Co	6,646,033	1,362,691	388
Hazel Atlas Glass	1,396,788	1,270,963	10
International Business Machines	4,728,336	4,293,482	10.1
Johns-Manville Corporation	1,457,213	1,110,319	31.2
Jones & Laughlin Steel	8,098,227	3,276,256	147
Lehigh Coal & Navigation (year ending June 30)	1,848,300	138,812	1,230
Lehigh Valley Coal Corporation	605,434	251,440	141
Libbey-Owens-Ford	5,377,247	5,176,748	3.9
Magma Copper Co	800,142	717,587	11.6
Mathieson Alkali Works	997,345	827,540	20.6
Minneapolis-Honeywell Regulator	1,104,278	603,921	83
Nash-Kelvinator (9 months to June)	3,734,246	1,307,878	186
National Lead	3,289,000	3,119,810	5.4
New York Air Brake	1,121,446	832,818	34.6
North American Aviation	3,900,745	2,367,638	64.7
Otis Steel	1,088,255	−362,143	----------
Owens Illinois Glass	7,640,538	8,589,202	−11
Pepsi-Cola	3,300,000	2,525,000	30.6
Phillips Petroleum	8,236,680	6,378,198	29.2
Remington Rand, Inc. (June quarter)	1,383,693	565,240	145
Reo Motors	147,994	−785,988	----------
Republic Steel	13,618,716	6,449,453	111
Reynolds Metal	1,886,853	1,312,447	43.8
Rustless Iron & Steel	1,164,460	430,537	171
Sharon Steel	813,241	388,903	109
Sloss-Sheffield Steel & Iron Co	863,464	572,543	51
Sunshine Mining	1,186,431	1,285,934	−7.8
Studebaker	1,313,877	957,309	37.2
Texas Pacific Coal	469,505	292,840	60
Union Carbide & Carbon	21,342,134	19,972,176	6.9
United Aircraft Products	346,329	172,948	100
United States Pipe & Foundry	1,816,700	783,018	132
United States Steel	61,374,746	36,315,003	69
Virginia Iron, Coal & Coke	27,788	−10,528	----------
Walworth Co	909,820	203,415	350
Westinghouse	11,568,400	9,837,012	17.6
Westinghouse Air Brake	4,011,380	3,204,000	25.2
West Virginia Coal & Coke	179,053	−87,466	----------
Wheeling Steel	4,689,196	1,664,078	182
White Motor Co	791,355	743,529	6.5
Youngstown Sheet & Tube	8,992,994	2,423,212	276

GOVERNMENT CONTRACTS AND CORPORATION PROFITS

Presently available data are not sufficient to make any thorough study of profits earned on Government contracts. Although the data below in table 12 are far from conclusive, it shows that some corporations obtaining large Government defense contracts have also earned phenomenal increases in profits.

TABLE 12.—*Relationship between Government contracts and corporation profits*

[NOTE.—From June 1940 to June 1941 the War and Navy Departments allocated $9,889,000,000 of supply contracts of which 73.9 percent in dollar value was awarded to 56 companies. Published financial data, which may differ somewhat from data submitted for income-tax purposes, are available for 14 of these corporations. The table below sets forth the dollar value of contracts received and the percentage increase in profits in 1940 over the average net income in the base period years 1936-39. Obviously, in most cases the contracts were merely awarded and not completed; hence, only part of the profits from Government contracts are reflected. Obviously, too, the profits reflect additional business from other than Government sources which may or may not be indirectly due to the defense program]

Corporation	Dollar value of defense contracts (in millions)	Percentage increase in profits in 1940 over 1936-39 average
New York Shipbuilding	507.3	2,448
General Motors	489.9	51
Curtiss-Wright	443.9	1,061
Newport News Shipbuilding	389.2	441
du Pont de Nemours	318.5	77
Glenn L. Martin	249.1	230
United Aircraft	224.5	452
United States Steel	209.9	163
Electric Boat	120.1	289
Sperry Corporation	108.0	238
American Car & Foundry	81.2	2,470
Chrysler Corporation	71.0	24
Lockheed Aircraft	46.5	328
Hercules Powder	29.9	92
Total	3,298.0	[1] 91.5

[1] Weighted.

PROFITS NOW AND PROFITS IN 1916

Another common allegation is the assertion that profits now do not compare with profits in the last war. Again, no conclusive evidence is available, but the following table of a few companies chosen at random is interesting in depicting "Shades of 1916."

TABLE 13.—*"Shades of 1916"—Comparison of net income of selected corporations in pre-World War and World War years with 1936-39 pre-defense and 1940 years.*

[Millions of dollars]

Corporation	Pre-war 1911-13	1916	Pre-defense 1936-39	1940
American Woolen Co	1.75	5.86	−0.32	3.96
Continental Can	.79	2.14	9.98	12.24
Du Pont de Nemours	5.53	82.11	63.44	112.53
General Motors	4.56	28.79	221.67	335.75
Hercules Powder	1.02	16.66	5.29	10.14
International Paper & Power	1.11	4.62	5.12	23.18
Standard Oil of New Jersey	....	....	171.98	197.37
Standard Oil of Indiana	14.68	30.04	....	....
United States Steel	63.59	271.53	59.24	155.83

Source: Current data from published financial reports. 1911-16 data from p. 62, Minority Report of Senator Robert M. La Follette, Sr., to H. R. 4280, 65th Cong., Revenue Act of 1917.

KINDS OF EXCESS PROFITS NOT REACHED BY THE COMMITTEE BILL

Apart from the fact that the two-headed plan of computing excess profits makes the Treasury a loser every time, the present excess-profits tax does not reach two major types of excess profits: (1) The profits of those prosperous corporations which have earned substantial net income during the base period, and (2) the profits of those cor-

porations which have earned phenomenal increases in profits due to the defense program, and yet are not liable for taxation thereon because of a high capitalization.

The injustices and abnormal competitive situations arising out of the former type were fully discussed in my minority report last year to the Second Revenue Act of 1940 (and quoted previously in this report). The situations arising out of the latter type have been discussed by the Treasury Department before both the House Ways and Means Committee and the Senate Finance Committee. The Assistant Secretary of the Treasury, Mr. Sullivan, told the House committee:

> Many corporations that are the principal beneficiaries of the defense effort and that hold large Government contracts are paying little or no excess-profits tax * * *. To meet this defect, we would suggest revising the 1940 proposal to provide * * * a tax at a low flat rate, possibly 10 percent, to that part of the current profits that is in excess of the base-period earnings * * *.

The House of Representatives adopted the proposal, but a majority of the Finance Committee saw fit to delete this special provision. The steel companies, railroads, and coal companies were thereby saved $67,700,000—which the committee added to the tax burden of the low-income taxpayer and corporations in general. In my opinion, not only should this special rule be applied, but the rates should be higher than the 10 percent suggested by the Treasury.

The specific illustrative examples below, typical examples, show the facts concerning corporations which fall into these two categories. Coca Cola, Chrysler, J. C. Penney, General Motors, and Liggett & Myers are illustrative of corporations earnings substantial profits during the base period. United States Steel, American Woolen, American Car & Foundry, and International Paper & Power are illustrative of corporations with high invested capital.

TABLE 14.—*Illustrative typical examples of corporations earning substantial net incomes during the base period 1936–39 and tax year 1940; Comparison of excess-profits tax liability (present law) under invested capital and average earnings methods*

[NOTE.—Computations are based on published financial data which may differ somewhat from data for income-tax purposes]

EXAMPLE NO. 1. COCA-COLA

	Millions of dollars
Net income:	
1936	27.1
1937	32.0
1938	33.5
1939	39.1
Average, 1936–39	33.1
1940	43.9
1940 equity capital	89.0
Return on equity capital:	*Percent*
1936–39	37.0
1940	49.3
	Millions of dollars
Approximate excess-profits tax, 1940:	
Invested capital method	13.1
Average earnings method	1.0
Difference	12.1

TABLE 14.—*Illustrative typical examples of corporations earning substantial net incomes during the base period 1936–39 and tax year 1940: Comparison of excess-profits tax liability (present law) under invested capital and average earnings methods*—Continued

EXAMPLE NO. 2. CHRYSLER

	Millions of dollars
Net income:	
1936	76.2
1937	63.0
1938	22.5
1939	47.9
Average, 1936–39	52.4
1940	64.8
1940 equity capital	188.8
Return on equity capital:	*Percent*
1936–39	27.8
1940	34.3
Approximate excess profits tax, 1940:	*Millions of dollars*
Invested capital method	17.0
Average earnings method	3.7
Difference	13.3

EXAMPLE NO. 3. J. C. PENNEY CO.

	Millions of dollars
Net income:	
1936	22.0
1937	19.7
1938	16.6
1939	20.0
Average, 1936–39	19.6
1940	21.8
1940 equity capital	85.6
Return on equity capital:	*Percent*
1936–39	22.9
1940	25.4
Approximate excess-profits tax, 1940:	*Millions of dollars*
Invested capital method	4.8
Average-earnings method	.4
Difference	4.4

EXAMPLE NO. 4. GENERAL MOTORS

	Millions of dollars
Net income:	
1936	282.3
1937	245.8
1938	130.3
1939	228.3
Average, 1936–39	221.7
1940	335.7
1940 equity capital	1,156.9
Return on equity capital:	*Percent*
1936–39	19.2
1940	29.0
Approximate excess profits tax, 1940:	*Millions of dollars*
Invested capital method	81.3
Average earnings method	39.1
Difference	42.2

TABLE 14.—*Illustrative typical examples of corporations earning substantial net incomes during the base period 1936–39 and tax year 1940: Comparison of excess-profits tax liability (present law) under invested capital and average earnings methods*—Continued

EXAMPLE NO. 5. LIGGETT & MYERS

	Millions of dollars
Net income:	
1936	28.4
1937	25.1
1938	25.0
1939	24.7
Average 1936–39	25.7
1940	27.1
1940 equity capital	154.3
Return on equity capital:	*Percent*
1936–39	16.7
1940	17.6
Approximate excess-profits tax, 1940:	*Millions of dollars*
Invested capital method	3.97
Average earnings method	.02
Difference	3.95

TABLE 15.—*Illustrative typical examples of corporations earning substantially increased net incomes in 1940 over the base period 1936–39, but which are not liable for heavy excess-profits taxation: Comparisons of excess-profits tax liability (present law) under invested capital and average earnings methods*

[NOTE.—Computations are based on published financial data which may differ somewhat from data for income tax purposes]

EXAMPLE NO. 1, UNITED STATES STEEL

	Millions of dollars
Net income:	
1936	62.3
1937	125.4
1938	−4.8
1939	54.1
Average, 1936–39	59.2
1940	155.8
Excess of earnings in 1940 over 1936–39 average	96.6
Excess-profits tax liability	0.0

EXAMPLE NO. 2. AMERICAN WOOLEN CO.

	Millions of dollars
Net income:	
1936	2.55
1937	−1.69
1938	−4.87
1939	2.74
Average, 1936–39	−.32
1940	3.96
Excess of earnings in 1940 over 1936–39 average	4.28
Excess-profits tax liability	0.00

TABLE 15.—*Illustrative typical examples of corporations earning substantially increased net incomes in 1940 over the base period 1936–39, but which are not liable for heavy excess-profits taxation: Comparisons of excess-profits tax liability (present law) under invested capital and average earnings methods*—Continued

EXAMPLE NO. 3. AMERICAN CAR & FOUNDRY

	Millions of dollars
Net income:	
1936	1.41
1937	.96
1938	−1.54
1939	.20
Average, 1936–39	.26
1940	6.58
Excess of earnings in 1940 over 1936–39 average	6.32
Excess-profits tax liability	0.00

EXAMPLE NO. 4. INTERNATIONAL PAPER & POWER CO.

	Millions of dollars
Net income:	
1936	5.69
1937	9.62
1938	.20
1939	4.96
Average, 1936–39	5.12
1940	23.18
Excess of earnings in 1940 over 1936–39 average	18.06
Excess-profits tax liability	2.13

PART IV. OTHER DEFECTS IN THE BILL

1. THE ESTATE- AND GIFT-TAX EXEMPTIONS AND RATES ARE TOO GENEROUS

The original Treasury recommendations proposed to reduce the estate- and gift-tax exemptions from $40,000 to $25,000 (with the insurance exclusion reduced similarly) and to apply tax rates on the net estate ranging from 4 to 70 percent, and on gifts, three-fourths of the estate-tax rate. It was estimated that the additional revenue yield would be $347,200,000.

The Ways and Means Committee rejected the proposal and merely increased the rates somewhat on net estates and gifts in excess of the present exemptions of $40,000. The Finance Committee made but minor changes. Hence, the bill as now recommended to the Senate will raise only an additional $157,600,000 from this source—less than one-half of the Treasury recommendation.

In my opinion, the original recommendations of the Treasury were amply justified. Except for the argument that small estates and gifts should be reserved to the States for taxation, no compelling argument has been raised to justify exemptions of $40,000 during the present fiscal emergency. Even the State-tax-base argument loses much of its validity in the face of much more serious encroachments of the Federal Government in the taxation of gasoline and individual income. It must be exceedingly difficult for those who favor a $40,000 estate-tax exemption to explain why the single man or woman earning less than $15 a week should pay an income tax based on an exemption of less than one-fiftieth as much. Under the bill as recommended by a majority of the committee, an estate of $41,000

will bear a Federal tax of $30. The same amount will be paid in income tax by a single individual earning $21.65 a week.

It is significant to observe that Great Britain imposes a $1,600 tax on a $40,000 estate (conversion unit: £1 equals $4). Even a $2,500 estate in Great Britain is taxed $50.

2. THE COMMITTEE BILL IMPOSES AN UNJUST AND INEQUITABLE AUTOMOBILE USE TAX

This proposed tax is a flat levy which would be paid in equal amount by the owner of a Ford or a Cadillac, by the 20,000-miles-a-year driver and the 500-miles-a-year driver. In the words of Mr. Sullivan during the Senate hearings on this bill:

> The proposed tax has no relationship to the extent of use or the value of the object taxed and, therefore, is unusually inequitable. It taxes a $5,000 town car exactly the same $5 as the fifth-hand car worth only $20. It will conflict directly with one of the most important State and local sources of revenue. In some States, the proposed tax will in effect increase the average cost of automobile registration by more than 100 percent. The proposed tax must be collected from 32,000,000 taxpayers located throughout every State and county in the country. This would require additional personnel in the Bureau of Internal Revenue of at least 3,800 new employees. The administrative cost is estimated to be $9,600,000 or approximately $6 per $100 of tax collected, which is more than five times the average cost of collecting other excise taxes.

The average motor-vehicle operator is already paying more than his share in gasoline and excise taxes and registration and other fees. Each motor vehicle in 1939, according to reliable estimates, paid an average tax of $50.82. The burden has grown since.

If it were deemed necessary to put an additional tax on automobiles, it would be more logical to increase the excise tax on new automobiles from the proposed 7 to 10 percent. With the curtailment in production necessary because of national defense, the consumer would be more than willing to pay the additional tax to secure a car; the supply and demand situation would be less acute; and the Government, instead of the manufacturer, would benefit from an increased price which is likely to be paid by the consumer in any case.

3. THE COMMITTEE BILL PLACES VARIOUS EXCISE TAXES ON A "PERMANENT" BASIS

Since the enactment of the Revenue Act of 1932, various taxes have been carried in our tax structure as "temporary taxes." They were renewed periodically by legislation extending the date of applicability. The committee bill makes these taxes "permanent." I, for one, have held the hope that these regressive taxes might be wiped off the statute books. The committee recommendation will make the future elimination of these taxes difficult, if not impossible.

4. THE COMMITTEE BILL FAILS TO CORRECT THE PRESENT OVERLY GENEROUS DEPLETION ALLOWANCES GRANTED FOR TAX PURPOSES TO CONCERNS ENGAGED IN THE EXTRACTION OF NATURAL RESOURCES

As pointed out by Secretary Morgenthau in the hearings before the Finance Committee, the present tax laws are too generous in dealing with depletion allowances. No one questions the fact that reasonable maintenance, depreciation, and obsolescence allowances must

be made in arriving at net income. However, the degree of such allowances must be measured and governed by comparative sacrifices borne by other taxpayers.

5. THE COMMITTEE BILL FAILS TO TAX A CONSIDERABLE VOLUME OF STATE AND LOCAL SECURITIES WHICH ARE STILL EXEMPT FOR INCOME TAX PURPOSES

The surtax in the committee bill, it is true, will reach a part of the interest derived from partially tax-exempt securities. About $31,-600,000 in additional Federal revenue will be derived therefrom. However, a large bloc of securities will still remain untaxed. More than 19 billion dollars of State and local securities are wholly tax exempt.

Exhaustive studies of this subject have been made by both the Congress and the Treasury Department. The Treasury Department under several different administrations has consistently advocated the removal of the tax exemptions. Economists are practically unanimous in agreeing that there is no rhyme or reason in allowing interest from Government bonds to go untaxed.

In my opinion, the Finance Committee should have given consideration to this subject in connection with this bill and, once and for all, eliminated the vestige of old tax theories on the subject.

6. THE LOWERED EXEMPTIONS ON THE PERSONAL INCOME TAX ARE UNJUSTIFIED

When Secretary Morgenthau appeared before the Senate Finance Committee on August 8, 1941, he said, speaking of lowered tax exemptions:

> * * * We ought not to accept such sacrifices, even though willing sacrifices, from millions of people with low incomes on whom the burden of other types of taxes falls most heavily, unless we reach in other places ability to pay which is escaping its fair share of taxes. Among these are the following:
>
> The excess-profits tax exempts profits of even the most prosperous corporation, except to the extent that such profits are in excess of its average profits for the years 1936-39. Surely Congress will not wish to impose additional taxes on millions more of our low-income group unless it also imposes the excess-profits tax on exempt excess profits of such corporations.
>
> Families pay lower Federal income taxes when both husband and wife receive incomes than when the same total amount of income is received by only one of them. This is a discrimination of which many wealthy people have taken advantage by large gifts of income-producing property between husband and wife.
>
> For years, the concerns engaged in extracting certain of our natural resources, notably oil, have been granted far greater allowances for depletion than can be justified on any reasonable basis of tax equity. If the income tax is to be extended to lower incomes, this privilege of tax escape should simultaneously be removed.
>
> A few months ago the Congress eliminated the tax-exemption privilege from new issues of Federal securities. The purchasers of new State and local securities still enjoy this exemption. The exemption was inequitable and expensive even in normal times. It cannot be borne longer in a time like this, and especially if we are to increase the direct tax burdens of persons with smaller incomes.
>
> In its suggestion to the Ways and Means Committee the Treasury recommended substantial increases in estate and gift taxes and lower exemptions. In part, this recommendation was followed but in my opinion, the estate and gift taxes should reach more estates and provide more revenue if we are going to tax smaller incomes.

Could anything more emphatic have been said about what should come first?

What did the committee do? They complied with none of the qualifying provisions, but proceeded to lowering the exemptions nevertheless.

As an advocate in past years for the lowering of income-tax exemptions, I have consistently maintained that such was a preferable choice as between that or consumption taxes. I still adhere to that view. But I am wholly unwilling to soak the poor man with both. That is precisely what this bill does.

The T. N. E. C. Monograph No. 3, entitled "Who Pays the Taxes," reveals some facts that many pressure groups are trying desperately to discredit. It reveals that, because of hidden and regressive taxes consumers in the lowest income brackets are paying a larger share of their income in taxes than are substantially wealthier income groups.

I am unwilling to place a heavier burden on them through this bill.

The following tabulation shows concisely how income-tax rates and exemptions have been changed in past years.

Federal individual income-tax rates

Income year	Personal exemptions		Normal tax rate	Surtaxes		Maximum, normal, and surtax
	Single	Married		Begin at—	Range of rates	
			Percent		*Percent*	*Percent*
1913-15	$3,000	$4,000	1	$20,000	1-6	7
1916	3,000	4,000	2	20,000	1-13	15
1917 [1]	1,000	2,000	2.4	5,000	1-63+	67+
1918	1,000	2,000	6-12	5,000	1-65	77
1919-20	1,000	2,000	4-8	5,000	1-65	73
1921	1,000	2,500	4-8	5,000	1-65	73
1922-23	1,000	2,500	4-8	6,000	1-50	58
1924	1,000	2,500	2-6	10,000	1-40	46
1925-28	1,500	3,500	1½-5	10,000	1-20	25
1929	1,500	3,500	½-4	10,000	1-20	24
1930-31	1,500	3,500	1½-5	10,000	1-20	25
1932-33	1,000	2,500	4-8	6,000	1-55	63
1934-35	1,000	2,500	4	4,000	4-59	63
1936-39	1,000	2,500	4	4,000	4-75	79
1940	800	2,000	4.4	4,000	4.4-75+	79+

[1] Certain individuals and partnerships were subject also to an excess-profits tax in 1917.

Source: Compiled from Statistics of Income and Revenue Acts. Because of numerous changes in the detailed provisions of the latter, the rates tabulated above are not strictly comparable.

PART V. CONCLUSIONS

The existing tax structure is inequitable. It violates the principle of ability to pay. The pending tax bill if enacted into law will impose even greater burdens upon the great masses of the people who have the least ability to pay. Taxes which mean a reduction of an already unconscionably low standard of living are proposed to be levied while fat profits from defense spending get off with only a relatively minor share of the total burden.

Smaller corporations are threatened by an economic pincers movement more powerful than the giant monopolies have ever been able to muster, fostered by Government itself. We face a paradox of depression and underemployment in the midst of defense prosperity. The two jaws of the Government pincers movement are priorities and defense contracts. Priorities are depriving nondefense industries of raw materials necessary for their existence. Defense contracts

have gone for the most part to big business. The result is that small business which is denied materials for normal production must shut down, while big business gets defense contracts to replace normal production.

The pending tax bill instead of drastically increasing the yield from an effective excess-profits tax shifts $500,000,000 from the normal corporation tax yield (by the reversal of credits) and adds it to the estimated yield from excess-profits taxes. At the same time corporations large and small are to have their taxes jacked up without regard to profits made from the defense spending.

For many years the Senate and the taxpayers have been promised a genuine revision of the tax structure and each year the promise is never fulfilled.

With an additional lend-lease appropriation for aid to other countries about to be submitted to Congress which will no doubt equal if not exceed the additional revenues to be raised by the pending bill, it is idle to lull ourselves into the false dream that the present bill is within gunshot of being adequate to meet the fiscal crisis which confronts the Treasury now and in the foreseeable future.

To pile a hodgepodge tax bill upon the existing hodgepodge tax structure impairs the functioning of our economy. One of the essentials necessary to free production for the defense effort is a sound tax structure. Passage of the pending bill with all of its acknowledged injustices and hardships might be accepted if the individual and corporate taxpayers could be assured this was all they would be asked to carry. Such is not the case. They have already been informed that another and bigger tax bill is to be enacted next year. This kind of blunderbuss tax procedure threatens the entire production effort for defense. It intensifies the resentment of all kinds of taxpayers. It will tend to increase disunity instead of foster unity.

It is my firm conviction that the pending bill, which makes an intolerable tax structure infinitely worse, should be rejected and thoroughgoing revision of the tax structure based on the sound principle of ability to pay should be immediately undertaken.

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THE REVENUE BILL OF 1941

SEPTEMBER 3 (legislative day, SEPTEMBER 2), 1941.—Ordered to be printed

Mr. VANDENBERG, from the Committee on Finance, submitted the following

INDIVIDUAL VIEWS

[To accompany H. R. 5417]

In the total tax raised by the pending measure, some such measure is inevitable if there is to be any pretense of protecting the public credit. It is inevitable because there is no inexpensive way to go to war or to prepare for war. It is inevitable because there is no inexpensive way to underwrite the war bills of all foreign countries which the President may choose to include within our war expenditures. The quicker the country understands this cruel fact, the sooner it can realistically assess the extent to which it is prepared to pursue the unlimited foreign policy upon which we are now embarked. It would be folly to put dollars ahead of freedoms. But it would be worse folly to ignore the fact that our resources are not unlimited; that we cannot become the unlimited "treasury" as well as the "arsenal" of all those who may choose to fight the Axis; and that this tax bill—which will probably be followed by a lend-lease request for added billions which will consume the total new revenue here provided—puts us and our Allies on notice to face facts. Although this bill takes every possible penny of new revenue which the Senate Finance Committee could find, so long as it ignores fundamental changes in our tax system; and although it will fall with heavy burden on all our people, its approximate 4 billions of return is less than 10 percent of our appropriations and commitments for this fiscal year. No crystal-gazing is required to see where these trends lead. This bill is but a preview of the "belt tightening" which lies ahead for all America. To this extent, at least, it is a contribution to candor and realism. If we are drawn into a shooting war the burden will be relatively heavier. These considerations will become utterly inconsequential if we are attacked. Even now they must be weighed in the scales of relative jeopardy. But they should be weighed. This bill brings the war home to the people of the United States. Some such measure is inevitable; and it

must be accepted as inevitable even by those citizens who have opposed the policies that make it necessary.

It is inevitable for another reason. This war and defense era was preceded by an 8-year nondefense spending spree without parallel in the history of the world; and now the "chickens are coming home to roost." Our people are now loaded down with a burden of Federal taxation which is 50 percent greater than even was required to pay our World War bills. From July 1, 1933, to June 30, 1941, this administration has already spent 67 billions, collected 40 billions in revenues, accumulated a combined peacetime deficit of 27 billions, and increased the public debt beyond 50 billions, not including collateral guaranties. Of the 67 billions, only 5 billions can possibly represent extraordinary defense expenditures. Our debt limit already has been raised from 45 to 65 billions. We are on our way to 100 billions (which is nearly equal to the assessed valuation of all the real estate in the United States). The danger inherent in this situation was defined by President Roosevelt himself on March 10, 1933, when he officially reported that accumulated deficits of only 5 billions had put us "on the road toward bankruptcy" and when he promised that if he was given his "economy bill" (which he was) "there would be reasonable prospect that within a year the income of the Government will be sufficient to cover the expenditures of the Government." That prospect became a mirage. Thrift became a hissing and a byword. Deficit-spending became a passion. Yet it never ceased to be true, as asserted by the President on March 10, 1933, that it "is our first concern to make secure the foundation" of the public credit; and that "most liberal governments are wrecked on the rocks of loose fiscal policy".

We entered upon this war era—this "defense era"—tragically handicapped by this inheritance. There is no consolation in recalling the facts. But they bear upon our present necessities. They accumulate the reasons why this Congress dare not turn its back upon a new tax bill—to be followed by other tax bills—to "make secure the foundation" of the public credit. Nor can those who consistently opposed this orgy of peacetime extravagance dismiss this necessity on the grounds that it was none of their doing. We face a condition, not a theory. We have all been shoved into the same boat. We must all face the bills and we must all help pay them.

The Secretary of the Treasury told us last April that he would not be responsible for the hazard to the public credit unless this Congress had the courage to put the Nation on a two-thirds pay-as-you-go basis; and, without regard to parties or politics, we all acquiesced. That called for a $3,500,000,000 new tax bill—and here it is, plus. But since then, the Federal expenditures have taken another flight—and many more flights are in prospect ere this fiscal year is done. The Secretary's pious formula is already out the window. Although this bill climaxes an annual public revenue at least 50 percent greater than we ever had in the World War—when we were at war—it does not approach the distinguished Secretary's "two-thirds" formula. It would probably be impossible presently to do much more, however, without wrecking our internal economy—and our internal economy is probably already threatened more by "priorities" and "price controls" and "curtailments" and "taxes", unless these factors are prudently

administered, than it will ever be damaged by any alien tyrant-on-the-march. But this only serves to emphasize two propositions: First, at the very least we must have this much of a new tax bill; second, we must, at long last, institute far-reaching nondefense economies. At the same time we must realistically determine how far, short of war, we can underwrite the war bills of the world. We owe this to ourselves; we owe it to those abroad who must not be left to a dangerous disillusionment. We cannot be content with a bankrupt Utopia.

Nondefense economies—plus our "money's worth," instead of wild waste, in defense expenditures—are just as important as new taxes in saving this situation. We have had practically none of them to date. They will never be achieved without the same sort of stern executive leadership which we had in 1933. But executive leadership alone is not enough. Congress must cooperate. The one and only economy veto from the White House in many red-ink months was promptly overridden in the Senate. These are dangerous trends. It is a desperately dangerous legislative state of mind. The public credit is the first line of the national defense. The best thing about the pending bill as it comes from the Senate Finance Committee is the Byrd amendment which valiantly struggles toward reduced nondefense expenditures. But it is only a national anesthetic unless the President and Congress highly resolve to follow the hard way of stopping all Federal expenditures which are not indispensable. We must quit the free-and-easy notion that the Treasury of the United States is inexhaustible. We must quit the complacent, convenient notion of the last prodigal decade that debts are an asset. We must "go to war" against our spendthrifts long before we "go to war" against another enemy 3,000 miles away. We may be relatively rich. But we do not possess Aladdin's lamp. Simple arithmetic cannot be repealed even by the New Deal.

But there will still remain the unescapable need for $4,000,000,000 in new revenue—and more. Therefore a tax bill to this end is unavoidable—and the worst kind of a tax bill (which this probably is) would be better than no tax bill at all. No relatively incidental sacrifice on the part of the citizen, as a result of this bill, could be as bad as his sacrifice if we should neglect the need for additional Federal revenues under the circumstances. The result of any such blind course would be the collapse of our capitalistic system.

There can be no denial of the fact that this bill has many dangerous taxes in it. They eat at the very heart of our domestic economy. Many of these new taxes are highly discriminatory. The burden is not fairly spread. The reduction in personal income tax brackets to an extreme degree is highly illusory as a means to "spread the burden." It goes down into incomes which cannot, by any stretch of the imagination, be further reduced. Yet it takes seven times as much out of the higher brackets as it does out of the lowest brackets, and really becomes a device to pile still more burdens upon that minority of Americans who already pay most of the Nation's bills.

The Senate Finance Committee voted down my proposal for a general manufacturer's sales tax as a substitute for many of these new, discriminatory taxes. There is no practical way that I can bring this issue to the Senate floor. It is much too complicated to be

settled on the Senate floor. But I venture the prophecy that some such recourse is inevitable within another 12 months. With food, clothing, and medicine exempted from such a tax—and with careful precautions against pyramiding—it would produce a minimum of one and one-half billion dollars at 5 percent; and yet, according to labor's own statistics, it would not touch 80 percent of the average wage earner's annual budget. It comes far closer to measuring "ability to pay" than any other new tax that could be devised. Yet it would create a "national partnership" in this business of salvaging America. It would be fair and just to all concerned. Either it, or a "withholding tax," must soon come if we are to meet this fiscal challenge which is just as real and far more imminent than anything which threatens from abroad. My complaint against this pending bill is its failure to go to fundamentals in meeting this emergency. We cannot much longer ignore tax fundamentals. Our whole citizenship must join in paying these bills. There is no other way. We have only started to pay in this pending bill. And we have "started" in the same old, familiar, habitual way—namely, by picking out the easiest and most convenient tax targets and giving them another blast. Yet I recognize the parliamentary fact that this bill must go to conference with the House and that the Senate could not hope to succeed in substituting entirely new formulas. And there must be action with least possible delay because we are losing $3,000,000 a day in sadly needed revenue every day that the final enactment of this measure is postponed.

I shall reluctantly support the bill, if at all, only because any bill could not possibly be worse than no bill at all in view of the truly desperate fiscal emergency which the Federal Treasury confronts. I shall hope to see it improved before final Senate action. But it can never be rid of its inherent vice until Congress is prepared to face the realities to which I have referred.

I cannot conclude this expression of my minority views without paying my tribute to the new chairman of the Senate Finance Committee, the distinguished Senator from Georgia, Mr. George, who has a completely sound conception of national finance and who, within the limitations with which he is surrounded, may always be trusted to serve the best welfare of the people of the United States.