REVENUE REVISIONS OF 1950

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

EIGHTY-FIRST CONGRESS

SECOND SESSION

ON

H. R. 8920

AN ACT TO REDUCE EXCISE TAXES, AND FOR OTHER PURPOSES

JULY 5, 6, 7, 8, 10, 11, 12, AND 13, 1950

Printed for the use of the Committee on Finance

UNITED STATES
GOVERNMENT PRINTING OFFICE
WASHINGTON · 1950

69174

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CONTENTS

Statement of— Page

Alvord, Ellsworth C., chairman, committee on Federal finance, Chamber of Commerce of the United States 832

Baggett, Sam G., in behalf of the Latin-American committee of the Business Advisory Council 880

Bahr, Henry, secretary, National Lumber Manufacturers Association 386

Balaban, Irving J., restaurant operator, New York, N. Y 188

Barker, Richard B., on behalf of Sand Springs Home and Widows Colony 656

Barta, A. K., secretary, Ethanol committee 182

Bess, John, distributor in the Philadelphia-New York-Washington area for home freezers 689

Bomze, Norman, chairman, legislative committee, National Licensed Beverage Association 173

Boyd, Robert Lee, vice president, Bloch Bros. Tobacco Co 211

Bozell, Harold V., president, General Telephone Corp., and president, United States Independent Telephone Association 241

Brown, Charles F., trustee and lawyer, Union College 550

Brown, Russell B., general counsel, Independent Petroleum Association of America 455

Buckley, Thomas A., president, Luggage and Leather Goods Manufacturers of America, Inc 309

Bulova, Arde, chairman of the board, Bulova Watch Co., on behalf of National Committee for Repeal of Wartime Excise Taxes 44

Carroll, Mitchell B., special counsel, National Foreign Trade Council Tax Committee 859

Carter, Steward R., Jr., legislative counsel, Printing Industry of America 238

Casey, Joseph E., Counsel, Associated Tobacco Manufacturers 192

Chafey, Donald E., Commerce and Industry Association of New York, Inc 444

Clark, A. Bryan, president, Associated Seed Growers, Inc 706

Colladay, Edward F., appearing for Lincoln Rochester Trust Co 317

Condon, Arthur D., in behalf of—

Amana Refrigeration, Inc 689

Chambers of Commerce of Panama and Colon 694

Craigie, Walter W., chairman, municipal securities committee, Investment Bankers Association of America 654

Cutler, Robert, on behalf of Community Chests and Councils of America, Inc., and others 542

Dane, John, Jr., member, committee on Federal finance, Chamber of Commerce of the United States 832

Davidson, Carter, chairman, committee on taxation and financial reporting to the Federal Government, American Council on Education 525

Doerner, E. J., trustee, Sand Springs Home and Widows Colony 656

Dumas, H. S., representing operating companies of the Bell System 70

Earle, C. E., secretary-treasurer, Council for Independent Business 601

Ecker-Racz, L. Laszlo, associate director, Tax Advisory Staff, Treasury Department 1

Eitel, Otto K., chairman, 20-percent Cabaret Tax Committee 311

Ela, Emerson, Ela, Christianson & Ela, Madison, Wis 214

Fernald, Henry B., chairman, tax committee, American Mining Congress 767

Flanders, Hon. Ralph E., a United States Senator from the State of Vermont 595

Statement of—Continued Page
Fletcher, R. V., special counsel, Association of American Railroads 99
Forestner, George, president, Amana Refrigeration, Inc 689
Francis, Joseph H., executive secretary, National Board of Fur Farm Organizations 233
Friedman, Elisha M., consulting economist, New York, N. Y 643
Green, Julius, chairman, National Fur Tax Committee 122
Griswold, Merrill, chairman, executive committee, American Research & Development Corp 596
Haas, George C., Director, Technical Staff, Treasury Department 1
Haley, James W., secretary, special tax committee, National Coal Association 757
Halligan, Charles W., chairman, tax committee, Rubber Manufacturers Association, Inc 298
Hamblin, W. P., director and attorney for W. D. Hayden Co 703
Harbaugh, M. D., vice president, Lake Superior Iron Ore Association 299
Hedden, Stuart, trustee, Wesleyan University 567
Henderson, Leon, economic adviser, National Committee for Repeal of Wartime Excise Taxes 50
Heyl, Louis H., vice president and general manager, Wyodack Chemical Co 447
Hill, J. Rutledge, chairman, committee on taxation, National Sand and Gravel Association 793
Johnson, Roy W., vice president, Alaska Industrial Corp 889
Joyce, R. E., on behalf of the tax council, Alcoholic Beverage Industries 142
Kaufman, Jerome, associate managing director, National Association of Tobacco Distributors 319
Kile, Elton, director and member of tax committee, Grain and Feed Dealers National Association 718
Killian, James R., Jr., president, Massachusetts Institute of Technology 374
Kilpatrick, H. Cecil, chairman, section of taxation, American Bar Association 400
Kirby, Vance N., tax legislative counsel, Treasury Department 1
Kitchen, C. W., executive vice president, United Fresh Fruit and Vegetable Association 117
Kosbie, Jacob, member, board of directors, Trailer Coach Manufacturers Association 836
Lamb, George A., on behalf of National Coal Association 253
Laylin, Clarence D., representing Council of State Chambers of Commerce and Ohio Chamber of Commerce 608
Leahey, Thomas F., Assistant Director, Technical Staff, Treasury Department 1
Lester, Garner M., president, National Tax Equality Association 710
Loos, Karl D., on behalf of National Council of Farmer Cooperatives, National Federation of Grain Cooperatives, and National Milk Producers Federation 735
Loveladv, R. M., president and legislative representative, Lodge 14, American Federation of Government Employees 694, 901
Lynch, Thomas J., General Counsel, Treasury Department 1
McDonald, Walter R., general solicitor, National Association of Railroad and Utilities Commissioners 519
Manice, William DeForest, director, Metropolitan Opera Association 161
Marsh, Benjamin C., executive secretary, The People's Lobby, Inc 77
Marshall, Walter P., president, Western Union Telegraph Co 81
Mason, Hon. Noah M., a Representative in Congress from the State of Illinois 828
Meck, John, treasurer, Dartmouth College 525
Mills, Reese, chairman, excise tax advisory committee, National Electrical Manufacturers Association 222
Morris, Curtis, on behalf of East Texas Chamber of Commerce 662
Munro, Howard F., legislative representative, Central Labor Union and Metal Trades Council of the Panama Canal Zone 651
Myers, Abram F., chairman, committee on taxation, Council of Motion-Picture Organizations 146
Nichols, Charles, appearing for Frank M. Mayfield, chairman, National Committee for Repeal of Wartime Excise Taxes 41

Statement of—Continued | Page
Parker, L. H., chairman, special tax committee, National Coal Association 757
Parker, W., president, Parker Bros 703
Quealy, William H., counsel, Federal taxation committee, Illinois Manufacturers' Association 431
Ragland, Edward F., executive secretary, Associated Tobacco Manufacturers 192
Ramspeck, Robert, executive vice president, Air Transport Association of America 219
Reilly, James F., representing League of New York Theaters and National Association of the Legitimate Theater 170
Rivers, Walter, director of repertoire, Capitol Records, Inc., Eastern Division 244
Ruthenberg, Louis, chairman of the board, Servel, Inc., on behalf of National Committee for Repeal of Wartime Excise Taxes 47
Sacha, F. L., Deepfreeze Division, Motor Products Corp 689
Sands, Charles E., representing Hotel and Restaurant Employees International Alliance and Bartenders International Union 171
Satterlee, Hugh, attorney, New York, N. Y., and Washington, D. C. 589
Schock, Clarence, president, the SICO Co 534
Schumacher, H. A., representing National Association of Photographic Manufacturers, Inc 259
Seefurth, N. H., on behalf of National Association of Life Underwriters 621
Seidman, M. L., chairman, taxation committee, New York Board of Trade, Inc 451
Skelton, Byron, representing Scott and White Hospital 791
Sligh, Charles R., Jr., chairman, taxation committee, National Association of Manufacturers 405
Snyder, Hon. John W., Secretary of the Treasury 1
Stassen, Hon. Harold E., president, University of Pennsylvania 498
Stewart, Charles W., secretary, Machinery and Allied Products Institute 436
Sullivan, Gael, executive director, Theater Owners of America, Inc 158
Tarleau, Thomas N., on behalf of Seaboard Air Line Railway 856
Taylor, Charles G., Jr., chairman, Joint Committee of the American Life Convention and the Life Insurance Association of America 626
Taylor, Hugh W., executive secretary, Burley and Dark Leaf Tobacco Export Association, Inc 304
Tunick, Abraham, Washington counsel, Wine and Spirits Wholesalers of America, Inc 177
Voorhis, Jerry, executive secretary, Cooperative League of the United States 722
Wahl, Charles F., Washington representative, International Brotherhood of Electrical Workers 694
Warner, Theodore K., Jr., chairman, Federal taxation committee, Pennsylvania State Chamber of Commerce 615
White, John C., on behalf of the New York Cotton Exchange 700
Wilkinson, R. J., executive manager, Master Photo Dealers' and Finishers' Association 281
Williston, Sam H., chairman, tax committee, Mining and Metallurgical Society of America 783
Woodward, Guy H., attorney, Mid-Continent Oil & Gas Association 461
Additional information submitted for the record by—
Agricultural Limestone Institute, statement of Henry A. Huschke, managing director 808
Alaska Development Board, telegram from Ralph Browne, to Delegate Bartlett 893
Allen-Bradley Co., letter from A. F. North, treasurer, transmitting statement 671
American Association of Museums, statement of L. V. Coleman, director 336
American Farm Bureau Federation:
Letter from Roger Fleming, secretary-treasurer 467
Statement of 804
American Federation of Labor, statements of 480, 481
American Patent Law Association, statement of Paul A. Rose, chairman, committee on laws and rules 680

Additional information submitted for the record by—Continued — Page
American Petroleum Institute, statement of James J. Cosgrove — 369
American Polled Hereford Association, letter from Walter E. Barton — 493
American Symphony Orchestra League, statement of Mrs. Helen M. Thompson, secretary-treasurer — 165
Amherst H. Wilder Charity, letter from F. M. Rarig, Jr., executive secretary, to Representative McCarthy — 675
Armour & Co., statement of W. R. Emery, tax attorney — 802
Associated General Contractors of America, Inc., letters from H. E. Foreman, managing director — 323, 679
Association of American Colleges, letter from Guy E. Snavely, transmitting proposed amendment — 669
Association of American Universities, report of the committee on financial support and taxation — 573
Association of Colleges and Universities of the State of New York, letters from Everett Case — 582
Association of Maryland Distillers and Allied Industries, statement of Donald Hammond, secretary — 343
Athletic Goods Manufacturers Association, letter from Fred J. Bowman, president and Philip H. Goldsmith, secretary — 333
Automobile Manufacturers Association:
Letter from A. E. Barit, chairman, committee on taxation — 126
Statement of — 361
Bangor & Aroostook Railroad, letter from F. H. Daggett, vice president and general manager — 798
Baptist Foundation of Texas, statement of A. B. Culbertson, vice president — 216
Baptist Joint Committee on Public Affairs, statement of Joseph M. Dawson, executive director — 217
Barton, Carlyle, letter from, to Senator Tydings — 680
Bates College, letter from Charles F. Phillips, president — 581
Bell System:
Excise taxes as amended by H. R. 8920 — 74
Principal excise tax changes in H. R. 8920 — 76
Black Hills Bentonite, Inc., telegram from A. C. Harding and Harry T. Thorson — 451
Boedtker, Alfred, statement of — 664
Bowey's, Inc., letter from W. H. Hottinger, Jr., assistant secretary — 800
California Farm Bureau Federation, letters from Ray B. Wiser, president, to Senator Downey — 817, 819
Cannon Foundation, Inc., statement of James L. Rankin, counsel and director — 495
Carnegie Corporation of New York, letter from Charles Dollard, President — 665
Carrier Corp., Krantz, Keller, treasurer:
Statement of — 358
Telegram from — 694
Chief Consolidated Mining Co., telegram from Cecil Fitch, president, to Senator Thomas — 801
Cigar Manufacturers Association of America, Inc., letter from Samuel Blumberg, general counsel, transmitting statement — 135
Clock Manufacturers Association of America, Inc., statement of — 325
Cohen, Sol, letter from — 822
Colgate University, letter from Everett Case, president — 582
Collins, Bradley, memorandum from — 677
Colorado State Chamber of Commerce, recommendations adopted by board of directors — 468
Committee for Economic Development, statement of J. Cameron Thomson — 371
Controllers Institute of America, letter from Oscar N. Lindahl, chairman, committee on Federal taxation, transmitting statement — 488
Council of State Governments, letter from — 754
Crane, Percy W., letter from — 676
Dartmouth College:
Letter from John S. Dickey, to Senator Tobey — 583
Memorandum from John F. Meck, treasurer — 584
Davis, Hon. Glenn R., statement of — 322

Additional information submitted for the record by—Continued Page
Disney, Wesley E., statement regarding clarifying amendments to section 204 ... 790
Edison Electric Institute, letter from Charles Wigand, vice chairman, taxation accounting committee ... 672
Flanders, Hon. Ralph E., letter from ... 807
Flavoring Extract Manufacturers' Association of the United States, proposed amendment to section 3250 (1) (5) of the Internal Revenue Code ... 341
Florida and Georgia Cigar Leaf Tobacco Association, letter from ... 137
Good Samaritan Hospital, letter from Frank J. Walter to Senator Cordon ... 681
Hall, E. S., statement of ... 822
Harvard Law Review Association, statement of James Vorenberg ... 682
Harvard University:
Letter from Edward Reynolds, administrative vice president, to Senator Saltonstall ... 572
Statement of Paul C. Cabot, treasurer ... 577
Hecla Mining Co., letter from L. J. Randall, comptroller ... 788
Hester, Clinton M., letter from ... 125
Higgins, Allan H. W., statement of ... 607
Holly Development Co., letter from C. A. Johnson, president, to Senator Knowland ... 683
Independent Natural Gas Association of America, statement of Wesley E. Disney, general counsel ... 789
International Apple Association, statement of Kathryn Casey, assistant secretary and general counsel ... 119
International Association of Machinists, letter from Elmer E. Walker, general vice president ... 700
International Handbag, Luggage, Belt and Novelty Workers Union, AFL, statement of Jack Wieselberg, international president, and Norman Zukowsky, general secretary-treasurer ... 354
International Paper Co., letter from H. R. Weaver, first vice president, transmitting statement ... 755
International Union of United Brewery, Flour, Cereal, Soft Drink and Distillery Workers of America, CIO, statement of ... 330
Investors League, Inc., statement of ... 483
Jackson, J. P., letter from, to Senator Fulbright ... 814
Jewelers Vigilance Committee, Inc., statement of P. Irving Grinberg, executive vice chairman ... 129
Jewelry Industry Tax Committee, statement of ... 129
Johnson, Hon. Louis, Secretary of Defense, letter from ... 827
Lancaster County (Pa.) Tobacco Growers' Cooperative Association, letter from C. L. Nestleroth, acting manager ... 136
Lion Oil Co., letter from, to Senator Fulbright ... 485
McFarland, Hon. Ernest W., letter from ... 321
Marcosson, Mark, c. p. a., statement of ... 120
Massachusetts General Hospital, letter from Phillips Ketchum, trustee ... 667
Massachusetts Institute of Technology, statement from the news service ... 575
Michigan, University of, letters from Robert P. Briggs, vice president, to Senator Ferguson ... 587, 588
Minneapolis Symphony Orchestra, statement of Arthur J. Gaines, manager ... 168
National Association of Motor Bus Operators, statement of Jack Garrett Scott, general counsel ... 355
National Beauty and Barber Manufacturers Association, statement of Jacob Reck, counsel ... 291
National Bowling Council, letters from A. L. Ebersole, executive secretary, and John Canelli, general counsel ... 334
National Building Granite Quarries Association, statement of Wesley E. Disney ... 790
National Committee for Repeal of Wartime Excise Taxes:
Domestic production of Bulova watches in relation to consumer expenditures ... 69
Statistics on excise taxes imposed or increased by Revenue Acts of 1941, 1942, and 1943 ... 55–62

Additional information submitted for the record by—Continued | Page
National Council of Farmer Cooperatives, letter from John H. Davis, executive secretary, transmitting statement ... 686
National Crushed Stone Association, statement of J. R. Boyd, administrative director ... 808
National Farmers' Union, statement of Russell Smith, legislative secretary ... 817
National Federation of Independent Business:
Statement of C. Wilson Harder, president ... 816
Telegram from George J. Burger, vice president in charge of Washington office ... 218
National Fruit and Syrup Manufacturers Association, proposed amendment to section 3250 (1) (5) of the Internal Revenue Code ... 341
National Grange, statement of—
Goss, Albert S., master ... 464
Sanders, J. T., legislative counsel ... 467
National League Distributors, telegrams from James F. Solley, Jr., president ... 345
National Live Stock Tax Committee, letter from Frank S. Boice, chairman, and Stephen H. Hart, attorney ... 914
National Manufacturers of Soda Water Flavors, proposed amendment to section 3250 (1) (5) of the Internal Revenue Code ... 341
National Retail Credit Association, statement of Harold L. Schilz, legislative committee ... 357
National Screw Machine Products Industry, statement of Orrin B. Werntz, general manager and counsel ... 331
National Sporting Goods Distributors Association, letter from Shelly Hines, president, and Marvin Shutt, secretary ... 333
Navy Department, letter from John F. Floberg, Assistant Secretary for Air ... 127
New York University, memorandum from Russell D. Niles, dean, school of law ... 580
North Carolina State Grange, statement of Harry B. Caldwell, master ... 716
Nusbaum, Simon J., memorandum of law ... 893
O'Brien, Daniel J., statement of ... 485
Oklahoma Farmers Union Cooperative, telegram from E. K. Dean, manager ... 715
Pacific Lock Operators Association, etc., statement of Charles F. Wahl ... 698
Peninsular & Occidental Steamship Co., statement of Harold B. Wahl, general attorney ... 342
Peters, Harvey W., statement of ... 678
Peterson, Hon. J. Hardin, statement of ... 139
Philharmonic-Symphony Society of New York, letter and telegram transmitting statement ... 131
Pitney-Bowes, Inc., memorandum from Shattuck, Bangs & Davis, attorneys ... 324
Portland Sanitarium and Hospital, letter from, to Senator Cordon ... 681
Providence College, letter from Robert J. Slavin, president ... 579
Regensburg, Edward J., statement of ... 137
Repeal Associates, Inc., letter from C. L. Chapin, president ... 344
Retail Tobacco Dealers of America, Inc., statements of Eric Calamia, managing director ... 141
Rugg, Charles B., letter from ... 910
Rutgers University, letter from A. S. Johnson, comptroller ... 468
Samuel Roberts Noble Foundation, statement of Guy H. Woodward ... 685
Savory Equipment, Inc., statement of J. T. Heilig, vice president ... 337
Schafer, Joseph A., statement of ... 469
Schlotterbeck & Foss Co., Inc., explanation of tax situation on alcohol ... 814
Smith, Hon. Lawrence H., statement of ... 322
Southern Pacific Co., statement of John E. Shea ... 796
Staso Milling Co., letter from Charles T. Kett, president ... 821
Teachers Insurance and Annuity Association of America, statement of George E. Johnson, vice president and secretary ... 670
Texas Independent Producers and Royalty Owners Association, statement of E. I. Thompson, executive vice president ... 819

Additional information submitted for the record by—Continued | Page
Thomas, Hon. Elbert D., letter from ---- 801
Toilet Goods Association, Inc., statement of Donald L. Bryant ---- 359
Toy Manufacturers of the United States of America, Inc., letter from Dow W. Harter ---- 342
Treasury Department:
Comparison of corporation income-tax liabilities under present law and under H. R. 8920, table ---- 22
Corporation income tax effective rates, chart ---- 22
Corporation tax payments under present law and under H. R. 8920, table ---- 28
Coverage of the individual income and estate taxes, 1939 and 1949, chart ---- 34
Details of present corporate income-tax rate structure, table ---- 20
Distribution of corporations and their income, 1950, chart ---- 23
Estimated effect on receipts of the dividend withholding system applied to the dividend payments of one calendar year, table ---- 13
Individual income and estate tax effective rates, 1939 and 1949, chart ---- 35
Individual income and estate tax exemptions, 1939 and 1949, chart ---- 34
Internal revenue derived from individual income and estate and gift taxes, 1939 and 1949, chart ---- 33
Profit rates of manufacturing corporations, 1947–49, chart ---- 24
Receipts from the dividend withholding system in a hypothetical full year of operation at current levels, table ---- 13
Tax payments of calendar-year corporations under provisions of H. R. 8920, chart ---- 28
Whitfield, Stratford & Co., letter from, to Senator Cordon ---- 492
Wine and Spirits Wholesalers of America, Inc.:
Letter from Wenchel, Tannenbaum & Nunan, to Bureau of Internal Revenue ---- 346
Statement of Fred M. Switzer, general counsel and executive vice president ---- 177
Wine Industry of the United States, statement of Edward W. Wootten, manager, Washington office ---- 365
Yale University, letter from A. Whitney Griswold, president, transmitting statement of L. G. Tighe, treasurer ---- 585

REVENUE REVISIONS OF 1950

WEDNESDAY, JULY 5, 1950

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D. C.

The committee met, pursuant to call, at 10 a. m., in room 312, Senate Office Building, Washington, D. C., Senator Walter F. George, chairman, presiding.

Present: Senators George, Connally, Lucas, Hoey, Kerr, Millikin, Taft, Butler, and Martin.

Also present: Mrs. Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will come to order, please.

Mr. Secretary, other members of the committee will be coming in, but in the interest of conserving your time, we will ask you to proceed with the hearing on the tax bill passed by the House last week, with which you are familiar. The committee will be pleased to hear you now.

STATEMENT OF HON. JOHN W. SNYDER, SECRETARY OF THE TREASURY; ACCOMPANIED BY THOMAS J. LYNCH, GENERAL COUNSEL; GEORGE C. HAAS, DIRECTOR OF THE TECHNICAL STAFF; THOMAS F. LEAHEY, ASSISTANT DIRECTOR, OFFICE OF THE TECHNICAL STAFF; VANCE N. KIRBY, TAX LEGISLATIVE COUNSEL; AND L. LASZLO ECKER-RACZ, ASSOCIATE DIRECTOR, TAX ADVISORY STAFF

Secretary SNYDER. Mr. Chairman, I have a prepared statement. With your permission I will read it.

Mr. Chairman and members of the committee: I am pleased to have an opportunity to appear before the members of this committee as you begin consideration of the tax revision bill, H. R. 8920, which the House of Representatives passed on June 29.

I read with great interest, Mr. Chairman, your statement that the committee decided to proceed with tax legislation in the full knowledge that present plans may need to be altered by developments in Korea. I am glad that the committee has decided to prepare a bill for action with the understanding that it could be halted if conditions later indicate that it would be unwise to go through with the legislation. I am in accord with this view of the committee and will present my testimony on the basis of this understanding.

In strengthening our resources for possible eventualities, improvement in the Government's fiscal position is a basic requisite of national preparedness

At the outset I should like to make it clear that the position which I have taken on other occasions with respect to our revenue system has not changed. It is my conviction that our general objective must be a tax system which yields sufficient revenue during prosperous times to meet the necessary expenditures of the Government and to leave some surplus for debt reduction. This was the goal expressed by the President in his tax message to the Congress last January. It is the position I have taken on many occasions in appearances before committees of the Congress. It is the only position consistent with my responsibility to the American people.

In the 5 months since I appeared before the Committee on Ways and Means of the House of Representatives in support of the President's tax program, it has become increasingly apparent that 1950 will be one of the most productive business years in our history, in terms of the actual output of goods and services. During recent months there has been growing recognition that the strong upturn in business this year is something more than a temporary inventory replenishment, as some had charcterized it earlier. It is more than a mere rebound from the lower production levels of 1949. There is no longer reason to question that the business improvements this spring and summer represent an important forward movement in our national economy.

The strength of this movement, in fact, has been so widely recognized in recent weeks that I shall not take your time on this occasion to go into the details of the business situation. I should like to stress, however, that personal and business incomes—the most important elements in our revenue potential—have continued during 1950 at a very high level. Excluding the special insurance dividend to veterans, personal incomes this year are well above the corresponding period a year ago, and not far from the record figures of 1948.

The earnings of business concerns, likewise, have continued to be exceptionally favorable. Corporate profits before taxes have been advancing steadily throughout the past 12 months, and are estimated for the first half of 1950 at an annual rate of a little under $33,000,000,000—almost $5,000,000,000 higher than a year ago, and not far from the record annual total of approximately $35,000,000,000 in 1948. You may be interested to note, in addition, that the present level of corporation profits, on an annual basis, is more than three times as high as the prewar record level of $10,000,000,000 in 1929.

Under these conditions of exceptional prosperity for both individuals and business concerns, we cannot justify less than a maximum effort to meet current expenditures and to further the program for reducing our outstanding debt. This principle is the foundation of our financial strength. With relations between nations in a troubled state, we cannot afford a short-range approach to the vital matter of the financial soundness of the United States Government.

The Federal deficit for the fiscal year 1950 amounted to 3.1 billion dollars and is estimated in the Presidents budget message of January at 5.1 billion dollars for the fiscal year 1951. If we do not take active measures to reduce deficits during periods of high business activity, we cannot hope to find our economic defenses at full strength to meet emergencies—either in the domestic field, or on the international front.

The financial strength of our Government, as you know, depends in part on its income. It depends on income derived from a revenue system which is fair and equitable as between taxpayers, adequate to meet governmental requirements, and of sufficient size during prosperous times to make some repayment on debts incurred in the past. Because of the size and importance of the Federal debt and of Federal financial operations, it is important also to make certain that our Federal revenue system does not hamper business and trade, but as far as possible acts to stimulate it.

The revenue proposals embodied in the bill before you make progress toward, these goals, which were outlined in the President's tax message. But the House bill does not go the whole way. The bill in its present form has the merit of making improvements in the equity of our tax system. It provides stimulation to business in certain areas in the form of lowered excise taxes on various products and services still taxed at wartime rates. It also provides lower taxes for smaller corporations, together with various measures which will be of direct assistance to business operations—for example, more liberal provisions permitting the business losses of one year to be deducted from the taxable income of other years. The proposals which you are considering do not provide, however, for increased revenue, although the need for keeping the finances of the Federal Government in a sound condition is even greater now than it was at the beginning of the year when the President made his tax recommendations.

I urge the members of this committee, therefore, to review fully the proposals for improving our revenue system outlined in the President's program, which I submitted in detail to the Committee on Ways and Means of a House of Representatives on February 3, 1950.

I turn now to the discussion of the House bill, first, in the light of the President's program and, second, with respect to its detailed provisions.

The President's Program

The President's program has a threefold purpose: (1) to improve the fairness of the tax system, (2) to bring in some additional revenue, and (3) to strengthen the economy.

In submitting this program to the Congress, the President recognized that in certain limited areas tax reduction was desirable. He proposed a conservative excise reduction program which balanced the most urgent needs for relief against the constraints imposed by an unbalanced budget during prosperity.

The excise taxes are still at substantially their wartime levels and their revision to better conform with present-day competitive business conditions is overdue. Judicious reductions in these taxes can make an important contribution to an improved revenue system. Not only will the tax system be made more equitable for consumers but the changes will aid employment and sales in the industries affected. Over the long run we should aim to reduce the role of excises in the tax system.

In view of our budgetary situation, however, the President recommended the closing of an accumulation of tax loopholes as a source of replacement revenue for the excise tax reductions.

In addition, the President recommended that a moderate amount of new revenue be obtained partly from the corporation income tax and partly from the estate and gift taxes, which now are not making a proportionate contribution to the Government's revenues.

Recent events have underscored the importance of the objectives of the President's program. Improvement in the equity and effectiveness of the tax structure is especially necessary at a time when taxes must remain high. Taxpayers bearing disproportionate and discriminatory burdens must be relieved. Favored groups must not be provided with unwarranted opportunity to escape taxes intended to apply generally.

The Committee on Ways and Means devoted more than 4 months to an intensive study of the President's program and gave most careful consideration to the separate proposals. It also explored other potential revisions in the tax system and developed a revenue bill which goes a long way toward meeting the objectives set by the President. When important tax revisions are undertaken, it is to be expected that the shape of complex legislation covering a wide variety of problems will not accord precisely with any single conception of the desired objectives. Compromise is characteristic of the democratic legislative process.

The House bill provides for excise tax reduction on a substantial list of commodities and services of mass consumption and relieves a number of industries that are in a relatively unfavorable position.

By closing serious loopholes in the present law, the bill would improve both the equity and administration of our tax system and also produce substantial revenue offsets to the excise tax reductions.

The revision of the corporation income tax contained in the bill would recoup most of the remaining revenue lost from excise tax reduction at the same time that it reduces taxes and eliminates the inequitable "notch" provision for the benefit of smaller corporations.

The principal deficiency of the House bill is its failure to add as much strength to the revenue system as the President recommended. It does not reduce the present excessive depletion allowances granted oil and mineral producers under the income tax but rather extends these allowances to new areas. Moreover, it fails to revise and strengthen the structure of the estate and gift taxes.

In addition, the bill contains some provisions which would create new inequities. I will call your attention to these in my discussion of the detailed provisions of the bill, to which I now turn.

Detailed Provisions of the Bill

EXCISE TAX REDUCTION

The President indicated that reductions are most urgently needed in the excises on transportation of property, transportation of persons, long-distance telephone and telegraph communications, and the four retail excises.

The plan for implementing the President's recommendations which I outlined to the Committee on Ways and Means would involve a net revenue loss of $655,000,000. The excise tax reductions made in the House bill amount to $1,010,000,000 and cover some groups not encompassed by the President's proposals.

Senator MILLIKIN. Mr. Secretary, which groups are included in the House bill which you did not recommend?

Secretary SNYDER. We will get into that.

Senator MILLIKIN. Very well.

Secretary SNYDER. The reductions in the retail excises on jewelry, fur, luggage, and toilet preparations from 20 percent to 10 percent would amount to $240,000,000, including the elimination of the tax on handbags and a number of miscellaneous items, such as baby oils, powders, and lotions. These reductions have a high priority because in recent years the 20 percent rate has depressed sales and employment in the taxed industries.

The transportation tax reductions amount to about $230,000,000. The bill would reduce the tax on transportation of persons from 15 percent to 10 percent and the tax on the transportation of property from 3 percent to 1½ percent. The President had recommended that the 3 percent tax be entirely eliminated, because it increases the cost of production and hence the prices of practically every commodity sold in this country. The transportation taxes discriminate against those geographical areas farthest removed from markets or sources of supply. A reduction of these taxes will benefit businessmen and consumers generally.

The reductions in the communications taxes provided in the bill would aggregate about $125,000,000. This is approximately the amount of the reductions proposed to the Ways and Means Committee. However, the House bill spreads the reduction over both local and long-distance telephone use whereas the President recommended that it be confined to long-distance communications because these taxes enter into business costs and create competitive inequities.

The tax on telephone-toll messages would be decreased from 25 percent to 20 percent, and the tax on domestic telegraph messages cut from 25 percent to 10 percent, while the tax on local residential use would be reduced from 15 percent to 10 percent.

It will be noted that while the House bill includes all of the items in the President's program it also includes a number of others. These consist principally of a reduction in the admissions tax which would lose a little over $200,000,000 and cuts in a number of manufacturers' excises which in total would lose another $200,000,000. Moreover, some of the changes contained in the House bill raise the question of whether the rates adopted in all cases result in the proper alinement of related taxes.

Senator MILLIKIN. Would you mind explaining that last sentence, Mr. Secretary?

Secretary SNYDER. Whether the rates adopted result in all cases in the proper alinement?

Senator MILLIKIN. The sentence I referred to was:

> Moreover, some of the changes contained in the House bill raise the question of whether the rates adopted in all cases result in the proper alinement of related taxes.

Secretary SNYDER. We were referring there to some of these manufacturers' taxes and one or two other groups.

Do you have a list of all those?

Mr. LYNCH. Yes, Mr. Secretary; we will have a list ready to present.

Secretary SNYDER. Senator, we will have a list prepared for you showing each one of the taxes and what the loss was and the ones that were included in the President's message and the ones that were not. Of course, the President did not intend to limit consideration. He just named certain taxes which appeared to be the most urgent ones. He did not intend to freeze it to that list.

Senator MILLIKIN. May I ask are you opposed to the taxes which you described in this last paragraph which has just been read?

Secretary SNYDER. I am not opposed to any of these changes. It is just a question of their priority, Senator.

Senator MILLIKIN. Do any of them fly in the face of Presidential policy?

Secretary SNYDER. If the revenue is provided to replace them, they do not; no, sir. There are some of them that were placed a little later along because of revenue limitations.

Senator TAFT. How about passenger transportation? Are you opposed to that?

Secretary SNYDER. No, sir; the President recommended that.

Senator TAFT. Passenger transportation?

Secretary SNYDER. That is right; yes. He recommended both of those, one to be eliminated entirely and one to be reduced.

Senator MARTIN. In my recollection of it, the President recommended, we will call it, complete elimination of freight.

Secretary SNYDER. He recommended complete elimination of that tax and reduction of the passenger tax.

Senator MARTIN. That is my recollection; yes.

Secretary SNYDER. The Treasury staff will be prepared to present to the committee at your convenience materials bearing on this question and related matters.

REPLACEMENT REVENUE FOR EXCISE REDUCTIONS

The excise reductions would be approximately offset by replacement revenues obtained from closing tax loopholes and other administrative improvements together with the increase in the corporation income tax.

The internal improvements in the tax structure achieved in the House bill cover a large number of changes. These embrace essential reforms referred to in the President's tax message and other changes as well, which on the whole are desirable.

Business operations of charitable and educational organizations

Our tax laws have long recognized the principle that organizations operated for worthy public purposes should be encouraged by tax exemption. I am thoroughly in sympathy with this policy and fear that it is in danger of being discredited because a minority has abused it. The President called this general problem to the attention of the Congress, and the Treasury Department presented to the Committee on Ways and Means recommendations for handling it.

The House bill incorporated the remedies developed cooperatively by the Department and the staff of the Joint Committee on Internal Revenue Taxation. These provisions preserve the tax-free status of the legitimate activities of educational and charitable organizations and, at the same time, correct the abuses which properly have received so much general condemnation.

Business operations of charitable and educational institutions clearly unrelated to their exempt functions generally would be subjected to the regular corporation income tax. This would apply to organizations now engaging in such unrelated business activities as the manufacture of food products, leather goods, vegetable oils, and the distribution of petroleum products. The bill would not tax their income from related activities, such as the operation of bookstores, dining halls, dormitories, or experimental farms, customarily carried on by educational and charitable organizations. Income from investments, such as interest, dividends, most rents, and royalties, would also continue to be exempt.

The bill would prevent these organizations from trading on their tax exemption where they acquire with borrowed funds properties subsequently leased to business concerns. The members of this committee are doubtless familiar with such arrangements. The transaction is profitable to exempt organizations since, in effect, it enables them to capitalize their tax exemption. It is also profitable to the lessee corporation because it enables it to share indirectly the nonprofit organization's tax exemption. The House bill corrects this discrimination against other investors, while safeguarding the existing exemption of educational and charitable organizations on investment income derived entirely from their own funds.

The House bill also contains provisions for preventing private exploitation of charitable trusts and foundations for tax avoidance purposes. The institutions affected are privately controlled and do not obtain financial support from the general public. Some of them were established with a view to securing unintended tax benefits for the founders and members of their families by enabling them to retain control over business activities. The provisions of the bill can be expected to reduce the use of nominally charitable and educational organizations for the purpose of bestowing tax exemption on private interests.

Increased extension of the tax-exemption privilege by nonprofit organizations and charitable trusts and foundations threatens to make substantial inroads on the revenue. While the present revenue loss is not large, it will increase unless preventive measures are promptly adopted. The prospective annual loss, in the absence of effective remedies, would be in the neighborhood of $100,000,000.

Life-insurance companies

As you know, the President requested the Congress to correct the present inadequate taxation of life-insurance companies on a permanent basis which would afford equitable treatment and at the same time safeguard the interests of policyholders. He endorsed steps that had been taken by the Ways and Means Committee to correct the situation for a number of recent years.

It should be our minimum goal to assess for those years in which no tax was paid the amount called for by the House bill. The industry has the required resources and has been prepared to pay the amount in question.

Senator MILLIKIN. Mr. Secretary, assuming that it has the required resources, on what theory do we impose tax when a tax is not due?

Secretary SNYDER. It would be on the basis that legislation has been in process of preparation for some time, since 1947. Some of

the companies, recognizing that, have set up reserves to take care of the tax if it were imposed.

Senator MILLIKIN. Even assuming that that be correct, why do we impose a tax when no tax is due?

Secretary SNYDER. Unless the Congress passes legislation, no tax will be due.

Senator MILLIKIN. I mean why should we do it retroactively beyond the period in which everyone had notice that it would be done?

Secretary SNYDER. It is just a question of adjusting a situation there that should have been taken care of earlier.

Senator MILLIKIN. Can you adjust the situations of that kind by the long reach of retroactivity? If the life insurance companies, why not every other taxpayer?

Secretary SNYDER. I am perfectly frank with you. I am not an advocate of general retroactivity in taxes, but it seems appropriate in this situation, Senator, because as the statute operated they were exempt from paying any tax. It was recognized at the time that this would have to be corrected.

Senator MILLIKIN. They were not exempt. It just happened that the formula was not adequate to catch them during this period of lessening interest rates.

Secretary SNYDER. The formula was inadequate to meet that situation. It should have been corrected as early as possible.

Senator MILLIKIN. But it was not corrected. The Government always had it within its power to correct and did not do so. Many companies had no notice that anything was brewing until 1949. I just want to say in passing that it is entirely unconscionable and very bad policy to extend the reach of retroactivity beyond the period of time in which people had fair notice that something might be done.

Secretary SNYDER. In 1948, for example, the increase in surplus was about 10 times the tax liability which would be imposed under the House bill for that year. For the smaller companies the ratio is even more favorable. There is evidence that at least some of the insurance companies have set up special tax reserves to cover the tax liabilities under this legislation which has been under discussion since 1947.

The investment income of life insurance companies now exceeds 1.7 billion dollars annually. Their investment assets, now aggregating more than $60,000,000,000, comprise an important part of the total national wealth. Continued inadequate taxation of the life insurance industry would be detrimental to our economy and to the long-run interest of the industry itself.

In view of the shortness of time for considering methods of permanent revision of the life insurance tax provisions this year, I recognize the need for extending the House-proposed stopgap formula to 1950. Such extension is included in the House bill. This would yield $55,000,000. However, I believe that the Congress should make clear that this is intended only as a temporary solution. I urge active consideration of permanent revision. The Department is prepared to cooperate with the congressional committees in developing a solution to this problem.

Senator MILLIKIN. I should like to add, if I may, Mr. Secretary, that the managers of life-insurance companies, to my mind, occupy the highest type of fiduciary responsibility. When a fiduciary comes

running in here asking to be taxed retroactively on a debt that he did not owe, it is somewhat disquieting. You would not do it if you were a trustee.

Miscellaneous loopholes

Secretary SNYDER. The bill also contains technical provisions restricting the opportunities for tax avoidance. The most important of these in terms of the revenue to be gained is the correction of the present advantage permitted in the case of sales of business property. When such sales result in profit, the profit is taxed at the reduced rates allowed long-term capital gains; when the sales are unprofitable, the loss is allowed in full as an offset against ordinary income. This inconsistency and the resulting prejudice to the revenue can be eliminated either by treating both gains and losses as ordinary income and loss or by treating them both as capital transactions. The Ways and Means Committee adopted the latter solution but failed to act upon a related recommendation as to the tax treatment of sales of livestock.

Present court decisions have held livestock regularly culled from a dairy or breeding herd to be depreciable property used in trade or business and, thus, any gain resulting from their sale to be capital gain. In light of the regularity with which such livestock is sold, and since cattlemen or dairymen are permitted to deduct the cost of raising the livestock currently from ordinary income, it seems appropriate to treat the profits therefrom as ordinary income. The Treasury Department is continuing its litigation of this important question. However, I believe that legislation specifically classifying these profits as ordinary income is desirable, regardless of which solution your committee adopts as to business property generally.

Other devices, such as the collapsible corporation and short sales of security or commodity futures, allow taxpayers unintended access to the more favorable rates of tax levied on long-term gains by permitting conversion of short-term gains or ordinary income into long-term gains. These devices have been curtailed by the bill.

There are a number of other loophole-closing provisions in the House bill dealing with specific situations resulting from court interpretations, unforseen business practices, or the development of tax avoidance techniques.

In most cases the loophole-closing provisions of H. R. 8920 will cope effectively with the tax avoidance against which they are directed and will raise about $125,000,000. Additional loophole-closing provisions will be recommended at the appropriate time. The closing of technical gaps in the law is necessarily a continuing process, required to preserve the fundamental equities of taxation and especially important when tax rates have to be kept high. We cannot expect to preserve the confidence of taxpayers in our revenue system without continued vigilance and aggressive action to overcome technical defects in the law as they develop.

Withholding on dividends

The House adopted a provision which would extend income-tax withholding to dividends at a flat 10-percent rate. While this provision was not specifically recommended by the President, it is a reform which the Department has carefully studied for some time with a view to determining the advantages it would afford.

The available evidence indicates that there is considerable underreporting of dividends on individual income-tax returns. A large part of this unreported dividend income is received irregularly, in small amounts, and probably is not reported by stockholders through inadvertence or careless bookkeeping.

Senator MILLIKIN. Many of those stockholders would not owe any taxes even if they were reported.

Secretary SNYDER. That is true. That is the case where a person has no other income and has a few shares of stock. That would be so small that he would not owe any tax. That is true.

Noncompliance cannot be as readily uncovered by the Bureau of Internal Revenue under the present information return system as through a withholding system.

Withholding provides an economical method of securing substantially improved compliance in this area, as it has in the case of wages and salaries.

Under the system proposed by the House bill, the corporation would withhold 10 percent from each dividend check. Stockholders would receive from the corporation either at the end of the year or after each dividend payment a statement, in any form convenient to the paying corporation, showing the amount of the dividends and the tax withheld. The stockholder would report his total dividends, including amounts withheld, on his tax returns and would claim credit against his total tax liability for the amount withheld on dividends. In those instances where the total tax withheld and other prepayments are larger than the total tax liability, the excess would be refunded.

The dividend-withholding system adopted by the House differs in one important respect from the system now employed for wages and salaries. For the convenience of the corporation, the bill provides that information on the amount of dividends and tax withheld may be made available to stockholders either on a separate statement, on a check voucher, or as part of the information on the check itself. Although stockholders would be required to itemize on their returns the dividends they receive from each corporation and the amount of tax withheld, they may not be able to attach documentary proof of their claim for taxes withheld.

This method will be less effective than the one used for tax withholding on wages and salaries. Names and addresses on income-tax returns will not necessarily be identical with those of record on the corporations' books. Since the matching of information forms filed by corporations with the lists attached to individual income-tax returns would be costly and imperfect, I believe it would be desirable to provide for a stockholder's receipt—either once a year or with each individual payment—similar in form to the wage withholding receipt. Most taxpayers are already familiar with the operation of the withholding system as it applies to wages and the extension of this system would cause no confusion for the average dividend recipient. The existence of such receipts would permit the Government to make prompt refunds with more assurance that they were due.

It is estimated that the adoption of the withholding provision of the bill would raise $160,000,000 in a full year.

Senator MILLIKIN. Mr. Secretary, that is a rather amorphous estimate; is it not?

Secretary SNYDER. Some of these estimates are of that nature. They of necessity must be.

Senator TAFT. Does that $160,000,000 include the interest on the taxpayer's money that you are holding for a year? Does that include the saving that you get by having the taxpayer's money without interest for a year?

Secretary SNYDER. He has already earned the money just as in withholding on wages or anything else. He has already earned the money, and an adjustment for interest would not be appropriate.

Senator TAFT. Do you refund with interest?

Secretary SNYDER. If it is more than 75 days after the end of the year.

Senator TAFT. At 2 percent under the bill or 6 percent?

Secretary SNYDER. So far it is 6 percent. Under this bill it is reduced to 3, but as the law now stands if the refund is not paid by March 15 6-percent interest accrues.

Senator TAFT. Take a college with a million-dollar income, dividends, and you take $100,000 out and keep it and pay it back the following year. Do you pay interest on that at 3 percent? Is that it?

Secretary SNYDER. Under the law as it stands today we pay 6 percent.

Senator TAFT. This law proposes to reduce it to 3.

Mr. KIRBY. The interest doesn't start to run until March 15 after the close of the year in which the tax was withheld.

Senator TAFT. So you get the use of the taxpavers' money for a year free, where the taxpayer does not owe the money, as in the case of charitable corporations or people with low income.

Secretary SNYDER. It would be the same as it is under the present for withholding on wages.

Senator MILLIKIN. I suggest it is even somewhat wider than that, Mr. Secretary. Regardless of your duty to refund in any particular case within 3 months without paying interest, you have a constant pool in the Treasury of withholding on which you are not paying interest of what size?

Secretary SNYDER. The withholding would, of course, continue throughout the year.

Senator MILLIKIN. I understand that, but I am talking about the effect of this 10 percent in building a pool in the Treasury.

Mr. KIRBY. It is a little less than that.

Senator MILLIKIN. If I may ask one of your experts, How much money will you have in the Treasury that is a continuous pool of money on which you are not paying interest under this withholding plan?

Mr. KIRBY. We do not have that information right here, Senator, but we can get that. I think we can get that.

Senator MILLIKIN. It should be very easily available. It would be a very large sum; would it not?

Secretary SNYDER. It would be. It would be less than 50 percent of the total collections from individuals.

Senator MILLIKIN.. We are withholding 10 percent?

Mr. KIRBY. At the present time——

Senator MILLIKIN. How much are our dividends per year?

Mr. KIRBY. Around $8,000,000,000.

Senator MILLIKIN. So you are withholding 10 percent of that.

Mr. KIRBY. Yes.

Senator MILLIKIN. That is $800,000,000; is that right?

Mr. KIRBY. Yes.

Senator MILLIKIN. So you will have a constant pool there of $800,000,000, will you not? Is that not correct?

Secretary SNYDER. Not necessarily, Senator, because a lot of these dividends are paid toward the end of the year. So your withholding would be only for a month or so.

Senator MILLIKIN. Does not that operation run all through the year? I mean you are withholding constantly, are you not, on all dividends as they are paid?

Secretary SNYDER. It would be on all dividends, but many of the dividends are payable only annually and are not paid throughout the year. The biggest proportion of them are paid at the end of the calendar year.

Senator MILLIKIN. Yes.

Secretary SNYDER. So there would not be such a long period during which the withheld would be available.

Senator MILLIKIN. I respectfully suggest, Mr. Secretary, that in the case of the larger corporations they pay dividends on a more frequent basis than once a year.

Secretary SNYDER. That is true.

Senator MILLIKIN. So you will have a constant pool of withholding there.

Secretary SNYDER. But it won't be as large as you think, sir, for the reason I just gave. Some corporations do not pay dividends except once a year.

Senator MILLIKIN. And many pay four times a year.

Secretary SNYDER. Some pay quarterly; yes.

Senator MILLIKIN. Some oftener than that.

Secretary SNYDER. But I do not think the figures would run nearly as large as you estimated, $800,000,000 constantly in that pool. I think it would be considerably less than that.

Mr. LEAHEY. Individuals could anticipate the withholding tax on dividends by reducing their current year tax declarations by the amount of tax withheld from their dividend payments. Therefore, to the extent that dividends are received by taxable individuals and to the extent that these individuals include such income in their declarations of tax, there will be no speed-up in receipts to the Treasury. There will be some speed-up in receipts in practice, however, because some dividends are received by nontaxable individuals and by tax-exempt organizations and because the first two declaration payments usually do not constitute half of the total income tax not withheld.

I shall insert two tables which may be of interest to you. The first table shows the effect on receipts of the dividend-withholding system as applied to only one calendar year's dividend payments by corporations (excluding cooperatives). The second table shows the effect on receipts in one calendar year of the dividend withholding system after the system has become fully operative.

Estimated effect on receipts of the dividend withholding system applied to the dividend payments of 1 calendar year

[In millions of dollars]

	Receipts from withholding on dividends [1]			Decrease in current payments of taxable persons [2]	Refunds	Net effect on receipts
	Taxable persons	Non-taxable persons, organizations	Total			
Year of liability:						
First quarter	65	12	77	91		−14
Second quarter	149	26	175	100		+75
Third quarter	169	30	199	106		+93
Fourth quarter	155	27	182	26		+156
Following year:						
First quarter	167	30	197	325	60	−188
Second quarter				57	65	−122
Total	705	125	830	705	125	

[1] Assumes the same timing of receipts as in the case of withholding from salaries and wages.
[2] Assumes the decrease in current payments of taxable persons will be distributed in proportion to the present pattern of declaration and final payments.

Office of the Secretary of the Treasury, Office of the Technical Staff, July 7, 1950.

Receipts from the dividend withholding system in a hypothetical full year of operation at current levels

[In millions of dollars]

	Receipts from withholding on dividends [1]			Decrease in current payments of taxable persons [2]	Refunds	Net effect on receipts
	Taxable persons	Non-taxable persons, organizations	Total			
Calendar year						
First quarter	232	42	274	416	60	−202
Second quarter	149	26	175	157	65	−47
Third quarter	169	30	199	106		+93
Fourth quarter	155	27	182	26		+156
Total	705	125	830	705	125	

[1] Assumes the same timing of receipts as in the case of withholding from salaries and wages.
[2] Assumes the decrease in current payments of taxable persons will be distributed in proportion to the present pattern of declaration and final payments

Office of the Secretary of the Treasury, Office of the Technical Staff, July 7, 1950.

Senator MILLIKIN. Coming back to the reliability of your estimate of revenue loss, how do you figure that? What I am driving at is, what is the basis of your estimate that you are losing $160,000,000 by avoidance?

Mr. LEAHEY. That is a rough estimate, sir.

Senator MILLIKIN. It is a rough estimate, but how do you get at it, just pull it out of the air? We have a problem here of harassment of the citizen. Is it worth while to harass him? Therefore we should be studying it. We should have something here which gives us a rather accurate estimate of how much loss there is to the Treasury through present practices.

Mr. LEAHEY. There is a gap of more than a billion dollars.

Secretary SNYDER. Senator, our estimate is about the same as that made by the staff of the Joint Committee on Internal Revenue Taxation.

Senator MILLIKIN. We will ask them, and I am now asking the Treasury.

Secretary SNYDER. Mr. Leahey will explain the estimate.

Senator MILLIKIN. We cannot find out. I respectfully suggest it is a serious question because we have to weigh the annoyance——

Secretary SNYDER. I wanted to supply you with additional sources of information.

Senator MILLIKIN. We will not overlook that one. We have a problem here of weighing annoyance to the citizens against the possible tax gain, and I think it is rather important that we have durable estimates on that.

Secretary SNYDER. I agree with you.

Senator TAFT. Is it not true also that the withholding of dividends differs in withholding of wages in that the withholding from wages is based on estimates of what probably will be paid with allowance for exemptions? Whereas this withholding of dividends is for charitable corporations and people below the exemption limit, and so forth. Therefore, is not this harsher on a lot of people than weighing withholding, which is adjusted pretty close to what the actual is?

Secretary SNYDER. Senator, there is a large amount of tax withheld on wages that is refunded because the individual returns are not taxable. Refunds of individual income taxes were about 2½ billion dollars last year. There will probably be around 1.5 billion dollars this year.

Senator TAFT. To people who do not owe anything on their wages?

Secretary SNYDER. Not necessarily.

Senator TAFT. Do you not allow in that withholding that if a man has below a certain income he does not pay? Is that not so? Is that not attempted? Do you not attempt in the case of wages to tax only if they are really taxable?

Secretary SNYDER. If he has a job for 2 months or something of that sort, they withhold on the estimate that he will work all year at that rate, don't you see? Then if it is shown at the end of the year that he did not earn enough to pay a tax, he becomes entitled to a refund. We have a world of situations like that, Senator.

Senator MILLIKIN. Mr. Secretary, it might be a greater burden for your part of the business, but why would not this problem be solved by the corporation furnishing your Department or the Bureau of Internal Revenue with all of the dividends paid including those under $100? I realize there are a lot of shares outstanding in street names and that sort of thing, but why not supply you that information and you follow the present practice of making spot checks?

Secretary SNYDER. The cost of doing that was given consideration. That would add materially to the cost of the enforcement relative to the additional revenue that would be obtained.

Senator MILLIKIN. How much do you estimate it would cost?

Secretary SNYDER. The Senator recognizes that the names would be different in many cases. The additional cost of enforcement would be substantial.

Senator MILLIKIN. Has anyone made an estimate on that, Mr. Secretary?

Secretary SNYDER. We will provide you with a statement of what is involved.

Senator TAFT. What would be the comparative additional cost of doing this business on the Government and on the corporations that would have to be spent on bookkeeping and so forth to work it out? What is the cost compared to this system now?

Secretary SNYDER. Some of the cost would be shifted to the corporation paying the withholding tax. There is no question about that.

Senator MILLIKIN. The large corporation, I should think, could handle it very comfortably, but the middling, small company might need an extra bookkeeper and a lot of those outfits cannot stand an extra bookkeeper.

Secretary SNYDER. The smaller corporations usually have few stockholders.

Senator MILLIKIN. May I put a clincher on that. Will you supply us with an estimate of what it would cost if the corporations furnished you with a list of all dividends paid to all stockholders and you folks operated it under normal methods of catching evaders?

Secretary SNYDER. We will be glad to do that.

(The information referred to above follows:)

Statistics compiled from tax returns of corporations and individuals indicate a gap of approximately $1,000,000,000 between the dividends paid by corporations and the dividend income reported on tax returns by individuals, after allowance is made for dividends paid to tax-exempt organizations and to individuals whose aggregate income is insufficient to require them to file tax returns.

While it cannot be stated definitely why individuals fail to fully report dividend income, it is generally agreed that a large part of the understatement is due to forgetfulness and carelessness rather than to deliberate efforts to understate income and tax liability. Individuals who receive dividends at irregular intervals and in relatively nominal amounts undoubtedly fail to keep adequate records of these receipts.

Under the provisions of H. R. 8920, corporations would withhold 10 percent of the dividends paid on or after January 1, 1951, and file information returns with the Bureau of Internal Revenue showing the name and address of each stockholder to whom a dividend payment was made, the amount of such payment, and the amount of tax withheld. A statement showing similar information would be furnished by the payor corporation to the stockholder. The stockholder would itemize his dividends in his annual income-tax return and claim credit for the tax withheld.

Under present regulations, corporations are required to file information returns with the Bureau of Internal Revenue showing the name and address of each stockholder receiving dividends of $100 or more during the calendar year. The present return forms require taxpayers to report the aggregate amount of dividends received from all corporations, but do not require itemization. It is contemplated that the return form for 1950 and subsequent years will require individuals to itemize their dividend receipts by payor corporations. This will result in some improvement over the present system since the itemization requirement will permit a better check with the information returns and will tend to encourage more careful reporting by taxpayers. However, since the basic problem appears to be one of poor record keeping and carelessness on the part of taxpayers with respect to dividend income, the itemization requirement alone is not likely to make a major contribution toward full reporting.

In the event withholding is not adopted, it is also proposed to amend the regulations for the tax year 1951 to require corporations to report all dividends, regardless of amount, on information returns. This, too, will tend to improve compliance in that it will make it possible to check the source of dividends listed by the taxpayer with the related information returns in those instances in which available manpower permits such a check. Knowledge that corporations make complete reports to the Bureau of Internal Revenue may have some salutary effect on taxpayers as well. It should be emphasized however, that this sytems will net only a small fraction of the added tax of $160,000,000 which would be

obtained through a withholding system. The matching of these information returns with income-tax returns would be a sizable and far from perfect operation. An airtight method of matching information documents filed by payor corporations with income-tax returns filed by dividend recipients is virtually impossible since the names and addresses on information returns do not coincide with the names and addresses shown on the corresponding income-tax returns. Joint returns of husbands and wives also complicate the matching of information returns with income-tax returns. Finally, the process of determining the amount of unreported dividends, the preparation of deficiency notices, and the subsequent follow-up and collection operations would involve substantial additional administrative costs. Under present appropriations, this check can be made in only a limited area, being at present something less than 5 percent of the returns. It is the inherent weakness of the information system that it is uneconomical for the Bureau of Internal Revenue to follow through on a larger scale.

The cost of collecting the additional $160,000,000 of revenue from dividends without a withholding system would be prohibitive, even if taxpayers were required to itemize their dividends and corporations were required to submit information returns with respect to all dividends paid. Although firm estimates of the additional cost cannot be made, it is clear that the amount would be very large. The additional enforcement cost in relation to the amount of revenue it would produce would be very high and could not be justified from the viewpoint of proper allocation of tax enforcement resources. Even if it were possible to obtain a large enough appropriation, it would not be profitable to follow through individually on the hundreds of thousands of stockholders with small amounts of unreported dividends.

It is estimated that the administration of a withholding system by the Bureau of Internal Revenue would cost about $2,000,000 annually. This is far less than the cost of an information return system that would recover the same amount of revenue because withholding insures better initial voluntary compliance. The statement which corporations would furnish to stockholders under H. R. 8920 would serve as a reminder to them. In many instances, it would be in a form suitable for retention by the stockholder for use in connection with the preparation of his return. Moreover, taxpayers are likely to be less forgetful of the receipt of dividends if some tax has been collected at the source. Once the level of initial compliance is raised, the task of locating delinquent taxpayers and of collecting tax deficiencies becomes more manageable and less costly.

Thus, a withholding system of the type provided by H. R. 8920 would automatically collect part of the tax on dividends and, in addition, would greatly improve initial reporting by taxpayers and final determination of tax liability. It would provide relatively complete tax enforcement in an area where the cost of corresponding enforcement by an information return system would be prohibitive.

Senator HOEY. Mr. Secretary, the purpose, I take it, of this withholding is to get revenue which is not now accounted for.

Secretary SNYDER. That was the intent.

Senator HOEY. If the plan were changed so that the taxpayer would have to give a list of his dividends instead of just a gross sum of dividends, would not that go a long way toward making him account for the dividends he received?

Secretary SNYDER. That was the suggestion the Senator made, and how much it would cost.

Senator HOEY. I am talking about the individual taxpayer. Presently the individual taxpayer merely reports $10,000 in dividends without saying where it comes from. If he was required to give a list of his dividends, do you not think that would result in collecting a large amount of these unaccounted for dividends, because now he can report $10,000 in dividends, and then the Government has to find out where they were and all about them, and he can cover up. If you required him to list his dividends with his return, do you not think that would correct a lot of this?

Secretary SNYDER. That provision is in the bill.

Senator HOEY. I understand that, but I was thinking about what effect that would have in supplying the amount and inconvenience on people in deducting dividends?

Secretary SNYDER. It might serve that purpose.

Senator HOEY. In estimating $170,000,000 to be received, would it be possible to make any kind of estimate of how much of that would be accounted for if all the taxpayers were required to list their full dividends?

Secretary SNYDER. We will try to do that. [See material supplied above.]

Senator LUCAS. Right on that point, Mr. Secretary, if they followed through like the Senator from North Carolina suggests, would it not require more auditors to go in to the particular income tax return to show whether or not he had included all the dividends?

Secretary SNYDER. There is no question about that.

Senator LUCAS. In other words, every one then would have to be audited from top to bottom and that is the thing you are trying to get away from, as I understand, as far as personnel is concerned. You just could not audit every return that comes in with the force that you have.

Secretary SNYDER. We cannot do it now, Senator, so that we couldn't take on the additional burden.

Senator LUCAS. Would it not compel you to make a better check or a more complete audit under that sort of arrangement than now?

Secretary SNYDER. It would just furnish us with information to check in addition to what we have now. In order to follow it through, it would take more people, yes.

Senator HOEY. Of course now, Mr. Secretary, you cannot possibly check all the returns. You make spot checks on them. I was thinking of the psychological standpoint. If the taxpayer knew he was having to report every dividend and he did not know whether you were going to check his or somebody else's, there would be more disposition on his part to account for more.

Secretary SNYDER. That is usually true; yes, sir.

Senator KERR. Is it not a fact that that kind of listing of the sources and the amounts would result in your being able to do just as good or a better job at less cost than at present?

Secretary SNYDER. It would if more reported dividends, but a lot of them——

Senator KERR. If they do not report it, you probably——

Secretary SNYDER. No, not if it is withheld.

Senator KERR. I am not talking about comparing it.

Secretary SNYDER. You mean leaving the withholding out of it?

Senator KERR. Yes.

Secretary SNYDER. That is correct, yes. Having them list all the dividends would certainly be a reason for their being more careful.

Senator KERR. It would produce more revenue than the present plan, and it would enable you to check with less time and expense than the present system.

Secretary SNYDER. That theory is certainly true. It would be an added help, there is no question about it.

Senator TAFT. Have you any estimate of the number of people who just do not make returns who should?

Secretary SNYDER. We did not go into that in this connection.

Senator TAFT. How can you make an estimate, then, if you do not know?

Secretary SNYDER. I will have to refer to the experts here. I must confess I didn't make this estimate personally.

Senator TAFT. What I suggest, if there are a lot of just plain straight evaders, you will get them much more if you can check by having the corporation information than by just the withholding, because they will not file claims for refund. They will not invite an inspection by you of whether they are paying taxes on other things or not. So in some ways the other system would get more evaders than the system you are proposing.

Secretary SNYDER. We will certainly look into that phase in connection with the question brought up by Senator Millikin.

The CHAIRMAN. I suppose you do know, Mr. Secretary, the total amount of dividends paid out during any year?

Secretary SNYDER. Oh, yes, we get that from the composite of the corporate returns.

The CHAIRMAN. You also know from spot checking the amount of dividends on which taxes are paid. You know the difference between the two. You are figuring here that that dividend indicates a loss to the Treasury of $160,000,000 or $170,000,000. That of course is partly accounted for by the nontaxable corporations, and is also partially accounted for by those people who have net incomes of less than the exemption and therefore make no returns. Do you still think, however, that there is a possibility of saving to the Treasury by requiring the withholding and the itemization of dividends received by the taxpayer in his return? As I understand it, the House bill does both. The bill provides for withholding and also requires the taxpayer to itemize his dividends and the sources of them.

Secretary SNYDER. That is correct. Of necessity it has to have both parts of the system in order to furnish the check. I will be glad to have the technical staff give you the basis of this estimate.

(The information requested is as follows:)

Statistics compiled from corporation and individual income-tax returns indicate that there has been a serious understatement on individual income-tax returns of dividend income in recent years. The discrepancy has been very large since 1941. It is not possible to state precisely the amount of this understatement. For instance, certain dividend recipients (for example, charitable and educational organizations) do not file tax returns; some dividend income is received by nontaxable individuals whose total income falls below the income-tax filing requirement; and some undetermined part of the fiduciary income reported by individuals is actually dividend income. However, it is possible to make a reasonable approximation of the amount of dividend income of these recipients to arrive at an estimate of the amount of dividend income representing an understatement of dividend income received by taxable individuals.

The following table shows the net corporate dividends paid in cash and in property of the company's own stock, the amount of dividends reported on individual income-tax returns as dividends, and approximations of (*a*) the dividend income reported by individuals as fiduciary income, (*b*) the dividends received by tax-exempt institutions, and (*c*) the dividends received by individuals not required to file, for the calendar years 1946 and 1947.

Dividends not accounted for on individual income-tax returns estimated for calendar year 1950 and actual for calendar years 1946 and 1947

[Amounts in billions of dollars]

	1950		1947		1946	
	Amount	Percent	Amount	Percent	Amount	Percent
Net dividends paid by corporations	8,300	100.0	[1] 6,483	100.0	[1] 5,784	100.0
Reported on individual returns:						
As dividends	5,650	68.1	[1] 4,295	66.3	[1] 3,684	63.7
As fiduciary income	830	10.0	628	9.7	485	8.4
Retained by taxable fiduciaries	320	3.9	301	4.6	294	5.1
	6,800	81.9	5,224	80.6	4,463	77.2
Received by tax-exempt institutions	290	3.5	227	3.5	202	3.5
Received by individuals not required to file, filing Form W-2, receiving dividends through partnerships, etc	170	2.0	130	2.0	116	2.0
Total dividends accounted for	7,260	87.5	5,581	86.1	4,781	82.7
Total dividends not accounted for	1,040	12.5	902	13.9	1,003	17.3

[1] Actual.

The estimated amount of dividend income reported as fiduciary income is based on statistics pertaining to fiduciaries included in individual income-tax returns. No tabulation of the various components of income reported by nontaxable fiduciaries is available. In the table above it is assumed that the dividend component of nontaxable fiduciaries is relatively the same as that reported by taxable fiduciaries for which data are available.

The amounts of dividends estimated to be received by tax-exempt institutions, by individuals not required to file, and by individuals receiving dividends through partnerships are based on admittedly sketchy data but it is believed that they represent reasonable approximations of the magnitudes involved.

The estimates for 1946 and 1947 (and for the years 1941 through 1945) have been carried through for the level of dividend payments by corporations estimated for the calendar year 1950 on a trend and proportionality basis. As shown in the table above, it is estimated that the total dividend payments not accounted for will amount to 1,040 million dollars in the calendar year 1950.

Allowing for the fact that part of the unreported dividends is received by persons in low-income brackets who are either not taxable or are subject to the first bracket rate, it is estimated that the withholding tax system would increase net income tax receipts by $150,000,000. The withholding system and its concomitant dividend reporting system will provide taxpayers with better records of dividend receipts and would thus lead to more accurate reporting of dividend income. It would also improve the efficiency of the auditing of income-tax returns and the withholding tax itself would produce considerable revenue.

The difference between the $150,000,000 estimated above and the total of $160,000,000 estimated for the effect of the withholding provision represents the $10,000,000 increase in individual income-tax collections estimated to result from the withholding of patronage dividends of cooperatives.

The CHAIRMAN. We will have the opportunity of examining the technical staff on the point, of course, because there might be a difference of opinion, whether it is well informed or not, as to whether or not you can effect any great saving by this process.

Secretary SNYDER. They will be available at all times, Mr. Chairman, to go into that.

Senator BUTLER. Mr. Secretary, how did you arrive at the 10-percent withholding? Why not 5 percent of 15 percent? What was the reason for the 10 percent?

Mr. KIRBY. That is the figure proposed by the House bill. At the present time there is 15 percent withholding for wages and salaries, but that is after an allowance for the personal exemption which, as

the Secretary indicated, is averaged over the year. In order to avoid the difficulties for the corporation by allowing exemptions on dividend withholding it was thought that that 15-percent rate might be reduced to something like 10 percent and have no exemption.

Senator BUTLER. To a great many taxpayers the 10 percent does not represent the amount of tax that is due from them.

Mr. KIRBY. That is correct. It may be either more or less.

The CHAIRMAN. In the case of the withholding principle, the House bill applies that to cooperatives also.

Secretary SNYDER. Yes.

The CHAIRMAN. From cooperatives you will have a large number of checks that will run sometimes down even into cents, and frequently less than $10 or less than $5. If a flat requirement of 10-percent withholding were applied in all those cases, the expense of handling those refunds is going to be rather large, is it not, in proportion to the possible beneficial results to the Treasury?

Mr. KIRBY. Most of those would not be refunds, Mr. Chairman. In other words, there would be a small tax withheld, but it would not necessarily result in a refund.

The CHAIRMAN. It would put a great burden on the farm cooperatives, though, in disbursing small amounts, less than $5 frequently, to withhold 10 percent of that.

Mr. KIRBY. It was felt on the House side that there was substantial noncompliance in those areas.

The CHAIRMAN. Perhaps so. All right, Mr. Secretary.

CORPORATION INCOME TAX

Secretary SNYDER. H. R. 8920 incorporates the first major change in the structure of corporation income-tax rates since 1938, when the present limited form of graduation was adopted as a basis for providing reduced rates to small corporations. This method results in the present high "notch rate" of 53 percent required to bridge the gap between the lower rates applicable to incomes under $25,000 and the general rate on corporations with income of $50,000 or more. The present rate schedule is shown in table 1.

(Table 1 follows:)

TABLE 1.—*Details of present corporate income-tax rate structure*

Net income	Normal tax	Surtax	Combined normal tax and surtax	Cumulative tax to top of bracket	
				Amount	Percent
	Percent	*Percent*	*Percent*		
0 to $5,000	15	6	21	$1.050	21
$5,000 to $20,000	17	6	23	4,500	22 5
$20,000 to $25,000	19	6	25	5,750	23
$25,000 to $50,000	31	22	53	19,000	[1] 38
$50,000 and over	24	14	[2] 38		

[1] The bracket rates on the first $50,000 average 38 percent, as follows:

	Percent
(*a*) Effective rate on first $25,000	23
(*b*) Effective rate on next $25,000 (the "notch")	53
(*c*) Total	76
(*d*) Dividing by 2, gives an average rate of	38

[2] Instead of applying the bracket rates, corporations with incomes above $50,000 are taxed at the rate of 38 percent on their entire income.

Secretary SNYDER. The President urged the elimination of this method in order to reduce this discriminatory rate and encourage the expansion of smaller corporations.

The House bill replaces the present complicated and repressive provision with a simple rate schedule. The proposed normal tax rate of 21 percent would be applicable to the profits of all corporations. In addition, a surtax rate of 20 percent would be levied on profits in excess of an exemption of $25,000, making a combined normal tax and surtax of 41 percent on the amount of profits above $25,000.

The changes in rates under the House bill would reduce the taxes of all corporations with net incomes between $5,000 and about $167,000 and would increase the taxes of corporations with net incomes of more than this amount.

Senator MILLIKEN. Mr. Secretary, do you have a figure handy of what that reduction would amount to for corporations within the "notch" area?

Secretary SNYDER. That is shown in table 2, Senator.

Senator KERR. That does not give the total.

Senator MILLIKIN. What is the total saving to the small corporation?

Secretary SNYDER. You mean each individual corporation?

Senator MILLIKIN. No. I mean how much money do the corporations save that heretofore have been affected by the "notch"? How much is saved to them by this proposed plan?

Secretary SNYDER. The over-all figure?

Senator MILLIKIN. Yes; the over-all.

The CHAIRMAN. Nothing would be saved by the corporation with an income of $5,000.

Secretary SNYDER. You are right; nothing.

The CHAIRMAN. $5,000 and under would remain as is.

Secretary SNYDER. The answer to your question, Senator Millikin, is $60,000,000.

Senator MILLIKIN. $60,000,000?

Secretary SNYDER. Yes.

The CHAIRMAN. And $60,000,000 would be saved on those corporations within the "notch" above $5,000 income up to the point where the rate would begin to increase.

Secretary SNYDER. That refers only to corporations with incomes between $25,000 and $50,000, the present "notch" area.

Senator MILLIKIN. How much taxes do those particular corporations pay per year?

Secretary SNYDER. About $350,000,000.

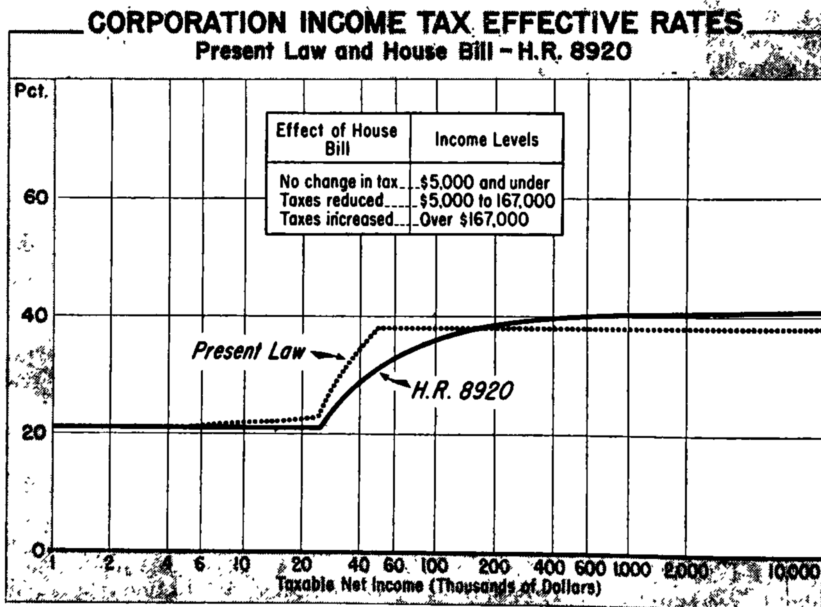
Over 170,000, or almost half of the taxable corporations would have their taxes reduced. This should provide substantial encouragement to an important segment of our business population. Less than 19,000 large corporations, constituting only 5 percent of all taxable corporations, would be subject to higher taxes. The tax liabilities for corporations of different size under the proposed rates and present law are compared in table 2 and in chart 1. The maximum tax reduction would occur at the top of the present "notch" area on net incomes of $50,000 and would amount to $3,500. The maximum tax increase would amount to three percentage points for the largest corporations.

(Table 2 and chart 1 follow:)

TABLE 2.—*Comparison of corporation income-tax liabilities under present law and under House bill, H. R. 8920*

Net income	Tax liabilities		Effective rates		
	Present law	House bill	Present law	House bill	Increase (+) or decrease (−)
			Percent	*Percent*	*Percent*
$5,000	$1, 050	$1, 050	21. 00	21. 00	0
$10,000	2, 200	2, 100	22. 00	21. 00	−1. 00
$25,000	5, 750	5, 250	23. 00	21. 00	−2. 00
$30,000	8, 400	7, 300	28. 00	24. 33	−3. 67
$50,000	19, 000	15, 500	38 00	31. 00	−7. 00
$60,000	22, 800	19, 600	38. 00	32. 67	−5. 33
$75,000	28, 500	25, 750	38. 00	34. 33	−3. 67
$100,000	38, 000	36, 000	38. 00	36. 00	−2. 00
$166,667	63, 333	63, 333	38. 00	38 00	0
$250,000	95, 000	97, 500	38. 00	39. 00	+1. 00
$1,000,000	380, 000	405, 000	38. 00	40. 50	+2 50
$10,000,000	3, 800, 000	4, 095, 000	38. 00	40. 95	+2. 95
$100,000,000	38, 000, 000	40, 995, 000	38 00	41. 00	+3. 00

CHART 1



Secretary SNYDER. The revised rate schedule, including the increased rate on larger corporations, would raise an estimated $410,000,000 additional revenue. This is after allowance for the reduction in taxes amounting to about $135,000,000, which would go largely to corporations with incomes of less than $100,000.

Senator MILLIKIN. Mr. Secretary, if you merely wanted to balance the gain to the corporations to which you are referring, that is, those having incomes of less than $100,000, how much would you have to increase your rate on the larger corporations?

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Senator KERR. You said the amount of the saving is $135,000,000 instead of $60,000,000.

Secretary SNYDER. An increase of one percentage point would be required to restore the revenue after curing the notch under the House bill.

Senator MILLIKIN. In other words, if we adopted a provision whereby we accomplished this relief for the notch people, that loss could be overcome with a 1-percent increase.

Secretary SNYDER. That is so. Senator Kerr, did that clear up what you had in mind?

Senator KERR. Yes.

Secretary SNYDER. As I indicated earlier in my statement, corporate profits are not far from 1948 record levels. This high level of profits has permitted corporations to pay dividends at a record rate and still retain about $10,000,000,000 of earnings, of four times the amount of profits retained in 1929.

The bulk of corporation income is concentrated in the very large corporations. As shown in chart 2, 5 percent of all corporations receive 81 percent of total corporation income. Recent profit trends for corporations of different size reveal an unmistakable improvement in the relative position of the largest corporations. These trends are shown in chart 3.

(Charts 2 and 3 follow:)

CHART 2

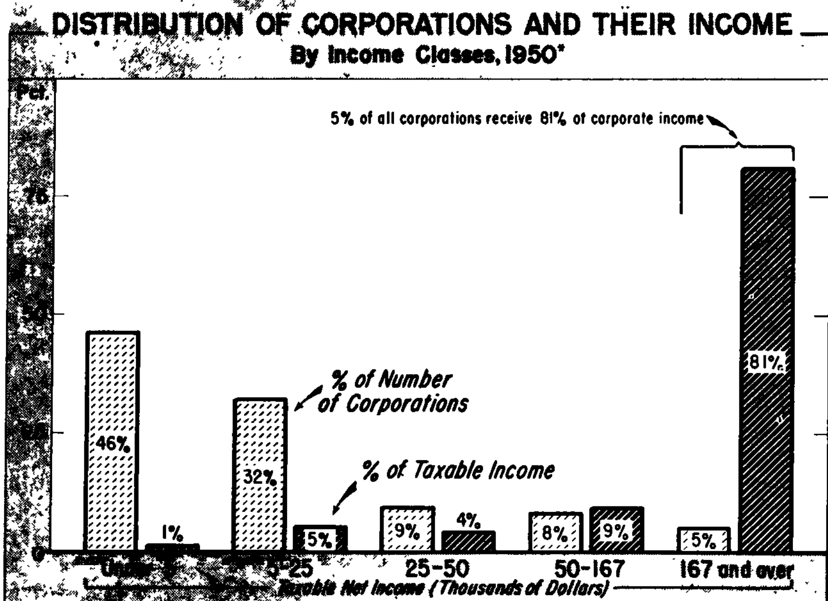
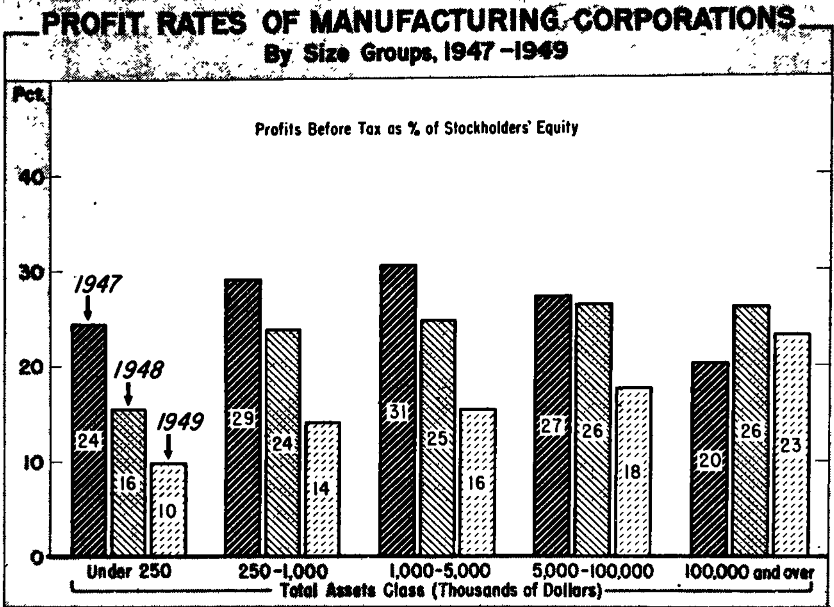


CHART 3



Secretary SNYDER. The strength of corporate business is also shown by the trend in its working-capital position. At the end of 1949, the net working capital of all nonfinancial corporations amounted to nearly three times the 1939 figure. During this period liquid assets increased from less than one-half to three-fourths of their current liabilities. At the end of 1949, corporations held more than $40,000,000,000 in cash and United States Government securities.

The President's recommendation for revision of the treatment of business losses is also carried out in the bill. Present law permits taxpayers to offset their losses in any given year against profits in the two prior years and to carry forward any remaining loss to be offset against income in the two succeeding years. The proposed revision would increase the carry-forward from 2 to 5 years and would reduce the carry-backs to 1 year. This would provide a total period of 7 years in which losses might be offset against profits as compared with the present 5-year period and thus reduce the tax advantage now enjoyed by stable as compared with unstable businesses.

More liberal loss offsets would be of particular benefit to new and small business and would promote their expansion. New concerns often experience losses or irregular earnings in their early history, since the development of a new business generally involves large initial costs which cannot be recovered immediately. Small business in general encounters great difficulties in withstanding the financial strain of hard times. Large firms on the other hand have a greater opportunity to average their own incomes because they are more likely to have diversified products and markets. Losses sustained from one activity or locality can often be offset in the same year against income from other sources.

The relief provided for small business by the revisions in the corporate rate structure and in the loss offsets accords with our objective to foster the development of this segment of the economy.

Senator MILLIKIN. Mr. Secretary, under your theory who would pay the cost of the increased rates for the corporations in the higher brackets?

Secretary SNYDER. I beg your pardon?

Senator MILLIKIN. Who would be paying that increase in taxes on the richer corporations? Would the stockholders suffer to that extent, or would the opportunity for the employee to make better bargaining contracts suffer, or would the corporation itself suffer? To whom would the cost of this increase be transferred?

Secretary SNYDER. Of course, that would be difficult to estimate. It is presumed that in most cases the corporation itself would absorb that additional tax, but I have no way of knowing whether they would pass it on or just how they would work it out. That would be up to the individual corporation.

Senator MILLIKIN. In some cases it would be passed on, would it not?

Secretary SNYDER. I would imagine so.

Senator MILLIKIN. And where that happens, roughly we are taking off one excise only to impose another one.

Secretary SNYDER. That is one of the problems of raising any revenue, Mr. Chairman.

Senator MARTIN. May I express an observation, Mr. Chairman. Does not the consumer pay all the tax? It is a tax on the cost of production, so the consumer really pays.

Secretary SNYDER. I think any tax we have finally comes to rest on individuals.

Senator MARTIN. The fellow who finally pays all the taxes is the consumer.

Senator MILLIKIN. I think the economists draw two or three or four fine lines of distinction as to what happens to the increase of taxes on corporations. Where the competitive situation is tight, the corporation, in a loose use of words, absorbs the tax, which means that the stockholder absorbs it or the expansion plans of the corporation absorb it. It solves nothing by saying that it is absorbed. Somebody bears the brunt of the absorption. Then they go on to say that where a corporation has something approaching a monopoly or a very fine lush position in business, they will pass that on, which has the effect of an excise, but in any event, someone's income is affected, the stockholders' income is affected, and that income is perhaps as dynamic as any that we have in the country for maintaining our economy, or you have a reduction in the expansion plans of the corporation, you have a reduction in the opportunity of the worker to get more wages. So someone is hit by these words which we so glibly use such as "absorption."

Secretary SNYDER. Well, Senator, I think we are both in agreement that it finally gets down to the individual in any tax.

Senator MILLIKIN. That is right.

Secretary SNYDER. It affects him, because it has got to come out of either his earnings, his assets, or what he pays for the goods. That comes about in any tax.

Senator MARTIN. Any way you take it, the stockholder, the consumer, or the wage earner—and they are the little fellows of our country—are the ones that eventually have to pay the bill.

Secretary SNYDER. That is true of most any tax. And if we have got to have the revenues, we have just got to face that, unfortunately.

Senator MARTIN. There is no way to remedy it. Or I might amend that to say that there is one way to remedy it, and that is to cut the cost of Government at the three levels, local, State, and Federal. That is the only way you can do it.

Secretary SNYDER. As the Secretary of the Treasury, charged with the management of the debt, I would like to have the additional revenue.

Senator MARTIN. I would like to get some revenue to cut the debt, myself.

Senator MILLIKIN. When was the last time that we cut the debt, Mr. Secretary?

Secretary SNYDER. Year before last.

Senator MILLIKIN. You do not mean in that awful Eightieth Congress.

Secretary SNYDER. Yes, that is right, Senator. You have guessed it.

SUMMARY OF REVENUE INCREASES

The revenue-raising provisions of the bill would yield $890,000,000 in a full year of operation and about $525,000,000 in the fiscal year 1951, as follows:

	Full year	Fiscal year 1951
Corporation tax increase	$410,000,000	$160,000,000
Life insurance companies	55,000,000	125,000,000
Charitable and educational institutions	100,000,000	
Miscellaneous loopholes	125,000,000	109,000,000
Withholding on dividends	160,000,000	127,000,000
Reduction in interest rate on tax refunds	40,000,000	5,000,000
Total	890,000,000	526,000,000

The CHAIRMAN. Mr. Secretary, I believe the House bill reduces the rate of interest on refunds to 3, but leaves the rate of interest on deficiencies at 6

Secretary SNYDER. Yes, sir. I am going to mention that.

This total falls short of matching the excise reductions by $120,000,000 on a full-year basis. You will note that the total includes $40,000,000 resulting from the reduction in the interest rate on tax refunds. In my view this cannot be construed as an improvement in the tax structure or an administrative reform, and is an inequitable method of meeting our revenue requirements.

I personally think that they both ought to be the same.

Senator MILLIKIN. May I ask, Mr. Secretary: What do you think would be a realistic rate of interest at the present time to apply to both?

Secretary SNYDER. Well, for the purpose of encouraging the taxpayer to get his taxes paid, I think that the higher rate, 6 percent, ought to be retained. Because it is more than just interest; it is an incentive for him to come in, pay his taxes, and settle up.

Senator TAFT. Is there a little incentive on the Government to pay back, when they owe him?

Secretary SNYDER. Of course. In the 3 years, Senator, we reduced the interest charge, in connection with returns claiming overpayment on March 15, from about $22,000,000 to a little over a million now. So we have been paying it back awfully fast.

Senator MILLIKIN. That is excellent. From $22,000,000 down to $1,000,000, you say?

Secretary SNYDER. We have done that in the last 3 years' time.

The CHAIRMAN. What is the total?

Secretary SNYDER. The total interest on all tax refunds is $80,000,000 to $100,000,000. But we have reduced interest paid on excess prepayments by accelerating refunds after March 15. A large part of the interest that is accruing now, of course, is on those profits tax cases. Those that we have not been able to get settled. Some of them are very large and are bearing pretty heavy interest right now.

But does that answer your question, Mr. Chairman?

The CHAIRMAN. I think so, yes.

Secretary SNYDER. The figures I have given indicate the revenue that would be raised before allowing for certain provisions in the bill involving the loss of approximately $50,000,000. I shall return to these undesirable provisions later in my statement.

Exclusive of increased fiscal year collections which would result from the system of speeding up corporation income tax payments adopted by the House, the bill as it stands involves an estimated revenue loss of about $170,000,000.

SPEED-UP OF CORPORATION TAX COLLECTIONS

The provision of the bill changing the system for installment payment of corporation income tax liabilities would substantially increase collections over a 5-year period beginning with the fiscal year 1951. This change does not alter the tax liabilities of corporations but merely the timing of the tax payments.

The objective of the provision is to reduce the lag in corporate tax payments. At present, two-thirds of all taxable corporations, accounting for 97 percent of total corporation income tax liability, pay their taxes in quarterly installments during the year following the close of the taxable year. On the average, the corporation income tax is now collected 7 months after the close of the taxable year. When this provision becomes fully effective 5 years hence, this lag will be reduced to an average of 4 months.

Operation of the plan is shown in table 3 and chart 4. It would gradually replace the present four-quarter payment privilege by a system providing for payment of the full tax liability in the first two quarters following the end of the taxable year. However, this would be accomplished over a 5-year period during which each year the tax paid in the third and fourth quarters would be reduced and the tax paid in the first and second quarters correspondingly increased. When the two-installment system is fully effective, one-half the corporation income tax will be collected 6 months earlier than at present.

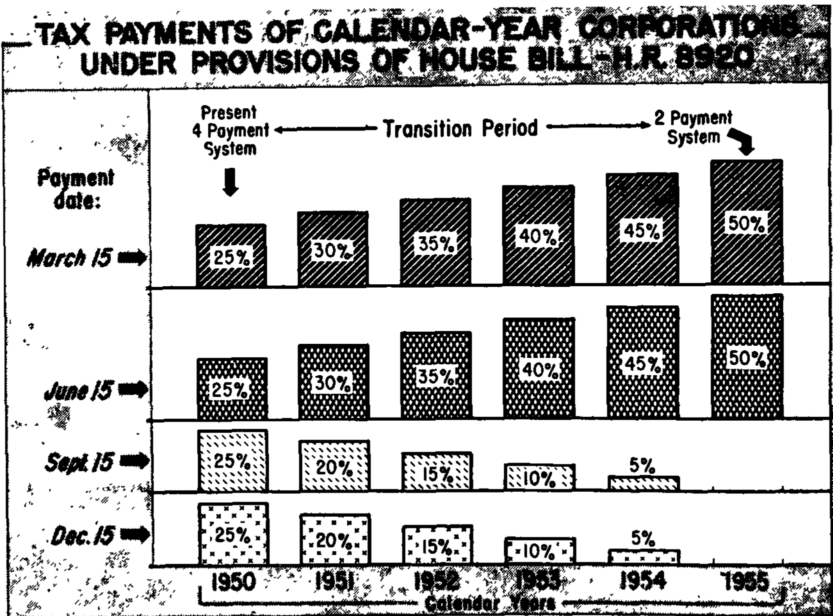
(Table 3 and chart 4 follow:)

TABLE 3.—*Corporation tax payments under present law and under House bill, H. R. 8920*

[Assuming a constant liability of $100 in calendar years 1949–54]

Date of payment	Present law	House bill	Date of payment	Present law	House bill
1950—Mar. 15	$25	$25	1953—Mar. 15	$25	$40
June 15	25	25	June 15	25	40
Sept. 15	25	25	Sept. 15	25	10
Dec. 15	25	25	Dec. 15	25	10
1951—Mar. 15	25	30	1954—Mar. 15	25	45
June 15	25	30	June 15	25	45
Sept. 15	25	20	Sept. 15	25	5
Dec. 15	25	20	Dec. 15	25	5
1952—Mar. 15	25	35	1955—Mar. 15	25	50
June 15	25	35	June 15	25	50
Sept. 15	25	15	Sept. 15	25	----------
Dec. 15	25	15	Dec. 15	25	----------

CHART 4



The gradual transition to the more current system provided for in the bill is desirable to prevent impairment of the working capital position of corporations that have not set aside funds to meet their accrued tax liabilities. Larger corporations generally fund their tax liability currently by buying tax anticipation notes or marketable securities as profits are earned. Accelerated tax payment will not affect the operations of these corporations except to deprive them of part of the small interest income from their tax funds. The 5-year transition should be sufficient to permit smaller corporations to adjust their payments without hardship. Moreover, the Commissioner of Internal Revenue can make extensions of time if it should become necessary.

Senator MILLIKIN. The taxpayer would have to pay interest if he got such an extension.

Secretary SNYDER. There is provision for interest; yes.

Senator MILLIKIN. Has any study been made, Mr. Secretary, of the history of the smaller corporations, as to the earliest time they could reasonably be expected to know what the profit and loss of the preceding year had been?

Secretary SNYDER. With most of them it would be immediately following their inventory taking, which would be within a relatively short time after the end of the year. It all depends on the type of the corporation. The arrival at the determination of profit and loss with the small corporations usually is rather a simple process.

Senator MILLIKIN. You have a lot of inventory problems. You have problems of goods in transit, goods partially fabricated. I think the reason for originally giving a year's time was because there is great difficulty with many corporations in knowing what their exact status was in the preceding year. I am wondering whether we are infringing on the business practice when we get into this.

Secretary SNYDER. I would be glad to have some research done on that, Senator.

Senator TAFT. Mr. Snyder, is there not already some lack of balance in the fact that the Government collects much more money the first 6 months than it does in the last 6 months; so that in a way you upset the whole economy by the drawing on people during the first 6 months, even today? And this, of course, will increase that discrepancy, will it not?

Secretary SNYDER. The speed-up will gradually call for larger payments in the first half of the year.

Senator TAFT. Will it not be the case constantly?

Secretary SNYDER. It will advance the payment by 6 months, yes, sir.

Senator TAFT. What I mean is that today, in the first 6 months of the calendar year you have an excessive receipts so great as to operate to almost cause a deflation in business enterprise, or to check inflation, as it has done in the last 2 or 3 years; whereas in the last 6 months, you have a deficiency of Government receipts, which stimulates inflation. Now, is this not going to make that situation worse?

Secretary SNYDER. It will concentrate tax payments into the first part of the year, of course.

Senator TAFT. In other words, you collect billions of dollars more the first 6 months, and you pay out billions of dollars more the second 6 months. Is that not a rather bad set-up for the Government, as affecting the general economy on inflation and deflation?

Secretary SNYDER. That, of course, could be adjusted by the debt management, because we could just borrow less money in the first half, maybe more in the last half, and that would balance itself out.

Senator TAFT. I do not think borrowing makes the difference. It is the spending that makes the difference.

Secretary SNYDER. Well, it is the amount of money that is in circulation that is important.

Senator TAFT. What I mean is that if you have a depression coming along, and it hits you about January, and then the Government draws $5,000,000,000 more out of the economy in that 6 months than in the next 6 months, you accelerate the depression. The Joint Committee

on the Economic Report has commented on that before. And I wondered if this did not make that situation worse, in that it gave you less opportunity, there; and whether it did not really affect the whole situation in such a way as to perhaps bring about a more serious depression, when it was not necessary.

Secretary SNYDER. I can see the point that you are making there. I was looking at it from the debt-management side. Of course, we could handle that through short-term debt operations.

Senator TAFT. Yes, you could do that.

Secretary SNYDER. But on the economy side, I think that it might have an effect. However, once it is in full operation, I should not think——

Senator TAFT. I should think the more you did it, the worse it would get; the more the system goes into operation, the more your excessive Government receipts in the first 6 months overbalances the Government expenditures. In other words, you draw $5,000,000,000 or $6,000,000,000 more, and it is more and more every year now, of the banks, out of the money that could otherwise be spent, and it seems to me that if a depression started at that time it would encourage the depression.

Secretary SNYDER. It would take the money out of the banks and move that much up into the first half. That is perfectly true.

Senator MILLIKIN. Does it not come down to this: That during the first 6 months we spend everything we take in, and during the second 6 months you will have to borrow to cover the second half?

Secretary SNYDER. No. What would actually happen is that when it comes in in the first half we would pay off short-term obligations held by nonbank investors and that would put it back into the banks again, don't you see. So it looks to me like in the long run it would pretty well balance out. It would not actually take any money out of the banking system.

The CHAIRMAN. Mr. Secretary, getting away from the present system, however, over to the one suggested in the House, you properly point out that it mitigates the hardship on the medium-sized and smaller corporations that would have to pay and not fund their taxes, but they would rather retain the taxes for necessary operating cost and maybe some expansion. Do you not run this one danger of rendering less stable your tax base for the full year? And is there not a great advantage to the Treasury in knowing that so far as the corporate taxes are concerned you have already taken the pattern of your corporate income, that is, your receipts from corporate income taxes, in the previous year? You have a year in which you would rather have a more stable basis for estimating your income from corporate taxes. Because you might have a disastrous drop in business in the latter half of the year, and in the next year, of course, you would have far less income.

Secretary SNYDER. This change would not effect tax liabilities at all. You could not just take the revenue for the first half and consider that as the projection for the next year, if we had experienced a set-back in the preceding 6 months.

The CHAIRMAN. I suppose it would wash out the same way; but there is an advantage in knowing that your base for roughly one-fourth of the income, for instance, of the Federal Government is more or less stable. And now you are shortening that period of stability for estimating and calculating purposes by 6 months.

You point out that this does not affect the tax liability whatsoever.

Secretary SNYDER. It is an acceleration of payment.

The CHAIRMAN. It is an acceleration of payment; yes. But since we are on more or less of a cash basis so far as our budget is concerned, anyway, it is helpful in that respect, is it not?

Secretary SNYDER. It would be helpful to get the payment accelerated; yes, sir.

But, as I am going to say here, Mr. Chairman, this is a tax reform. It is a tax reform and does not raise any additional revenues. It is simply a tax reform, and it happens that in this first five fiscal years of operation it will accelerate and bring in a little more money. It is not adding anything to the tax revenue of the Government.

Senator MILLIKIN. Mr. Secretary, this is just a detail affecting administration. At the present time, having to make returns by March, the accountants and tax lawyers are rushed to death, and many citizens find difficulty getting their own businesses in shape so that they can make an accurate return. I think that this would also have a tendency to accentuate that difficulty. It puts an enormous amount of work into the available people who can do the work for the citizen within the 6 months period.

Secretary SNYDER. This would not change the auditing, Senator.

Senator MILLIKIN. If you would have to make your payments and get your business all done within 6 months, it certainly makes for a more condensed period of operation for the bookkeeper.

Secretary SNYDER. The taxpayer now has to write a check for 25 percent of it anyway. It would not affect the filing of the return to make it for 50 percent.

Senator MILLIKIN. Yes; I think your point is well taken.

Secretary SNYDER. At the present level of corporate profits and under the rates of the House bill, this speed-up in collection will increase fiscal year 1951 tax receipts by nearly $800,000,000 and receipts in each of the four succeeding fiscal years by a somewhat larger amount.

This provision, in my opinion, is a desirable tax reform. It will bring corporations closer to the current-payment basis which applies to business income of individuals, and will make corporation income-tax revenue more promptly responsive to changes in tax rates or economic conditions. However, I should like to emphasize that the speed-up in corporate tax payments is not a revenue-raising measure and therefore cannot be regarded as an offset to the revenue lost from excise tax reductions.

REVISIONS IN THE BILL

Some provisions of the bill conflict with sound taxation, and I urge you to consider their modification or deletion. These include the further expansion of already excessive percentage depletion allowances and revisions affecting the estate tax.

Percentage depletion

The most objectionable provision of the House bill is the extension of percentage depletion to some 20 types of nonmetallic minerals not covered by present law and the increase in the rate of percentage depletion for coal from 5 to 10 percent of gross income.

This action represents a continuation of the movement for expanding depletion allowances which gathered momentum under the guise

of wartime necessity. In 1942, when percentage depletion was first granted to ball and sagger clay, producers of other clays complained of discrimination and inequitable taxation. So in later years percentage depletion was extended to bentonite and china clay. The House bill now proposes further extension to refractory clays, fuller's earth, fire clays, and brick and tile clays. Such extension would give rise to further claims of discrimination by producers of miscellaneous clays and in turn by producers of synthetic and reworked materials competitive with clay.

The basis for these allowances is so vague that it can be readily applied to practically every situation. Each industry, for example, can argue that it is essential to national defense. The last war showed conclusively that practically every industry is essential to an economy devoted to war. After one mineral has been given favorable treatment, no end is in sight to the list of minerals that can plead for inclusion on the ground of competitive inequity. The special concessions now in the law create serious competitive discriminations because of unreasonable disparities in the percentage depletion rates. There is even greater discrimination between the groups favored with concessions and other industries and classes of taxpayers not so favored. In consequence, persistent pressure may be expected to obtain equality by raising the lower rates to the higher level and by extending benefits to other industry areas. The bill as passed by the House of Representatives goes so far as to concede special tax relief to those who strip hillsides of gravel. This could be justified because similar treatment is to be given to those who scoop sand off the seashore.

Because each group feels that special tax exemption can be equally justified in its case as a means of fostering the growth of that particular industry, the result is the development of a system of concessions which is not only incongruous in a sound and equitable tax system but which is also ill-suited for a sound national policy of mineral development and conservation.

Taxpayers in the favored industries, and particularly a few large corporations, benefit at the expense of the rest of the business community. The advantage is defended on the grounds of special risks in the oil industry which, incidentally, is regarded as a favored investment by conservative investment trusts. A businessman desiring to invest in a new product might incur greater risk but is limited in determining his taxes to the recovery of his actual investment costs over the life of the property. The allowance for tax purposes of deductions many times the investment that may be made in oil properties means that many other types of businesses are now paying more taxes than they should in order to enable the Government to recoup the tax leakage from percentage depletion.

Improvement of the equity and strength of the tax system requires that we definitely reject the undesirable extensions made in this bill and move toward elimination of these special privileges. The high level of revenue requirements which necessitates even the retention of some onerous excise taxes makes this improvement the more urgent. Consequently, I wish to urge upon your committee the changes which were proposed to the Ways and Means Committee which would carry out the recommendation of the President that the more excessive special depletion allowances permitted under present law be reduced.

Senator MILLIKIN. Did the President urge the reduction of the oil percentage depletion?

Secretary SNYDER. From 27½ to 15 percent; yes.

This would reduce the revenue loss from these provisions by over $200,000,000. The staff is prepared to present to the committee the results of the Department's study of this subject, covering the amount of the benefits and their effect on the economy.

Estate and gift taxes

Another conspicuous weakness of the House bill is the omission of the long overdue estate and gift tax revisions. The need for strengthening these taxes in the revenue system is widely recognized. Such a program has been repeatedly urged by the administration, most recently by the President in 1948 and 1949 and again this year. The revisions proposed in these taxes would make an important contribution to additional revenue.

The present weakness of the estate tax and the failure of this levy to keep pace with the income tax is clearly illustrated in charts 5 to 8. The estate and gift taxes are now weak because (1) the imposition of separate, unrelated taxes upon property disposed of during life and at death permits undue escape from taxation, (2) property left in trust is accorded extensive advantages over property left outright, and (3) changes made in 1948 result in excessive exemptions and unreasonably low effective rates for married persons. The program which was outlined to the Ways and Means Committee would correct most of these defects and would restore the revenue from these taxes to a level somewhat above that reached prior to the 1948 act.

(Charts 5 through 8 follow:)

CHART 5

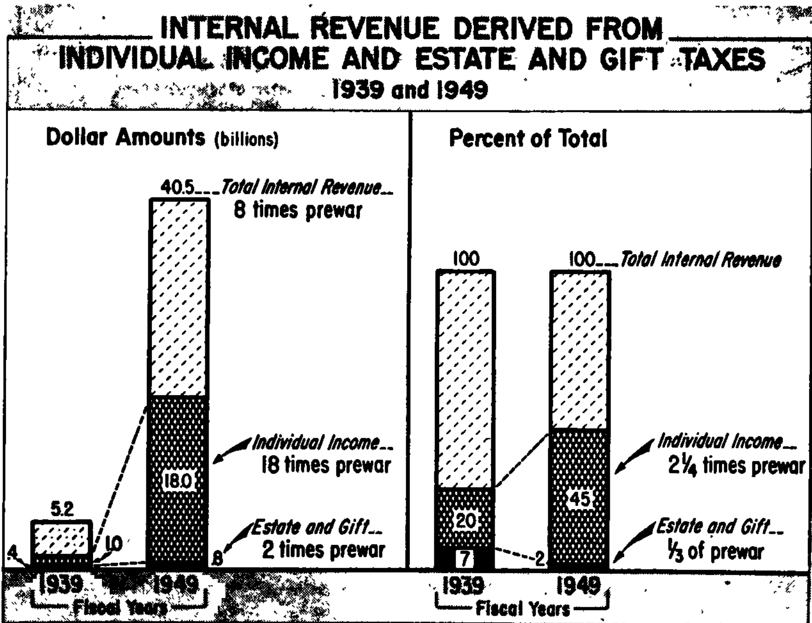


CHART 6

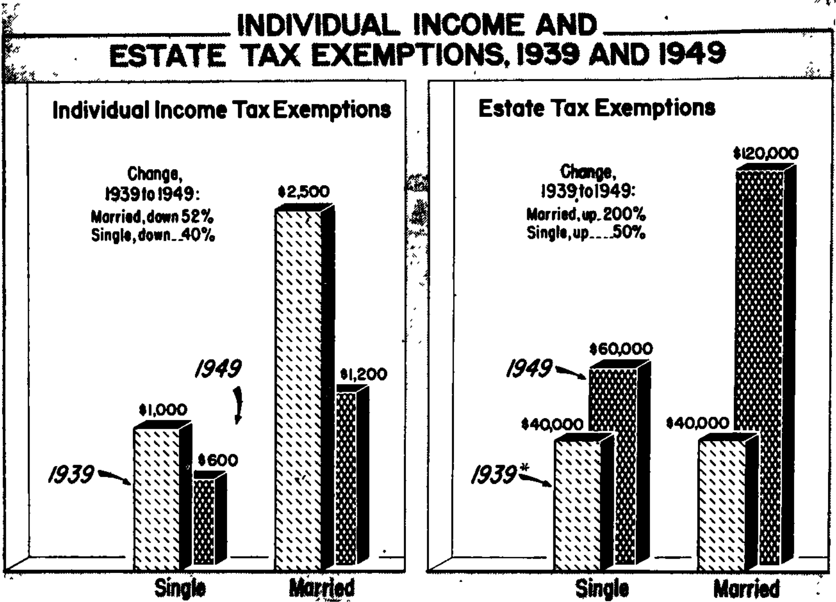


CHART 7

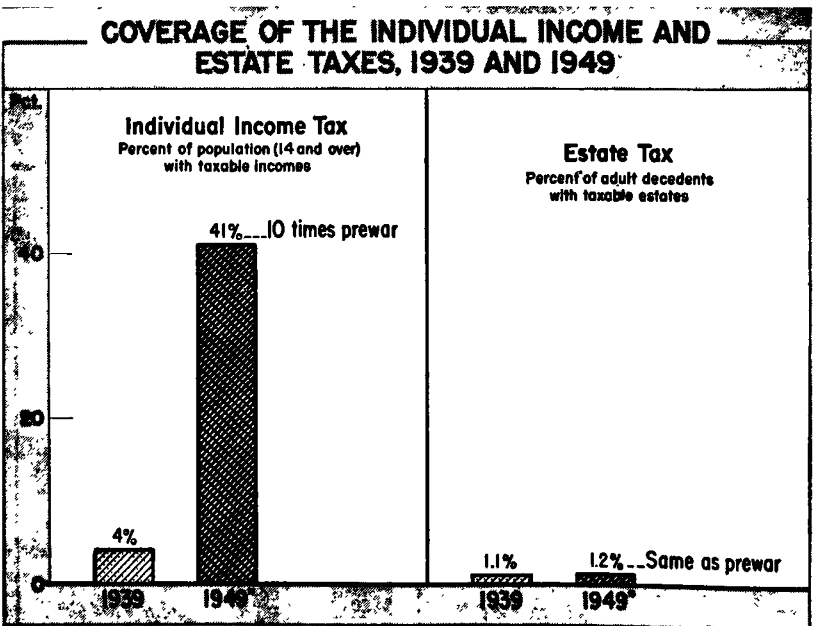
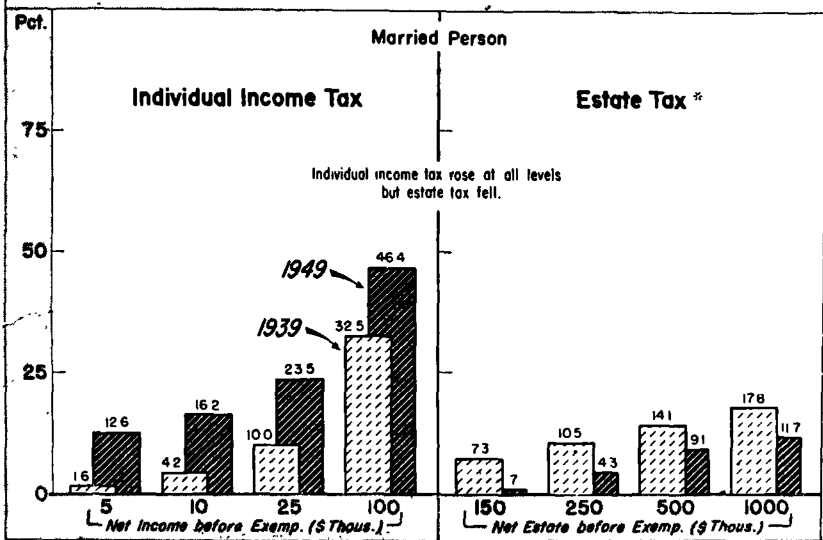


CHART 8



Senator MILLIKIN. It would not abolish the community property split, would it?

Secretary SNYDER. No; it would not.

Senator MILLIKIN. No one is recommending that?

Secretary SNYDER. No, sir. That is not recommended in the President's program.

Senator MILLIKIN. Is anybody recommending the repeal of the 1948 act?

Secretary SNYDER. In toto? Someone here last year made such a recommendation. I think one of your Senators did.

Senator MILLIKIN. They did not get very far, did they?

Secretary SNYDER. The House bill makes no provision for a general overhauling of the estate and gift tax structure. Moreover, it contains two provisions which are undesirable.

One of these would weaken the estate tax law by excluding certain gifts made in contemplation of death from the estate tax base. As I pointed out to the Ways and Means Committee, the best over-all solution of the contemplation of death problem would be to integrate the estate and gift taxes into a single transfer tax. Pending a review by your committee of the proposal for an integrated tax, I urge that the House amendment to the contemplation of death provision not be adopted.

Another objectionable provision in the bill would exempt from income tax, in cases where a closely held corporation is the principal asset in the estate, the dividends paid by the corporation to the estate up to the amount of liability for death taxes. While this is intended to meet a special problem, the solution proposed would invite extensive tax avoidance. It would be preferable to deal with

this problem on a more limited basis or defer it until the broader question of estate tax revision is considered.

Senator TAFT. Would you be satisfied if we put in the bill some provision for special study? It seems to me in the short time we have we can hardly go into this estate tax business, if the House has not done it.

Secretary SNYDER. That is exactly what we are suggesting here: That if you do not have the time to do it right now, it would be preferable to deal with this problem on a more limited basis or defer it until the broader question of estate tax revision is considered.

Point 4 tax proposals

The House bill contains no legislation carrying out those parts of the President's tax recommendations which derived their impetus from the point 4 program. These recommendations relate to the tax treatment of income derived abroad and are designed to remove tax deterrents to the movement of private investment and technicians to foreign countries.

One of these recommendations would treat the income of foreign branches established by domestic corporations as the tax laws now treat similar income obtained through foreign subsidiaries. The tax would be postponed until the foreign earnings are brought home. Such a provision would eliminate tax differentials as a factor in determining the organizational form of a foreign business operation and would afford greater flexibility to those contemplating investments abroad. It would also permit reinvestment of foreign earnings abroad without current tax consequences.

A corporation receiving dividends from a foreign subsidiary is now permitted a credit for the income taxes paid abroad by the subsidiary. This provision helps to eliminate international double taxation. However, it applies only to a domestic firm which owns a majority of the voting stock of the foreign corporation. Consequently, when two or more U. S. firms undertake to share the risk of a foreign enterprise, only one of them, at most, can be safeguarded against double taxation. One of the Department's proposals in this field would lower the majority control requirements so that ownership of any substantial interest in a foreign corporation would qualify a U. S. firm for the foreign tax credit. This would encourage joint ventures abroad, and would facilitate the participation of local capital in such enterprises.

There is need also for liberalizing the foreign tax credit provisions as they apply to firms that derive income in one foreign country but incur an offsetting loss in another and for extending it to the estate tax.

The scope of the exemption now accorded individuals on income earned abroad requires adjustment. The present exemption begins to apply only with the first full taxable year of bona fide foreign residence. There is no sound reason why the earnings of the first 11 months, say, of an individual's foreign residence should be taxed when it is clear that it is part of long-term employment abroad. Accordingly, the Department has proposed that, once an individual qualifies for exemption as a foreign resident for a taxable year, the exemption should apply retroactively to his earnings throughout the entire period of his stay abroad.

In presenting my comments on the House bill I have undertaken also to provide your committee with the background of the program which the President asked the Congress to consider.

The House bill makes an important contribution toward meeting the objectives of the President's program presented in January. However, it does not go far enough and should be improved. I earnestly urge you to consider the changes which would bring the bill more in accord with our present requirements.

I want to say once more that I am sure that the future course of world events is very much in your minds, as it is in mine. Increased disturbance to world peace would involve increased demands upon us which would require additional fiscal measures.

The effect of recent international developments on our expenditures will become clearer as events unfold. Therefore, if during the course of your consideration of this legislation it appears that we are confronted with a substantial increase in defense expenditures and strains on the economy, I shall not hesitate to so advise you. As the President indicated in his tax message, we must be ready to gear changes in the revenue laws to the needs of our economy.

These are times when our political and economic institutions are challenged and we should not hesitate to protect and perfect them. A healthy economy, a sound fiscal and tax policy, fair and adequate taxation are all parts of our pattern for national strength and world leadership.

The CHAIRMAN. Any questions?

Senator TAFT. Mr. Chairman, I would like to ask the Secretary regarding the budget report for the last year and the reduction of the deficit from $5,400,000,000, estimated, to $3,100,000,000. Can you give us an idea of why that is, and whether that is permanent, or whether it is just a postponement of expenditures that will make the expenditures bigger next year?

Secretary SNYDER. The revenue was somewhat less than was estimated in the original budget.

Senator TAFT. In the original budget, or the reestimate in January?

Secretary SNYDER. Actual receipts were $700,000,000 less than estimated in the budget last January.

Now, the large difference has come in the expenditures. The expenditures have been less than were anticipated and contemplated in the budget, and that was due for one thing to a number of reductions in the National Military Establishment. There, as I understand it, it was due in part to delays in the programs.

Senator TAFT. You mean, though, instead of starting them this year, they will be started a year from now, or something of that sort, you see. So for that reason it will never be added on to. It will never catch up. It will always be pushed into the future and will never double up in any one year.

Senator MILLIKIN. A reduction of that type means that it will be added at some time in the future. The reduction in our deficit this year, under your explanation, if I understood you, means an added deficit in the future.

Secretary SNYDER. I would like to have the Military Establishment explain that themselves. But it is our understanding that a large part of that is due to programs not having started that were contemplated.

Senator MARTIN. They have been delayed in the starting of their work, for different reasons, the preparation of plans and things of that kind.

Secretary SNYDER. That is my understanding; yes.

Senator MILLIKIN. I think it is very interesting to know whether this reduction of anticipated deficit represents a genuine curtailment of expense and not merely postponement.

Secretary SNYDER. I think the Defense Department could, with greater propriety, explain that.

Senator TAFT. How much difference in this $2,300,000,000 reduction is due to cuts in the military expenditures?

Secretary SNYDER. One billion dollars.

Senator MILLIKIN. And ECA?

Secretary SNYDER. ECA by about $500,000,000.

Senator TAFT. $500,000,000?

Secretary SNYDER. That is correct. That is from $4,100,000,000, which was the estimate, and it actually was $3,600,000,000.

Senator TAFT. These are actual expenditures? Or they may have encumbered that?

Secretary SNYDER. These are actual expenditures.

Mr. HAAS. This means the actual expenditures were this much below the January estimate for that period.

Senator TAFT. You have estimated for next year a deficit of $5,100,000,000, if I remember correctly, or something of the sort.

Secretary SNYDER. That is correct.

Senator TAFT. Do these postponements mean that the deficit is going to be bigger?

Secretary SNYDER. No, sir; not necessarily.

Senator TAFT. In ECA you think it will?

Secretary SNYDER. In that case. But it is not contemplated that this will increase the deficit materially.

Secretary SNYDER. We get that from the Budget, and they tell us this will not necessarily raise that deficit next year, because it will always be pushed on out further.

Senator TAFT. They will be as slow next year as they were this year in spending it? And the Army, too?

Secretary SNYDER. That is why I suggested that you get the testimony from them as to that.

Senator TAFT. Take the Korean thing, where they spent nothing. They will obviously spend much more in the current year.

Secretary SNYDER. There is no doubt about that. That is why I flagged that point in the statement, there; so that, if that condition changes, you will have it brought to your attention.

Senator MILLIKIN. The ECA reduction rather shatters the illusion of the impeccability of their estimates. If the Congress wishes to reduce their estimates $500,000,000, any one that favors that is a very villainous sort of a person, because "they cannot get along without one penny less than their estimates." But under their own operations they can get along with less, thank God.

Secretary SNYDER. Are you not kind of pleased, though, that the Treasury came so close to their estimates?

Senator MILLIKIN. That is why I say, "Thank God." I say it reverently.

Senator TAFT. Mr. Secretary, is there any effect in refunds? Are your refunds less or more than you intended? Does that appear now in the revenue end, in the next figure on revenue, or expenditures?

Secretary SNYDER. The revenue figure is net, after the refunds are made.

Senator TAFT. The refunds do not appear as an expenditure now?

Secretary SNYDER. No, sir; nor as revenue either.

Senator TAFT. They appear as a deduction from revenue, or they are a reduction from revenue; is that correct?

Secretary SNYDER. That is correct.

Senator TAFT. And how do they compare with your estimates made in January? Those made in January, and not the original.

Secretary SNYDER. You mean this last January? That was very close to the estimate, within about $20,000,000.

Senator TAFT. And the revenue is almost the same as estimated in January of this year?

Secretary SNYDER. A year ago. When we first made up the budget for 1950 it was 18 months ago.

Senator TAFT. How did it compare with January of this year?

Secretary SNYDER. It is down seven hundred million from the January estimate.

Senator TAFT. Seven hundred from the January estimate.

Has it been increasing recently?

Secretary SNYDER. Yes. It has been going up.

We anticipated that it would go up, in making the estimate.

Senator TAFT. I thought I saw some reports that it had gone up rather extraordinarily in May and June.

Mr. HAAS. No; the increase was in conformity with our estimate

Secretary SNYDER. It has gone up $400,000,000 from our April estimate.

Senator TAFT. What other savings have there been?

Secretary SNYDER. I was going on down the list, sir. The Veterans' Administration, $250,000,000; and in "Other expenditures" there is a reduction from the January budget, of $1,300,000,000. I will get the breakdown on that.

Senator MILLIKIN. I think it would be interesting, Mr. Secretary, to know what part of this is merely a deferred affair.

Secretary SNYDER. Mr. Chairman, may we investigate that and give you a memorandum on it, as to what the Budget expects?

The CHAIRMAN. Yes, sir.

Secretary SNYDER. I think it would be better to have it that way. Because we will have to go back to sources on that.

Senator TAFT. I would like to have as detailed a picture as possible as to what this is and how it will affect the budget next year.

Secretary SNYDER. We will prepare a memorandum for the use of committee. On that question you asked: Our estimate on the refunds was $2,177,000,000, and the actual was $2,160,000,000; $17,000,000 difference.

Senator TAFT. An accurate estimate; more accurate than some of the Treasury's estimates.

Secretary SNYDER. Again I will say these always have to be estimates.

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Because you are projecting ahead in these budget figures, they are necessarily estimates. But through the experience of the people working on it we try to arrive at the best figures we can. It just happened to be the case that we were awfully good this time.

The CHAIRMAN. Are there any further questions?

You will supply that information, then.

Secretary SNYDER. Mr. Chairman, our staff will be available at all times for the use of your committee, and we will supply any information that you call on us for, that we can compile for you, sir.

The CHAIRMAN. Thank you very much, Mr. Secretary, for your appearance. I suppose Mr. Kirby or Mr. Lynch will be available throughout the hearings.

Secretary SNYDER. Anyone that you want; but Mr. Kirby will head up the staff that will be available. However, Mr. Lynch or Mr. Ecker-Racz or any of them can come down if you want them.

The CHAIRMAN. Thank you.

Secretary SNYDER. Thank you very much, Mr. Chairman and members of the committee.

The CHAIRMAN. If it is agreeable with the committee, we will recess until tomorrow morning at 10 o'clock.

Those who were scheduled to be on hand this afternoon will be back tomorrow morning.

(Whereupon, at 12:02 p. m., the committee recessed to reconvene Thursday, July 6, 1950, at 10 a. m.)

REVENUE REVISIONS OF 1950

THURSDAY, JULY 6, 1950

United States Senate,
Committee on Finance,
Washington, D. C.

The committee met, pursuant to recess, at 10 a. m., in room 312, Senate Office Building, Senator Walter F. George, chairman, presiding.

Present: Senators George, Connally, Hoey, Kerr, Millikin, Taft, Butler, and Martin.

Also present: Mrs. Elizabeth B. Springer, chief clerk.

The Chairman. The committee will please come to order.

We will have to start promptly, gentlemen, although all members of the committee have not come in yet. They cannot get here exactly on time because of so many conflicting committee meetings but will be coming in before the end of the session.

Mr. Nichols, I believe you are scheduled first this morning.

STATEMENT OF CHARLES NICHOLS, PRESIDENT, G. M. McKELVEY CO., YOUNGSTOWN, OHIO, APPEARING FOR FRANK McCONNELL MAYFIELD, CHAIRMAN, NATIONAL COMMITTEE FOR REPEAL OF WARTIME EXCISE TAXES

Mr. Nichols. That is right, Senator.

The Chairman. Do you gentlemen wish to be asked any questions as we go along, or do you wish to wait until you have presented your case before we ask you questions?

Mr. Nichols. Senator George, in the interests of saving time, I would suggest that the statements are very brief and I believe if we could wait until the end for the questions and operate as a panel, it would save a lot of time.

The Chairman. Very well. We will observe that, then, and not ask you anything until you have presented your case as a whole, and then we may ask questions of the representatives who are appearing.

You may proceed, Mr. Nichols.

Mr. Nichols. My name is Charles Nichols. I am a merchant—president of G. M. McKelvey Co., a department store in Youngstown, Ohio. I am also president of the National Retail Dry Goods Association, a representative of its tax committee, and a director of the American Retail Federation.

However, I appear here today acting for Mr. Frank McConnell Mayfield, chairman of the National Committee for Repeal of Wartime Excise Taxes. This national committee was organized last December and is composed of the principal executives from companies engaged in lines of business which are directly affected by the wartime excise taxes. I am submitting to your committee the reso-

lution adopted by the members of this national committee shortly after its organization. I am also submitting the petition to the Congress signed by the members of the national committee. There are enough copies for each member of this committee.

The resolution of policy sets forth the reasons for the national committee's specific position that the wartime excise taxes enacted in 1941, 1942, and 1943—except those on tobacco, alcoholic beverages, and gasoline, which are a special category and present problems of their own—should be repealed forthwith.

Naturally, every member of our committee, speaking for a substantial company in one of the fields affected by these wartime excise taxes, would like to appear to tell you in person of the experience of his company, its employees, its distributors, and its customers with wartime excise taxes. Since we are anxious to expedite these hearings the National committee will present through four witnesses the general case for the repeal of wartime excise taxes as distinct from the separate and individual cases on specific products and specific industries.

As a retailer in the department-store business, I have had a first-hand opportunity to appraise the effects of the continuation of these wartime excise taxes. We sell both goods that are not taxed and goods that are taxed. Our experience since the end of the war proves to me that these excise taxes discourage customers from buying the taxed items. In the last year or two particularly, our departments which sell taxed goods have not enjoyed the firm demand of the other departments.

The impact of the excise tax is a serious one—any sales clerk who has lost a commission on a $30 suitcase because of the additional $6 tax can tell you in no uncertain terms not only how he feels but also how the customer felt when he refused to buy.

I have come to the conclusion that a failure to repeal these taxes now would be short-sighted and hurtful to my store, to the industries directly supplying me, and to my community. Selective taxation of particular categories of merchandise prevents business from achieving their maximum effectiveness in their appeal to the consumer. It operates as a brake on consumer purchasing power which is bad for our business and the economy of the country, and grossly unfair and discriminatory to the producers and sellers of the products affected.

In an effort to save the time of your committee, the National Committee for Repeal of Wartime Excise Taxes has digested the thousand pages of testimony of 231 witnesses before the House Ways and Means Committee on the subject of excise taxes. This blue pamphlet is presented for your individual use, and, if you think it desirable, for incorporation into the record. The names and affiliations of the individual members of the national committee are shown on the back cover of the blue pamphlet.

Although the last few months have witnessed important developments in the field of excise tax-relief we believe that the most important step remains for your committee.

The President of the United States in his tax message to Congress on January 23, 1950, enunciated a new executive policy calling for excise tax reduction.

Subsequently, the House Ways and Means Committee acted to apply the sound reasoning of the President's message not only to the seven industries for which he had recommended some relief, but to a

much larger number of the 27 industries affected. It concluded, as we have concluded, that relief should not be limited to the excise taxes levied in 1943, but should be extended to include those levied in 1941 and 1942, saying:

> Your committee has not restricted the excise reductions to taxes where the rates were increased in the Revenue Act of 1943. Increases were also made during 1941 and 1942 which are equally deserving of consideration since they were made under wartime conditions. (See H. Rept. 2319, 81st Cong., 2d sess.)

The statement by the President, the report by the House Ways and Means Committee, and the subsequent action of the House on last Thursday are commendable, so far as they go, but it is our conviction that the action taken does not go far enough. It remains for your committee to recommend a sound, equitable, and progressive tax policy, namely, the repeal of all the wartime excise tax levies of 1941, 1942, and 1943 (excluding those on alcohol, tobacco, and gasoline).

The issue before this committee is not whether excise taxes should be reduced. Everyone concedes that proposition. Indeed, there is no substantial body of opinion in the public or in Congress that wartime excise tax levies should not be ultimately eliminated from our peacetime tax structure.

The national committee feels that the measure as it passed the House did not go as far as it should toward the ultimate goal of repeal. Most of the Members of the House of Representatives who spoke on the subject in debate last week feel the same way. Mere reduction in the rate of wartime excise tax levies is a halfway measure. Our three remaining witnesses will demonstrate that complete repeal is the only just and practical course.

This committee is well aware of the situation in Korea. We know that it is impossible to foretell the outcome of these events and the responsibilities which future events may place upon our national economy for an all-out economic effort to preserve democracy, freedom, and world peace.

It has been the position of our committee before the House Ways and Means Committee, and it is our position here today, that the discriminatory excise levies of World War II should be eliminated now, and that taxes on consumption should not again be imposed except in conjunction with those other fiscal and economic controls on the American people that would result in an over-all mobilization of our resources.

We are sometimes told we should not suggest repeal unless we can recommend some other sources of revenue. We do not agree with this proposition. In the first place, our national committee has no facilities to formulate a national tax policy. In the second place, we do not know that it is necessary to tax anybody else if the wartime excises are repealed. In the third place, since they are discriminatory and unfair, these taxes should be repealed regardless of their effect on current revenue.

Therefore, the national committee has taken no position with regard to the various compensating measures of taxation in the House bill.

However, the national committee has developed economic information which it believes will be helpful to this committee in appraising the revenue consequences in event our recommendation is accepted. We believe we will be able to show through the testimony of Mr.

Leon Henderson, who will appear for the committee, that the gross revenue estimated to be lost by excise tax repeal is not the accurate measure of loss to the Treasury. The net loss is the important and material consideration.

The House Ways and Means Committee, in the report on this bill, for the first time has recognized the increased yield of income taxes as an element of distinction between gross and net loss of revenues. The House report affirmed that—

receipts from the corporate and individual income taxes will be increased by $100,000,000 as a result of the effect of excise tax reduction on the volume of sales and the business expense reduction in the taxed industries. (See H. Rept. No. 2319, 81st Cong., 2d sess., p. 2.)

Although the House Ways and Means Committee adopted the principle urged by the representatives of the national committee, we believe that its estimates of the net loss are overly conservative. It is our estimate, and Mr. Henderson's testimony will be directed to this proposition, that the bill passed by the House, could be amended to provide for complete repeal of all wartime excise tax levies—except those on alcohol, tobacco, and gasoline—with a net annual loss to the Treasury of $247,000,000. This is without consideration of the additional $800,000,000 a year in revenue which would be available to the Treasury each year for the next 5 years from the acceleration of corporate income tax payments.

In addition to hearing from Mr. Henderson on this vital phase, the national committee will present two of its vice chairman, Mr. Arde Bulova, chairman of the board of the Bulova Watch Co., and Mr. Louis Ruthenburg, chairman of the board of Servel, Inc., to present on behalf of the committee the brief substantive arguments for complete repeal. Our next witness is Mr. Arde Bulova.

The CHAIRMAN. All right, Mr. Bulova.

We are proceeding, gentlemen, with the understanding that we will question the witnesses when this group has finished its direct statement.

STATEMENT OF ARDE BULOVA, CHAIRMAN OF THE BOARD OF THE BULOVA WATCH CO., APPEARING ON BEHALF OF NATIONAL COMMITTEE FOR REPEAL OF WARTIME EXCISE TAXES

Mr. BULOVA. May I proceed, Mr. Chairman?

The CHAIRMAN. Yes, Mr. Bulova.

Mr. BULOVA. My name is Arde Bulova. I am chairman of the board of the Bulova Watch Co. But I am not appearing before you in order to plead a special case—either for my company or my industry. I appear before you as a vice chairman of the National Committee for Repeal of Wartime Excise Taxes. I am here to urge you, in behalf of 27 American industries represented by our national committee, to repeal the wartime excise and rate increases which were enacted by Congress in 1941, 1942, and 1943. I am here to urge you to repeal these taxes in their entirety, and to repeal them now.

The House of Representatives has taken a valuable and constructive step in reducing the excise tax burden, but there are powerful reasons for concluding that the House did not go far enough.

The wartime excise taxes are unfair; they are unwise; they are discriminatory. They hurt business; they hurt production; they hurt

labor; they create unemployment; they disrupt entire communities in our Nation; they dislocate whole areas of our economic structure. They punish the consumer, and they hit hardest those people who are least able to pay an added tax burden—people in the low-income brackets, people whose income is used up on the simple necessities of living.

Only complete repeal of the wartime excise taxes can eliminate their unfairness and their discrimination. These taxes are not part unfair, or part unjust, or part discriminatory.

The committee is convinced that only repeal of the wartime excises can restore to American business the fair conditions of competition in a free enterprise system. When you tax some businesses and not others, you are putting a special penalty on the taxed businesses.

It is estimated that in 1950 $2,200,000,000 will be collected in excise taxes from the 27 affected industries. The House bill makes certain reductions, but still leaves discriminatory taxes of $1,200,000,000. The House bill gives partial relief to 18 industries, but it leaves 9 industries untouched. The reduction of excises does not eliminate the discrimination; it only changes the shape.

Let me give you a few examples:

Under the present law, an electric light bulb which is used in floodlamps for photographic purposes is taxed at 25 percent; the same bulb, if used to floodlight a building, is taxed at 20 percent. Under the House bill, the bulb used to floodlight a building would still be taxed at 20 percent, but the same bulb used in photographic equipment would be taxed at 10 percent.

Under the present law you pay a 2-cent tax per thousand on plain matches; if you buy colored matches, you pay a tax of 5½ cents a thousand. The House bill would reduce the 2-cent tax to 1 cent, but would still leave the 5½-cent tax on the colored matches.

The excise taxes not only discriminate among products, they also discriminate among businesses and among consumers. If you send a night letter, you pay a tax; if you send a letter by air mail, which is the chief competitor of the night letter, and is subsidized to boot, you don't pay tax. The tax even acts unfairly between producers who sell the same product. For example, a tripod which is used to support a projection machine is not taxed; but the identical tripod, if used for a camera, is taxed. Toys that look like musical instruments are taxed; other toys are not If you can afford to have seat covers made to order for your car, you do not pay a tax; but the man who wants to buy inexpensive seat covers, ready-made, has to pay a tax. A radio placed in an automobile is taxed as a radio at 10 percent, but a heater normally taxed at 10 percent put into an automobile becomes an "automobile accessory" taxed at 5 percent.

I could go on with this list of contradictions—sterling flatware against plated flatware; silver bowls against crystal bowls; a household electric heater is exempted under the House bill, but a household electric fan would still be taxed. If you buy a desk or cabinet which has a built-in radio, you pay a tax—not on the radio alone but on the total price, which includes the value of the desk or cabinet. Under the present tax law, some articles have been declared contagious—they infect other articles with taxability. Before the House bill, the same contagion applied to a fountain pen with a gold or silver cap. The House bill imposes the tax only on the cap, provided you

price it separately from the rest of the pen. This would impose a ridiculous trade practice.

These discriminations, gentlemen, are absurd and illogical; and they will not be ended by reductions; they can be ended only by repeal.

The Treasury seems to think that if excise tax collections are high that means business must be good. But let's take a case I happen to know about first-hand. Since the summer of 1949, there have been Nation-wide liquidation sales of watches—at half price or even less. It has produced a lot of sales and a lot of excise taxes. But it has not produced any profits; on the contrary, the industry has suffered substantial losses.

I wish to call your attention to the last paragraph on page 3 of the statement of Secretary of the Treasury Snyder before your committee yesterday commenting on the President's program. He states as follows:

> The excise taxes are still at substantially their wartime levels and their revision to better conform with present-day competitive business conditions is overdue. Judicious reductions in these taxes can make an important contribution to an improved revenue system. Not only will the tax system be made more equitable for consumers but the changes will aid employment and sales in the industries affected. Over the long run we should aim to reduce the role of excises in the tax system.

That is from the Secretary's representation before you yesterday.

It must be remembered that whereas a business may be able to reduce its general expense and overhead by reducing employment, it is the workers in these affected industries that get the worst deal. They work 3 or 4 days a week or are laid off while workers in other industries work full time. They earn less but pay more for the things they must buy. Aside from all the economic reasons given for the removal of these discriminatory excise taxes, this is vicious. Since the ending of the war, the workers in these affected industries have been given the roughest deal and it's about time these discriminatory taxes were removed—lock, stock, and barrel.

Let us not deceive ourselves about one point, gentlemen; the excise taxes make it increasingly difficult—and often impossible—for some industries to keep the employees they already have on their pay rolls. You simply cannot depress production on one front of the economy without seriously affecting the economy as a whole. You can't foster reduced employment in certain industries without increasing unemployment in other industries. You can't arbitrarily manipulate the conditions of free and fair enterprise—free production and free consumption—without serious repercussions on the whole economy. It is hard for me and the other members of the committee to believe that the wartime excise taxes can be defended as either good tax policy, or good economics, or good sense.

Excise taxes are pyramided—and pyramiding often means double taxation. The amount of the tax is added to the retailer's cost and is increased by the amount of his mark-up; and the tax is computed on the final selling price.

The time and expense and confusion which are involved in conducting business under excise taxes represents an additional burden on the American businessman. In this area, reduction does not serve as a relief. The retailer has to do just as much bookkeeping on a 10-percent tax as on a 20 percent tax. For a striking illustration of this

point, I suggest you read the testimony of Mr. Sherrard, a member of this committee, on page 54 of the blue pamphlet.

Gentlemen, I well remember the original purpose and the original reasoning behind the wartime excises. The more I compare that purpose and those reasons with the actual effects which these taxes are having today on American business and on the American people, and the more I analyze the provisions of the House bill, the more convinced am I that excise taxes are unwise and unproductive.

The excise taxes were supposed to end 6 months after the war ended. They have been plaguing business and the consumer for the 5 years since the war ended. It seems to me that this is no longer a matter of reducing an injustice; it is a matter of returning to a basic principle of American life—fairness, nondiscrimination. Virtually all of the wartime measures which were imposed from 1941 to 1945 have been ended by Congress.

I weigh my final words carefully, and with a full sense of my responsibility. Our economy as a whole will be served wisely and well by the outright repeal of the wartime excise taxes. It was with the national interest in mind that the national committee for which I speak said: Repeal these taxes. Repeal them entirely. Repeal them now.

I thank you.

Senator CONNALLY. Mr. Chairman, when is the questioning? After each witness, or after all three?

The CHAIRMAN. When the group has finished. That was the understanding. We thought that would shorten the time required.

Mr. BULOVA. This is the representation of the committee.

The next witness to appear before you is Mr. Ruthenburg of the Servel company.

The CHAIRMAN. Mr. Ruthenburg, you may have a seat, sir, and we will be glad to hear you at this time.

STATEMENT OF LOUIS RUTHENBURG, CHAIRMAN OF THE BOARD, SERVEL, INC., ON BEHALF OF NATIONAL COMMITTEE FOR REPEAL OF WARTIME EXCISE TAXES

Mr. RUTHENBURG. My name is Louis Ruthenburg. I am chairman of the board of Servel, Inc. The company is engaged, among other things, in the manufacture and sale of automatic household refrigerators and gas water heaters. These products are subject to a manufacturer's excise tax of 10 percent.

I appear before your committee today as vice chairman of the National Committee for the Repeal of Wartime Excise Taxes. I will try to explain why all the wartime excise taxes which were imposed in 1941, 1942, and 1943, except those on alcohol, tobacco, and gasoline, should be repealed.

All groups—employees, customers, stockholders, management—importantly interested in our national economy are agreed that repeal would be in the public interest.

This is strikingly revealed in a recent report of the Joint Committee on the Economic Report which contains a tabular summary of the stands taken on major issues by national organizations representing business, labor, and agriculture. This table outlines the views of three business organizations, three farm organizations, and the two

principal labor organizations. It records seven of the eight as favoring measures to reduce or repeal excise taxes, with no view recorded on that topic for the eighth organization.

On no other single issue, domestic or foreign, was there such a complete unanimity of view except the proposition of encouraging and protecting private capital in foreign investment and the provision of technical assistance to foreign countries. (See Congressional Record for Tuesday, June 27, at pages 9411–9414 for reprint of this table.

In the face of this extraordinary national agreement, the most important single fact about the repeal of wartime excise taxes is that they have not yet been repealed.

Rather than take your time to go into a chapter and verse documentation of these general propositions, our National Committee for Repeal of Wartime Excise Taxes endeavored to digest the hearings before the House committee in such a manner as to provide detailed illustrations from the testimony of the witnesses for the various industries. The pamphlet, containing 334 excerpts from the statements of many of the 231 witnesses who testified on excise taxes, has been presented to each member of the committee. I shall devote the remainder of my time to the specific issue confronting this committee: Will it content itself with a pattern of partial reduction of certain of these wartime excise taxes, or will it repeal them across the board?

I wish to advocate the complete repeal of these wartime excise taxes on the 27 affected industries because I believe the continuance of these taxes in peacetime even at reduced rates maintains a drastic intrusion of Government into the regulation of business inconsistent with our free enterprise system.

It may be argued, and with some force, that the reduction in certain of the excise taxes, contained in the House bill, serves to eliminate some of the more excessive rates and take off the pressure at points where particular excise taxes are most damaging to the industries or products concerned.

But such arguments ignore the proposition that the retention of some of the wartime excises even at reduced rates and the retention of others at their existing rates serve to continue the discriminatory regulation inherent in a system of discriminatory wartime excise taxation in peacetime.

Failure to provide complete repeal means continued regulation by the Government of the industries affected. It would reserve to the Government the peacetime power to determine whether the taxed industries shall be permitted to grow and expand to the full position they might achieve in a free competitive system. It would continue to substitute political control and political penalties for the judgments of the consumer.

The excise taxes restrain the American consumer and discourage him in spending his dollars for this product or that service, whenever one vestige of this system is retained. That is not the role of government in peacetime in a free enterprise economy.

The House Ways and Means Committee, as it was constituted in 1943, explicitly stated that the excise tax rates in the Revenue Act of 1943 were justified only because of the emergency of war. They decided that the reason and necessity for wartime excises would disappear 6 months after the war was over.

That is the policy decision which ought to be reaffirmed now and acted upon so that the country may know that Congress no longer supports a national policy which discriminates against a group of industries by making them subjects of regulation by taxation.

Whether it is intended or not, these taxes influence the whole pattern of consumer spending, the cost and price levels in the industries affected, the structure of these industries, the volume of their production, the size of their employment, the level of distribution of national income among them.

These taxes regulate my company and all other companies affected. They put handicaps on my company that non-excise-taxed companies or industries do not have to endure.

We cannot accept the right of Government to regulate and discriminate against these 27 industries in time of peace.

To accept any other standards of public policy is to subject certain sectors of our economy to discrimination, to impose restrictions on the consumer's freedom of choice, and to jeopardize the freedom, vitality and flexibility of our economy. This is inconsistent with the role of government in a system of free enterprise and free choice.

As vice chairman of the National Committee for the Repeal of Wartime Excise Taxes I refrain from special pleading for the refrigeration industry. I simply cite this industry's position to illustrate the discriminatory and illogical nature of the excise tax. Gentlemen, a man from Mars would get a loud laugh out of the fact that the Congress of the United States levies a discriminatory tax upon instruments of food preservation and at the same time the Congress heavily subsidizes food production. No greater absurdity would be apparent if the Congress subjected farm products to excise taxes to raise revenue for subsidizing the refrigeration industry.

Passage of the House bill, H. R. 8920, by the Senate and its signature by the President would still leave in existence a substantial system of wartime excise taxation 5 years after the repeal of the wartime excess-profits tax, the substantial reduction of corporate taxes, the elimination of priorities, allocations, rationing, price control, and the other measures of economic control for war. The present tax bill would leave in effect excise taxes on retailers of luggage, jewelry, furs, and cosmetics, amounting to approximately $182,000,000 a year; on admissions amounting to approximately $223,000,000 per year; on manufacturers products, such as tires and tubes, musical instruments, radios, refrigerators, sporting goods, gas, electric and oil appliances, photographic apparatus, business and store machines and matches in the neighborhood of $355,000,000. It would leave wartime excise taxes on communications amounting to $463,000,000, and transportation taxes on persons and property imposed in wartime amounting to $340,000,000. In all, this action in the House bill represents a 40-percent reduction in the system of wartime excise taxation. Such a measure falls far short of reflecting adequately the principle and policy that wartime excise taxes have no place in our peacetime system of taxation.

The National Committee for the Repeal of Wartime Excise Taxes is not in favor of halfway measures to right the existing wrong.

To reduce all of the taxes in part, leaving some still in existence, is to say to the industries, workers, consumers, and communities

affected that their relief is only partial and temporary; that the wrong done them will be continued in a milder form, and come the next open season for tax increases, they would be the most likely subjects for increased taxation.

In conclusion, may I venture a few observations which I hope appeal to you as common sense.

The elimination of the economic evils that are inherent in excise taxes cannot be achieved by a partial reduction of the rates of these taxes.

I am quite aware that our proposal for complete repeal runs squarely up against the argument that revenue from these excise taxes is still necessary.

It seems to us that there are two answers to this contention in the light of the present bill.

First, these taxes were not imposed for revenue alone; they were imposed for two primary reasons—one was revenue but the other was to maximize the war effort by diverting manpower and material and by controlling inflation. Had the purpose been revenue alone, these taxes would not have been imposed, but instead some more general tax falling equitably upon the entire economy would have been adopted. If the need for revenue is advanced as the reason for retaining some part of these wartime excises, then it is clear the taxes must be repealed, because they are discriminatory and unfair in peacetime, and any revenue deemed to be necessary must be raised equitably, not selectively; evenly, and not by discriminatory taxation.

Second, it is our view and we believe the testimony of Mr. Henderson will support it—that the present House bill serves not to diminish the revenue available to the Treasury but to substantially increase it during the years ahead.

If this be true, it would seem inescapable that the benefit of this availability of increased revenues should redound to the benefit of those who have borne the weight of wartime excise taxes in peacetime. If our calculations are accurate and are accepted, then this committee has before it the task of effecting a substantial step forward from the present bill toward the ultimate objective of complete repeal.

Gentlemen, our next and final witness is Mr. Leon Henderson.

The CHAIRMAN. Mr. Henderson, we will be very glad to hear from you; and after that, you gentlemen will please stand by, because there may be questions.

STATEMENT OF LEON HENDERSON, WASHINGTON, D. C., ECONOMIC ADVISER TO THE NATIONAL COMMITTEE FOR THE REPEAL OF WARTIME EXCISE TAXES

Mr. HENDERSON. Mr. Chairman and members of the committee, my name is Leon Henderson. My business address is 1026 Seventeenth Street, NW., Washington, D. C. I am a consulting economist and I am retained in that capacity by the National Committee for the Repeal of the Wartime Excise Taxes to present the over-all economic impact of these taxes.

Before the House Ways and Means Committee, where I also appeared on February 15 last, I recalled that I had come to that committee in 1941 as Administrator of the Office of Price Administration

and Civilian Supply to ask Congress to use the taxing power to control inflation and the diversion of acutely needed defense materials.

I reasoned then that excise taxes had the power to control and divert.

I come today to urge full repeal of the wartime excises, because I have seen their power to control, restrain, and divert.

The Congress then responded magnificently. It passed over several items with attractive revenue potentials, and imposed the excise tax restraint on products and services which, in the large, competed with defense for resources.

That 1941 list had significance and high meaning when it was chosen. The crisis which dictated that selection passed, but the tax persists to emphasize that the rhyme and reason no longer exist. I urge full repeal so that the historical record of Congress of abandoning such restraints may be preserved. The Nation's knowledge of controls today is far superior to that of 1941. If there should be need to adopt restraints, mechanimss of direct control would be requested first—not the indirect powers of taxation on which controllers had to rely in 1941. Even if the strain reached the point of necessitating excise levies, it is my considered opinion that agencies like the National Security Resources Board would suggest a list of commodities and services tailored to 1950. In my House statement last February, I detailed what now are completely fortuitous reasons why certain items are locked within the smothering embrace of excises, and why others are completely free to compete for the buyer's dollar.

I shall not trespass by duplicating the House testimony. For the Senate Finance Committee I have prepared some up-to-date tables which delineate the experience of the 27 industries on which wartime excise taxes were imposed or increased. These 27 are exclusive of alcohol, tobacco, and gasoline.

I invite your attention to table I, which is a simple record of increases and decreases in excise collections in the postwar period. Table I will be found at the end of my testimony. If you are interested in the dollars involved, you may find these in table II, while table III gives the most recent figures—those for the 11 months ending May 31, 1950.

The first item of significance in table I, it seems to me, is that in the last 11 months of record, 20 of the 27 industries affected showed less business than in the similar 1949 fiscal period, and that the Treasury estimates of February 1950 forecasts that most of these losing businesses will decline further in 1951, or fail to gain. Also that the number of declining businesses has grown each year.

Table I also enables you to note that several industries have declined in every period since 1947. Viewing the vigorous business expansion of businesses with which they once kept pace, it is small wonder that persons attached to businesses like furs, jewelry, luggage, tires, and others, and in the entertainment field tend to blame the discriminatory tax.

The total yearly collections from these 27 categories show an illusory steadiness which might seem to argue stability. The illusion is dispelled by following the line of passenger-car collections (table II). The annual increases from this source have compensated for the steadily increasing number of categories showing losses. Look at

the record in table III. Passenger cars showed increased collections of $120,000,000 over the previous 11-month period of 1949.

In table IV, I have set out the percentage increases and declines experienced by the 27 industries in the 11 months of fiscal 1950. Some of these disastrous declines are undoubtedly due to buyer's resistance to purchase while there was uncertainty about repeal of excise taxes which can add neither value nor utility to the purchase. Moderate reductions are scarcely likely to create a buyer's panic.

To do simple justice to those who are attached to the excise-tax ridden industries, to bring them to their full and rightful stature in the congress of American industry, full repeal of the wartime excises is required. Regardless of your desires to bring about such relief, I know you cannot ignore the matter of loss of revenue.

The House bill deals with the war excises adopted in 1941, 1942, and 1943. Exclusive of alcohol, gasoline, and tobacco, these revenue acts taxed 27 industries, of which 27 there are 18 granted relief by the House bill.

As far as the fiscal year 1951 is concerned, the loss of gross excise revenue is not of large magnitude.

This committee today could accept completely the excise reductions contained in House bill 8920 with full confidence that even the gross loss from the 27 industries on which wartime excises were imposed would be in the neighborhood of only half a billion dollars in fiscal 1951. This half billion or so loss is completely independent of any additional revenue offsets from corporate tax increases, loophole closings or Mills plan acceleration.

The House bill has been talked about, and written about, as if a billion dollars were being lost right here and now. I know the publicity value of round numbers, and the attention value of a billion-dollar figure can't be beat. The half-billion figure I used is more than half as good.

Let me substantiate my statement that in fiscal 1951, the House bill before you would occasion, in and of itself, around a half-billion gross loss.

The House report, table II, page 22, says the 1951 loss would be $690,000,000. This is gross. Using the Ways and Means Committee's own basis of allowance for increased income tax, their net figure is roughly $621,000,000. These figures are lower because the excise-tax reductions cannot possibly take effect until at least 2 months of the fiscal year have passed.

The 18 industries of our 27 which were granted some measure of reduction account for $672,000,000 gross, or $605,000,000 net, of this estimate.

Excise revenue from passenger-car sales alone, based on continuation of the present rate of monthly collections, will yield additional revenue of from $120,000,000 to $150,000,000 gross above the budget estimates, and could be more.

Regardless of whether we use the House committee's gross or net figure, the gross loss of revenue for the 27 industries, excluding alcohol, gasoline, and tobacco, on which wartime excises were imposed, is "around half a billion." And, again, this would be the gross loss without any additional revenue from corporate-tax increases, loophole closings, or the Mills plan.

Thus far we have spoken mostly of gross excise collections.

Knowing that the real or net collections from excise taxes were substantially below reported revenue collections, the national committee asked me to study how much net loss in revenue would occur if the so-called temporary wartime excise impositions were completely repealed.

As reported to the Ways and Means Committee, we came to the conclusion that net loss would be about 25 percent of gross. To put it bluntly, an excise-tax dollar was worth about 52 cents, net.

Several methods of estimating net loss were available. We chose to study individually the offsets to gross from five separate sources.

We could have utilized exactly the same methods of calculation as are currently employed by the Department of Commerce in forecasting results of national-income increases on business expansion, tax receipts, and so forth. Approximations, using these methods, yield about the same result as our study.

There are substantial offsets to gross excise revenue from these five major sources.

First, as this committee knows, on some United States Government purchases the Government pays the excise tax. This taking of money out of Uncle Sam's appropriation pocket to fatten Uncle Sam's excise revenue adds nothing but confusion, for no one seems to know how much is paid. We use a modest guess.

Second, we estimate that at least 30 percent of excise taxes are paid by business, and deducted as business expense. The percentage might be as high as 50 percent. In table V, the last table, we have compared estimated business expense deductions with the gross excise yield from 17 industries on which we had some acceptable basis of estimate. And most of the time these were Treasury or governmental estimates. As you can see, in 1949 the total expense deduction here was $955,000,000, or 53 percent. The total gross excise collections in the same year from 27 industries was about $3,100,000,000. So if there were no business charges to expense for theater tickets, night clubs, and eight other categories—the amount of excise taxes charged off by business would be 30 percent of the total. The popular conception—or misconception—of excise tax is that the consumer pays. Whether or not you think that the ultimate consumer ultimately pays for the excise tax, depends on how you think prices are made. There can be no doubt, however, that business firms deduct such excise taxes, and we believe this means a lower base of business income on which income taxes are applied. The Treasury thus suffers an offset to the taxes it ran up in the excise column. The corporate income rate is 38 percent, but we have used a 30-percent rate to allow for small concerns, partnerships, and individual businesses.

Third, if excise taxes are abolished, the taxpayer, either individual or business, has just exactly the gross amount of the relief to spend or save. It is like a welcome addition to spendable income. Over a period of recent years, the Federal Government has managed to recapture in taxes about 20 percent of such income on the average, so we have used 20 percent in our table.

Fourth, the persons attached to several of these 27 industries believe that the burden of the excise tax is at least partially responsible for stagnation and unemployment in their enterprises. Many of the workers have been drawing unemployment compensation and at times relief. To measure unemployment trends and the need for compen-

sation, we retained Mr. E. R. Lerner independently, and his study has been made available to you as it was presented to the Ways and Means Committee in February. It needs to be read to be appreciated.

It is a convincing record that workers in the excise-taxed industries have fared worse than others in nonagricultural employment. While all other such employment was increasing 2 percent between 1947 and 1949, the taxed list had a net decrease of 6 percent. By the end of the period, 430,000 jobs in the declining excise-taxed callings had evaporated.

How have these workers fared in recent months, when the total of unemployment was shrinking at a gratifying pace?

Two or three have shared in the housing and automobile booms. Some had very modest reemployment records. Furs, photographic appliances, watches and clocks, office and store machinery, jewelry and silverware are still on the down side. All of the industries for which figures are available are substantially below 1948.

A quick review of the charts, beginning after page 11 of the Lerner study, shows clearly that in periods of decline, the industries under review suffer more sharply.

If I may, I will go through these very quickly.

The CHAIRMAN. Yes, sir.

Mr. HENDERSON. You can notice what happened with the downturn in 1949 in watches and clocks [indicating charts]. Jewelry, silverware, and plated ware had the same experience. Office and store machines began in the middle of 1948 and continued their decline clear down to the end of 1949. Electric appliances had a very, very substantial drop, of depression size, during the 1949 period, and had been declining also from mid-1948. The service industry and household machines got into a situation as represented by the red line in 1949, where entire factories were closed down and entire communities were at a serious disability and had to be on unemployment compensation and at times relief. Heating apparatus and plumbers' supplies had the same experience, despite the fact that there was an increase in the housing units started in that period. The same thing was true of tires and tubes. They kept below all the time and then had a very sharp dip in mid-1949. The costume-jewelry experience is about the same. Photographic apparatus, which has been referred to, had this enormous experience, and the testimony in the House was that the tax was the competitive disadvantage that they had.

In 1949 it is estimated that $94,000,000 in unemployment benefits were paid to workers in the excise-taxed industries. We have used this as a basis for computing another offset to excise revenue.

The fifth offset derives from the well-recognized concept that reduction in price of a commodity or service will almost universally result in increased sales. Most Members of Congress have received personal letters from constituents persuasively contending that excise taxes had prevented their businesses either from gaining a proper proportion of the consumer dollar, or instancing their estimates of new business which would follow repeal.

It was to measure the probable increased business activity to result from full repeal that Mr. Ralph E. Burgess, president of the Commodity Marketing Corp., was retained. As a former actuary for your Joint Committee on Internal Revenue Taxation, Mr. Burgess was well

qualified for this job. His report, made with complete freedom, is on your desk.

If your committee should commission a staff of experts to calculate the stimulus to business activity, given the assumption of excise-tax repeal, I feel confident that the experts would employ the same accepted techniques that Mr. Burgess used.

At this point, Mr. Chairman, I would like to say that any other staff of experts would need the two and a half months that the Burgess report required, and it would take the services of seven technicians that are competent in this field. This was the most intensive study of the impact of the reduction of prices on sales that I believe has ever come to my attention.

Mr. Burgess' estimate, column 52, shows an offset to gross revenue loss of $286,700,000, derived as follows:

First, a careful estimate showed that the 27 affected industries had a volume of annual business in excess of $34,000,000,000. That is the amount of annual business with which the 27 industries are concerned.

Then, for each industry, an individual calculation was made as to the portion of the tax reduction which might be expected to be reflected in lower prices.

Then, for each industry, price elasticity of demand studies were made to determine increased unit sales to result from lowered prices.

Burgess estimated a total gross increase in business of $1,700,000,000 and a salary and wage payroll increase of $1,000,000,000.

On page 2 of this report the resultant direct gains from six revenue sources in Federal revenue are shown to be $286,700,000.

With the completion of the five individual offset estimates, it was possible to compute net loss if all wartime excises were repealed. Gross collections attributable to these amounted in 1949 to $2,400,000,000 for the 27 industries represented, excluding alcohol, tobacco, and gasoline.

On page 13, I show a summary table, with the offsets, from the figure of assumed gross revenue for 1951, of $2,200,000,000.

(The table referred to is as follows:)

TABLE A.—*Net loss resulting from complete repeal of wartime excise taxes, imposed under Revenue Acts of 1941, 1942, and 1943 (except alcohol, gasoline, and tobacco)*

Estimated gross revenue (full year)		$2,200,000,000
Less:		
Federal Government excise payments	$50,000,000	
Lowered business income tax	260,000,000	
		310,000,000
Total		1,890,000,000
Less 20 percent Federal tax recapture		378,000,000
Total		1,512,000,000
Less:		
Unemployment compensation and relief saving	$80,000,000	
Revenue from increased business activity in 27 excise-taxed industries	286,700,000	
		366,700,000
Net loss		1,145,300,000

(See p. 985, House Ways and Means Committee Hearings on Revenue Revision of 1950.)

Mr. BULOVA. The net loss figure of $1,145,300,000 does not represent an extreme in calculation. There are many people who say that the excise-tax net is nominal. I would place our estimate in the middle of a range of estimates. There are several points which argue that the estimate is on the modest side. Business-expense-deduction estimates for the 10 unstudied industries would raise the figure. In most cases the highest percentages mentioned by Government surveys were reduced for our table, and certainly 30 percent as a business-income rate is on the low side.

In the hands of consumers and businesses the additional $1,890,000,000 of spendable income could very, very easily be presumed to have a stimulating effect which would produce secondary, tertiary, and further spending, but no "multiplier" was used in this study.

The Burgess report leaned to the caution side in several respects. The delines in price, resulting from the tax repeal, were always less than the total reduction.

The testimony of our business witnesses is that they would all be passed along. The increase in sales, estimated at 5 percent, was much lower than informed business estimates. A 6-percent rate for individual incomes was used—other authorities have considered 9 percent proper. Above all, though the Burgess study foresaw a payroll increase of $1,000,000,000, no allowance or multiplier was used for increased sales from this pool of new purchasing power.

Since the estimates for the five offsets were made separately, there is admittedly some possibility of duplication or "double counting." Since the 27 industries, with their $34,000,000,000 of business, represent less than one-tenth of the economy, the duplication could scarcely exceed 10 percent. Allowance for double counting of 10 percent would still keep the net loss well under $1,200,000,000.

The House report accompanying H. R. 8920 provided in its table I some estimated revenue effects of the bill.

In table B, I have indicated that the Congress could accomplish full repeal of the wartime excises with only a net revenue loss of $247,000,000, assuming the passage of the new revenue clauses.

In this I have taken our estimate of $1,145,000,000 as the net loss, and then I have taken the House estimate of a full-year gain in revenue from their proposals, and it shows that without any attention to the Mills plan the net revenue loss would be $247,000,000.

If the Mills plan for accelerated payments were adopted along with the "offsetting additional revenues," as they are termed in table I of the House report, then full repeal of the wartime excises could be had with a net annual revenue increase of $553,000,000, as shown in table C.

TABLE B.—*Estimated annual net revenue loss (1952 to 1955), assuming (A) additions to revenue from tax rate and tax base changes provided by H. R. 8920 and (B) complete repeal of wartime excise taxes imposed under Revenue Acts of 1941, 1942, and 1943 (except alcohol, gasoline, and tobacco)*

Loss, full repeal, wartime taxes	$1, 145, 000, 000
Gain, H. R. 8920, corporate rate change, loophole closings, etc	898, 000, 000
Net revenue loss	247, 000, 000

TABLE C.—*Estimated annual net revenue increase (1952 to 1955), assuming (A) additions to revenue provided by H. R. 8920 and (B) complete repeal of wartime excise taxes imposed under Revenue Acts of 1941, 1942, and 1943 (except alcohol, gasoline, and tobacco)*

Additions to revenue (H. R. 8920):	
Corporate rate change, loophole closings, etc	$898, 000, 000
Accelerated payments of corporate income taxes	800, 000, 000
Total	1, 698, 000, 000
Less estimated net loss, full repeal, excise taxes	1, 145, 000, 000
Net annual revenue increase	553, 000, 000

I have prepared two charts to show the effects. In the first one, which I have set off on the left here, the gross loss of $2,200,000,000, the net loss of $1,100,000,000, and below that the offsets, the five offsets, that I computed, are shown. Then I have applied against that, on the other side, the additional revenue provided by H. R. 8920 to show that the net annual loss would be about $247,000,000.

Then I have in the next chart shown what the net effect would be in a full year given the assumption of full repeal and the accelerated income tax payments from corporations; and that shows that a net annual revenue increase of $553,000,000 would be available.

The House report, for the first time, I understand, has recognized the principle that the net loss of excise tax reductions is less than gross collections, by reason of greater income tax collections. It sets a figure of $1,010,000,000 as the loss in revenue, after taking account of increased sales which would accompany lower prices resulting from excise cuts. The report also allows for $100,000,000 as an increase in income taxes. I believe the Ways and Means Committee should be praised for establishing the principle, but I also feel that it has been extremely cautious in its estimates.

I have made an estimate of the net loss resulting from the reductions in excise taxes carried in the House bill. The bill would grant relief to 18 of the 27 industries our national committee has studied, and for these 18 the gross loss would be $984,000,000. This is almost 40 percent of the total full year revenue for the 18 industries. Applying this 40 percent to four of our offsets, and with a separate calculation of lowered business income, I arrive at a net loss of only $548,000,000, which is 56 percent of the gross. The detail is given in the table below, table D.

TABLE D.—*Net loss resulting from reductions in excise taxes by H. R. 8950 (except tobacco and alcohol)*

Estimate of H. R. 8920 excise tax reduction [1]		$984, 000, 000
Less Federal Government excise payments	$20, 000, 000	
Less lowered business income tax	96, 000, 000	
		116, 000, 000
Total		868, 000, 000
Less 20 percent Federal tax recapture		174, 000, 000
Total		694, 000, 000
Less unemployment compensation and relief saving	$32, 000, 000	
Less revenue from increased business activity in 27 excise taxed industries	114, 000, 000	
		146, 000, 000
Net loss (56 percent)		548, 000, 000

[1] H. R 8920 estimated tax reduction of $1,010,000,000 less small changes in tobacco, spirits, and certain occupational taxes, amounting to $26,000,000.

In common with many other economists, I have never liked excise taxes. I think when I appeared before Senator Taft and the Joint Committee on the Economic Report in 1947, I indicated I thought they were bad, and Senator Taft indicated he thought they ought to be repealed, along with the reduction in the personal income taxes. When I appeared before the House Ways and Means Committee in 1941, to urge excise taxes as a control measure, I said: "Turning to the proposals for excise taxes, the only case which may be made out for such additional taxes at the present time from a total defense point of view, must rest upon effectiveness in discouraging civilian production which competes with the defense program for men, materials, and machines."

In recent months I have had unusual opportunity to observe that excise taxes really "discourage civilian production." To me, they are bad taxes. Let others argue their merits; I see their faults.

They are bad for the worker, as the Lerner report documents.

The consumer always gets a bad bargain. At best, the tax represents a portion of price for which no recognized value is to be seen. At the worst, the consumer pays for the pyramiding effect, which makes an 18-cent price for 10-cent tax at source. Excises are universally recognized as viciously regressive. The House report details the many necessities which are now excise-taxed.

The businessmen who comprise the national committee have listed the defects of this punitive type of levy, page after page, in the blue book they presented to this committee of testimony from representatives of thousands of American business firms.

But, above all, the excise tax is a bad tax for governments. It fails to meet the standards of sound taxation. Since it is a transaction tax, it approaches a quasi-capital levy at times, particularly in the last year, as Mr. Bulova pointed out, where, due to sales that have price, a number of jewelers took an enormous loss, but the Government got its same rate of income. It encourages collusive evasion. It seems to me that the national committee has added chapter and verse to the complaint by pointing out how much the excise tax dollar is inflated, that its yield must always be subject to long discounts. The best praise I ever heard for the excise was that it provided stability of revenue throughout the business cycle. Even this is not true for many of the 27 industries represented here. Recently I checked the range of collections between the high year and the low and found declines of 28 percent, 36 percent, one of 47 percent, and as high as 43 percent for furs.

Our committee has sought to track down the economic facts as to many contentions which were once mainly vocal.

It seems from my recital, Mr. Chairman, that the facts, when discovered are apt to make the discoverer more conscientious, and more vocal.

At various times, the national committee discussed whether it should suggest alternative sources of revenue to compensate for the loss involved in excise tax repeal. I believe I am correct in reporting, as Mr. Nichols did, that it felt that initiating revenue sources was not a matter for which such an ad hoc committee of business principals had facilities.

The public discussion challenging the necessity for increased taxes coming from high officials and committees of responsible businessmen

did not go unnoticed in the national committee. This gave rise to a reasonable doubt as to the existence of any such necessity. However, in its petition to the Congress of January 30, the committee had the following to say, and this was in an advertisement also:

This is a matter of simple arithmetic.

1. How much revenue would the Federal Government lose if the wartime excise taxes of 1941, 1942, 1943 (not including tobacco, gasoline, and alcoholic beverages which present problems of their own) were entirely repealed? The net loss will not exceed 1½ billion dollars; it may well be less.

2. Can the Federal Government safely accept such a reduction of revenue? The budget now includes $1,920,000,000 to make loans and purchase certain assets, many of which are already guaranteed by Government agencies. Guaranteed mortgages and loans are a major part of this item. This $1,920,000,000 is not an expense; it is a recoverable asset. (See p. 1117 of the Federal Budget just published.)

3. This sum alone is greater than the maximum net loss of all wartime excise taxes of 1941, 1942, 1943. (Not including tobacco, gasoline, and alcoholic beverages which present problems of their own.)

That concludes my testimony, Mr. Chairman.

(The supplementary material attached to Mr. Henderson's prepared statement follows:)

TABLE I.—*Increases and decreases in excise tax collections from industries on which excises were imposed or increased by revenue acts, 1941, 1942, and 1943 (except alcohol, gasoline, and tobacco)*

[Data from reports of Internal Revenue Bureau, Treasury Department]

Industries arranged in order of collections in fiscal 1949	Fiscal years			11 months of 1950 above or below 11 months of 1949	Treasury 1951 estimate above or below 1949 [1]
	1947 above or below 1946	1948 above or below 1947	1949 above or below 1948		
1. Communications	+	+	+	+	+
2. Admissions, theater	+	−	0	−	+
3. Transportation property	+	+	+	−	−
4. Passenger cars	+	+	+	+	+
5. Transportation, persons	+	+	+	−	−
6. Jewelry	+	−	−	−	−
7. Tires and tubes	+	−	−	−	−
8. Trucks and busses	+	+	+	−	−
9. Automobile parts	+	+	−	−	−
10. Toilet goods	0	−	+	+	+
11. Luggage	+	−	+	−	−
12. Gas, electric, and other appliances	+	+	−	−	−
13. Mechanical refrigerators	+	+	+	−	−
14. Radios, records, musical instruments	+	+	−	−	−
15. Furs	+	−	−	−	−
16. Admissions, cabarets	−	−	−	−	−
17. Photographic supplies and equipment	+	+	−	−	−
18. Business machines	+	+	+	−	−
19. Club dues	+	+	+	+	+
20. Electric bulbs	+	+	+	−	−
21. Coin devices	+	−	+	−	0
22. Sporting goods	+	+	+	−	−
23. Firearms	+	+	−	−	0
24. Safe-deposit leases	+	+	+	+	+
25. Matches	−	+	−	+	+
26. Playing cards	−	+	−	+	0
27. Bowling alleys	+	−	−	−	0
Total:					
Down	3	9	12	20	16
Up	23	18	14	7	7
Same	1		1		4

[1] Data from exhibit 1—Excise Taxes: Rates and Yields—to accompany Secretary Snyder's statement, House Ways and Means Committee, Feb. 3, 1950, except for safe-deposit leases, playing cards, and bowling alleys.

TABLE II.—*Excise tax collections from industries on which excises were imposed or increased by revenue acts, 1941, 1942, and 1943 (except alcohol; gasoline, and tobacco)*

[Data in thousands of dollars, from reports of Internal Revenue Bureau, Treasury Department]

Industries arranged in order of collections in fiscal 1949	Fiscal years						First 6 months of 1950	Above or below first 6 months of 1949	Estimated 1951 [1]	Above or below 1949
	1947	Above or below 1946	1948	Above or below 1947	1949	Above or below 1948				
1. Communications	417.7	+	468.8	+	535.9	+	274.3	−	580	+
2. Admissions, theater	392 9	+	385.1	−	385.8	0	201.9	−	395	+
3. Transportation, property	275.7	+	317.2	+	337.0	+	163 4	−	330	−
4. Passenger cars	204.7	+	271.0	+	332.8	+	250.0	+	350	+
5. Transportation, persons	244.0	+	246.3	+	251 4	+	126.2	−	240	−
6. Jewelry	236.6	+	217.9	−	210.7	−	82.4	−	201	−
7. Tires and tubes	174 9	+	159.3	−	150.9	−	79.4	−	140	−
8. Trucks and busses	62.1	+	92 0	+	136.8	+	60.0	−	105	−
9. Auto parts	99.9	+	123.0	+	120.1	−	47.0	−	90	−
10. Toilet goods	95.5	0	91.9	−	94.0	+	43.2	+	95	+
11. Luggage	84.5	+	80.6	−	82.6	+	34.9	−	80	−
12. Gas, electric, and other appliances	65 6	+	87.9	+	80.9	−	36.9	−	65	−
13. Mechanical refrigerators	37.4	+	58.5	+	77.8	+	27.5	−	65	−
14. Radios, records, musical instruments	82 5	+	85.4	+	65.9	−	24.7	−	45	−
15. Furs	97.5	+	79.5	−	61.9	−	19.7	−	55	−
16. Admissions, cabarets	63.3	−	53.5	−	48.9	−	21.4	−	40	−
17. Photographic supplies and equipment	36.2	+	43.9	+	43 1	−	21.6	−	42	−
18. Business machines	25.2	+	32.7	+	33.6	+	14 4	−	30	−
19. Club dues	23.3	+	25.5	+	27 8	+	13.0	+	29	+
20. Electric bulbs	23.2	+	24.9	+	26.1	+	9.2	−	25	−
21. Coin devices	20.4	+	19.2	−	21.0	+	16.6	−	21	0
22. Sporting goods	17.1	+	18.8	+	19.8	+	7.3	−	18	−
23. Firearms	8.4	+	12.1	+	11.1	−	5.4	−	[2] 11	0
24. Safe-deposit leases	8 6	+	9.0	+	9.5	+	4.4	+	10	+
25. Matches	8 4	−	10.6	+	8.7	−	4.8	+	10	+
26. Playing cards	7.7	−	7.8	+	7.5	−	4.7	+	[2] 7	0
27. Bowling alleys	4.5	+	4.0	−	3.8	−	2.8	−	[2] 4	0
Total	2,818.8		3,026.4		3,185.4		1,597.1		3,083	
Down		3		9		12		21		16
Up		23		18		14		6		7
Same		1				1				4

[1] Data from exhibit 1, Excise Taxes: Rates and Yields—to accompany Secretary Snyder's statement, House Ways and Means Committee, Feb. 3, 1950.
[2] Not included in Treasury estimate; 1949 figure used.

TABLE III.—*Comparison of excise tax collections, 11 months 1950 with 11 months 1949, from industries on which excises were imposed or increased by revenue acts 1941, 1942, and 1943 (except alcohol, gasoline, and tobacco)*

[Data from reports of Internal Revenue Bureau, Treasury Department]

[Fiscal years, millions of dollars]

Industries assigned in order of collections in fiscal 1949	11 months, 1950	11 months, 1949	1950 above or below 1949
Communications	518.8	495 9	+22 9
Admissions, theater	342 4	355.1	−12 7
Transportation, property	292 5	311 0	−18 5
Passenger cars	412 9	292 7	+120.2
Transportation, persons	211 6	234 2	−22 5
Jewelry	175 9	194 9	−19 0
Tires and tubes	136 9	138.8	−1 8
Trucks and busses	115.5	128.4	−12 9
Auto parts	80 2	111 5	−31.2
Toilet goods	86 8	86.3	+ 5
Luggage	70 2	74 8	−4 5
Electric and other appliances	72 4	75 8	−3.3
Mechanical refrigerators	55 8	72 3	−16 5
Radios, records, musical instruments	51 2	61 5	−10 3
Furs	43 8	.59 7	−15 8
Admissions, cabarets	37 9	45 0	−7 1
Photographic supplies	36 9	40 0	−3.1
Business machines	27 6	30 6	−3.0
Club dues	25.6	24 6	+ 9
Electric bulbs	19 7	24 7	−4 9
Coin games	18 0	18 8	− 7
Sporting goods	14 3	17.9	−3 6
Firearms	8 0	9 7	−1 6
Safe deposit leases	8 7	8 6	----------
Matches	8.3	8.0	+ 2
Playing cards	10 0	7.1	+2.9
Bowling alleys	3 0	3 1	−.1
Total—27 classifications	2,884 9	2,931.0	−46 1
Total—26 classifications (excluding passenger cars)	2,472 0	2,638.3	−166.3

NOTE.—Figures rounded and will not necessarily add to exact totals.

TABLE IV.—*Increases and decreases—11 months 1950 compared with same 11 months 1949—in excise tax collections from industries on which excises were imposed or increased by Revenue Acts of 1941, 1942, and 1943 (except alcohol, gasoline, and tobacco)*

(Arranged in order of percentage increase or decrease)

	Percent
Increases from 1949 (7):	
Passenger cars	41
Playing cards	41
Communications (long distance and telegraph, down; local telephone, up)	11
Club dues	4
Matches	3
Toilet goods	Negligible
Safe-deposit leases	Negligible
Decreases from 1949 (20):	
Auto parts	28
Furs	26
Mechanical refrigerators	23
Electric bulbs	20
Sporting goods	20
Firearms	17
Radios, records, musical instruments	17
Admissions—cabarets	16
Trucks and busses	10
Business machines	10
Jewelry	10
Transportation—persons	9
Photographic apparatus	8
Transportation—property	6
Luggage	6
Gas and electrical appliances	4
Coin devices	4
Admissions—theater	3
Tires and tubes	1
Bowling alleys	Negligible

LOWERED BUSINESS INCOME TAX REVENUE

Businessmen have contended for many years that a substantial portion of excise taxes were paid by businesses and charged as business expense, thus resulting in lowered business income for tax purposes.

Below are presented the gross yields of excise-tax collections in the fiscal year 1949 for 17 industries, with estimates of the business expense deductions, and the citation of the authorities used in making the estimates. The total of such deductions is $955,000,000, which is 53 percent of the total excise-tax collections from these 17 industries.

Applying an average 30 percent over-all income-tax rate to these deductions, the offset to the gross excise-tax yield from the resulting lowered business income in $286,500,000.

TABLE V.—*Deductions as business expense of excise tax collections from 17 of 27 industries on which excise taxes were imposed or increased by revenue acts of 1941, 1942, and 1943* [1] *(except alcohol, gasoline, and tobacco) fiscal year 1949*

Excise tax (17)	Gross yield 1949	Estimated business expense deduction
Communications	$461,000,000	[2] $276,000,000
Transportation of property	337,000,000	[3] 303,000,000
Passenger cars	166,000,000	[4] 17,000,000
Transportation of persons	251,000,000	[5] 126,000,000
Tires and tubes	75,000,000	[6] 25,000,000
Trucks and busses	68,000,000	68,000,000
Auto parts	60,000,000	20,000,000
Gas and electric appliances	81,000,000	[7] 8,000,000
Refrigerators, etc	49,000,000	[7] 5,000,000
Photographic supplies	43,000,000	[8] 29,000,000
Business machines	34,000,000	29,000,000
Club dues	12,000,000	[9] 6,000,000
Electric light bulbs	26,000,000	13,000,000
Coin devices	21,000,000	21,000,000
Safe deposit leases	4,000,000	[9] 2,000,000
Bowling alleys	4,000,000	4,000,000
Toilet goods	94,000,000	[10] 3,000,000
Total	1,786,000,000	955,000,000

[1] No deductions have been estimated for 10 categories, for lack of estimating base. These are: Theater admissions, cabaret taxes, jewelry, luggage, furs, sporting goods, firearms, matches, playing cards, and a category which includes radios, records, and musical instruments.
[2] Based upon estimates included in Excise Taxes on Communications, U. S. Treasury Department, July 21, 1947.
[3] Based upon statement of Secretary Snyder before Ways and Means Committee, Feb. 3, 1950.
[4] Based on estimates furnished by Automobile Manufacturers Association and other sources.
[5] Based in part upon Excise Taxes on Transportation, U. S. Treasury Department, Dec. 19, 1947.
[6] Assuming trucks constitute 20 percent of all motor vehicles and that their use is wholly for business purposes, and assuming 10 percent of passenger cars are used for business purposes. An additional 5 percent was added (making a total of 33 percent), to reflect greater mileage for business vehicles.
[7] Arbitrarily assumed to represent 10 percent.
[8] Estimate furnished by National Association of Photographic Manufacturers, Inc.
[9] Arbitrarily assumed to represent 50 percent.
[10] House Report No. 1970 (80th Cong.), Ways and Means Committee, p. 3.

The CHAIRMAN. Now, are there questions of any of the witnesses? Senator Connally, did you wish to ask Mr. Bulova a question?

Senator CONNALLY. Yes; I wanted to ask Mr. Bulova this: You have testified that excise taxes hurt production. How does the production of your factory compare now with what it produced several years ago? Has it been increasing, or declining?

Mr. BULOVA. Declining.

Senator CONNALLY. What percentage?

Mr. BULOVA. Twenty-five percent.

Senator CONNALLY. As compared to what years, now?

Mr. BULOVA. 1946–47.

Senator CONNALLY. 1946 and 1947. And now, you mean, you are producing 25 percent less watches than you did in 1946 and 1947?

Mr. BULOVA. Correct.

Senator CONNALLY. Well, you had big sales in 1946 and 1947, did you not?

Mr. BULOVA. Correct.

Senator CONNALLY. If a man bought a watch then, it would last, would it not, from 1946 and 1947 to now? If it was a Bulova it would last, would it not?

Mr. BULOVA. That might be one of the handicaps of the industry. But nevertheless, you have a certain replacement, if you only figure the replacement of one in 10 years. You have a certain quantity of replacement usually made.

Senator CONNALLY. You mean you have to replace a Bulova in 10 years?

Mr. BULOVA. Well, we change the styles.

Senator CONNALLY. I have a watch here that I bought in 1924. It is still running. I have not replaced it. It is not a Bulova, though.

Mr. BULOVA. Yes, Senator, but the watch that you are wearing is a little outdated, and you are not making a contribution to our present economy.

Senator CONNALLY. I am not paying Bulova a profit that it did not earn. This watch is not out of date. I challenge you on the time. It is 11:10 by this watch. I do not know how you figure it.

Mr. BULOVA. It is style.

Senator CONNALLY. Style. Well, I do not buy a watch for style. I buy a watch to keep time.

Mr. BULOVA. That is right.

Senator CONNALLY. You mean you are advocating, then, a change every 10 years, because you want to produce a new kind of watch?

Mr. BULOVA. But, Senator, you as a consumer would be a handicap to industry.

Senator CONNALLY. Well, I am not in business to support you. You claim, then, that you have reduced your production 25 percent over 1946 and 1947?

Mr. BULOVA. Correct.

Senator CONNALLY. How is your employment? Did you reduce your employment?

Mr. BULOVA. Accordingly.

Senator CONNALLY. So you have not lost anything. You just reduced the employees' wages.

Mr. BULOVA. That is right; reduced the overhead; and the poor fellow that suffers is the worker that is out of the job or works 3 or 4 days a week.

Senator CONNALLY. I do not see his representative here. I see you here, though. You are the employer. You are growling about this tax.

All right. That is all.

The CHAIRMAN. Any questions of any of the witnesses?

Senator Kerr?

Senator KERR. Yes, I would like to ask a question. I would like to know what there is about an excise tax that is entirely evil when applied to 27 industries and entirely virtuous when applied to gasoline.

Mr. HENDERSON. May I reply to that? I think you were not here when Mr. Nichols, the first witness, was on. This committee considered all the wartime increases, 1941, 1942, and 1943, and they felt

that the ones on gasoline and alcohol and tobacco had had special reasons for their adoption in the prewar periods. And as they said in the House hearings, this selection of 27 industries was without prejudice in any way to the presentation of a gasoline, tobacco, or alcohol case for reduction of the wartime levies. And that was generally understood. It did not take the position that they should not be reduced. It was possible, since most of these were for the reduction in the use of strategic materials, to get a composite of 27.

Senator KERR. Well, if it were discriminatory when applied to 27 plus 3, which would make 30 industries out of the entire list, would the discrimination be alleviated or eliminated with reference to the remaining three if it were removed from the 27?

Mr. HENDERSON. Personally, I think it is a discriminatory tax myself. There are special reasons of regulation, as I understand it, and particularly in the States, for the gasoline tax. There is no doubt in my mind that it falls under the general band of discriminatory taxes.

Senator KERR. Do you mean the general band or general classification?

Mr. HENDERSON. General classification.

Senator KERR. If there were some discrimination or a good deal of discrimination when applied to all of the industries now affected, if it were removed with reference to 27 and left with reference to three, and I address my question primarily to that on gasoline, would that not just dramatize and increase the discrimination remaining against the gasoline consumer?

Mr. HENDERSON. That is correct, as I think Mr. Bulova said about some others, it would merely alter the shape of the discrimination.

Mr. BULOVA. I might say that we are in favor of taxing the profits and not the product.

Senator TAFT. Gasoline is taxed in proportion to the amount you use on roads and most of it is used to pay for roads. It seems to me that is a special justification for the gasoline tax.

Mr. HENDERSON. We went into that and I said that is the reason for noninclusion in the 27.

Senator KERR. As I understand it, this committee has taken the position that excise taxes have resulted in decreased purchasing of the items subject to the tax?

Mr. HENDERSON. Table 1 shows that very clearly.

Senator KERR. How do you explain the amazing increase in the purchase of automotive equipment?

Mr. HENDERSON. I think we have two or three factors there. One was the long, long years during which a deficit in automobile production and consumer demand was piling up. The second one is that the tax is relatively percentagewise smaller than on most of the consumer items.

Senator KERR. What is the excise tax percentagewise with reference to automobiles?

Mr. HENDERSON. Seven percent.

Senator KERR. Do you know what the average is in the States?

Mr. HENDERSON. That is, the Federal tax is 7 percent. I do not know.

Senator KERR. Apparently it has been no deterrent there, has it?

Mr. HENDERSON. No; it is not.

Senator KERR. Might it not be reasonable to assume that where some industries have experienced less demand for their products and others have experienced greater demand, that actually the increases or decreases are the result of needs and wants of the people rather than in the existence of the tax?

Mr. HENDERSON. Not in the testimony of literally two hundred and some witnesses before the House committee.

Senator KERR. I am asking you for your own opinion.

Mr. HENDERSON. In my opinion, and it is based on long study, there is no doubt that consumers pass by the taxed items such as handbags, furs, jewelry, where it is very, very evident what the tax is, and it is a high one, and take the commodities which are untaxed.

Senator KERR. Is it not possible that they might take commodities which are more needed or more desired?

Mr. HENDERSON. It is possible, but given a choice between one on which you pay 20 percent wind and another article which is priced at 100 percent, there is no doubt, and the testimony has been such from the department stores and others, that the customer does pass by and make that choice. There is no doubt about it in the retail end.

Senator KERR. I believe Mr. Bulova said there has been a 25 percent decrease in the output of his factory for 1948 and 1949 as compared to 1946 and 1947. Is that correct?

Mr. BULOVA. Yes.

Senator KERR. How does 1948 and 1949 compare with 1941 and 1942?

Mr. BULOVA. That would be difficult to answer from the point of dollars and cents because you have had an increase of 100 percent in labor cost since 1941.

Senator KERR. Do you mean that it is difficult to tell the committee whether your factory produced as many watches in 1948 and 1949 as it produced in 1941 and 1942?

Mr. BULOVA. Yes; without referring to the record by count and number. I would have to know the units and pieces. I do not know that.

Senator KERR. Will you tell the committee how much you produced in 1948 and 1949 as compared with 1941 and 1942 in terms of dollar output?

Mr. BULOVA. In dollar output it would be undoubtedly materially less because you have a 100-percent increase in the cost of your product. The unit that cost $10 to produce in 1941 costs $20.

Senator KERR. If the unit sells for twice as much as it did 10 years ago, then you would say you undoubtedly have an increase in dollar output?

Mr. BULOVA. Yes; undoubtedly an increase in dollar output.

Senator KERR. It looks to me as though it would work the other way.

Mr. BULOVA. It would not if you count the number of units.

Senator KERR. Can you answer the question as to the comparative output of your factory either in terms of units or in terms of dollars?

Mr. BULOVA. Yes. In units we probably have produced fewer units.

Senator KERR. In 1948 and 1949 than you did in 1941 and 1942?

Mr. BULOVA. That is correct.

Senator KERR. How would you compare 1948 and 1949 with 1935 and 1936?

Mr. BULOVA. Based on dollar spending?

Senator KERR. Estimate with reference to the output of your factor either in terms of dollar sales or in terms of sales of units.

Mr. BULOVA. In dollar sales it would have to be less.

Senator KERR. In 1948 and 1949 than it was in 1935?

Mr. BULOVA. No; in dollar sales it would have to be more based no the increase in labor cost.

Senator KERR. I am asking you to answer the question either way, if you can or will.

Mr. BULOVA. I cannot refer to 1935 without referring to a record, but I can answer your question on 1941 and 1942, that our units have been fewer and our dollar sales have been greater, which is caused by the increased cost of labor. You have an increase of over 100 percent in your payroll.

Mr. HENDERSON. I would like to suggest that from the prewar period to the present not only has the population substantially increased but the total production of all goods has practically doubled.

Senator KERR. Are you talking about 1948 and 1949 in comparison with 1941 and 1942?

Mr. HENDERSON. As to prewar, 1939 and 1940. This Nation's national product has doubled in physical units what it was around 1939. The contention of many of these industries is that they have not kept pace; that they have always, whether there was an up or down, kept pace with what the national income was and now they are not getting their percentage. If all of our industries were only at the 1939–40 level, we really would be in a depression.

Senator KERR. I believe that is a different subject than the one about which I was trying to get information. The committee would be interested in your views on that but I personally would like to have the answer to the question.

Senator MARTIN. Senator Kerr, might I interject there with a question which might clarify this?

As far as watches are concerned, is not the decrease due to a large extent to the importation of watches?

Senator KERR. I was going to ask him that question next as to what had been the difference in the amount of imports as between 1941 and 1942 and 1948 and 1949.

Senator MILLIKIN. Mr. Chairman, I suggest that you have to distinguish between the watch manufactured domestically from the beginning and the assembled watch consisting of foreign movements. I would suggest during the war period practically speaking we manufactured no watches in the United States from the beginning to the end but that we did sell a lot of movements imported from abroad. I think you have to separate those two things, if you can, to get an answer to the question the Senator asked.

Senator KERR. I do not believe I can get an answer to the question no matter how it is asked.

Senator MILLIKIN. I would like to carry on the question asked by Senator Kerr. Sometimes consumer preference for some item will be so heavy for whatever the reason, that it can override the existence of what might otherwise be a regressive tax. Is that not the case with automobiles and automobile parts?

Mr. HENDERSON. That is the case for many reasons. It is an item of transportation and it represents a larger and larger percentage of going to work and other uses. It is transportation, a very necessary one.

Senator MILLIKIN. When you get out of those special items, is it not a fact that every commodity is in competition with every other commodity for the cut out of the dollar?

Mr. HENDERSON. That is correct.

Senator MILLIKIN. The refrigerator is in competition with the automobile, the refrigerator is in competition with a thousand or ten thousand other commodities all fighting for their cut out of the dollar. Where you do not have this overriding special consumer desire for one item, then you really have a hard scramble among all the people who are fighting for that dollar, and there you feel the full impact of a regressive tax. Is that not correct?

Mr. HENDERSON. That is correct. As I said in table 1, showing what has happened to some of these industries since 1947, here is a number of other consumer items with which they have always kept pace and they have been going down here feeling just this choice that is made and also the regressivity of it. Taken as a group, you could not pick another segment, another one-fifth of the American economy, and show the same result had taken place. So it is obvious that is due, without contending that all of it is, to the excise tax that this group has suffered more, whether you have taken it from the labor component or whether you have taken it from the sales component.

Senator MILLIKIN. Is it not a fact that the consumer enters the store with a dozen things he might want to buy, that the consumer will take into account the amount of tax in the item and is apt to avoid the item that carries the heavy tax?

Mr. HENDERSON. That was the testimony of Frank Mayfield, the chairman of this committee, who is the head of a large department store in St. Louis, and it has been supported by the testimony of the American Retail Federation groups. We hear also that they have taken out the fur departments in many of the department stores for the reason that the customers pass it by.

Senator TAFT. The more necessary the product the less the effect of the excise tax on the sale?

Mr. HENDERSON. That is correct.

Senator TAFT. What do you figure was the economic effect in 1941, 1942, and 1943 in terms of the general sales tax on consumption goods and services?

Mr. HENDERSON. The Burgess study, to which I referred and which you have, indicates that if there were full repeal, that there would be $1,700,000,000 of new business created; that is, the price cut, some of them 20 percent, some of them 15 percent, would induce that much on the familiar principle that price cuts really attract sales.

Most of that computation is made up of demand studies in the individual industries. So the committee says that we would get in effect about a 5 percent increase in the business of these 27 industries and have taken no account of what the increase in business would be from other industries. There is no multiplier used.

Senator MILLIKIN. Is it not impossible to calculate the beneficial effect of the ultimate ripples of anything of that kind?

Mr. HENDERSON. The national income figures and the technique used by the Department of Commerce do calculate that and they have has a very good record. They have a multiplier and they carry it on to about the sixth or seventh wave that is induced. We took no account of that. As far as the $1,700,000,000, that results from the increased purchases or from the $1,700,000,000 that is released to all consumers.

Senator MILLIKIN. It could be argued, could it not that after a short lag there would be no loss in revenue at all?

Mr. HENDERSON. As I said, we are somewhere in the median line of the various estimates.

Senator MILLIKIN. Let me ask you another question. Am I roughly correct in this, that whether a corporation can absorb any kind of tax depends perhaps principally upon its competitive position.

Mr. HENDERSON. That is correct.

Senator MILLIKIN. But even if the corporation absorbs the tax and does not immediately pass it on, it ultimately is absorbed by the consumer?

Mr. HENDERSON. Or by the losses:

Senator MILLIKIN. And it is immediately absorbed by either the stockholder in the corporation or by the corporation as an entity in the way of restricting its expansion capacity and in the end the consumer pays whatever the tax may be?

Mr. HENDERSON. We would have liked to measure, Senator, what would have been the result of a tax with respect to failure to expand in some of these large industries. I am quite sure it is substantial in the transportation and aviation field.

Senator MILLIKIN. What I was driving at was that I do not think there is a complete analogy or complete substitution, but I think that the additional tax that the House committee would put on the corporations is in itself almost in many instances an excise tax and that you have to some extent a spurious solving of your problem. You take off one type of tax on the consumer only to put another one on him.

Mr. HENDERSON. That is my personal opinion. The inability to pass on in competitive industry is relatively small.

Senator CONNALLY. Mr. Bulova, in answer to Senator Kerr did you testify a while ago that your company produced more units in 1948 and 1949 than it did back in 1941 and 1942?

Mr. BULOVA. No; fewer. We produced more units in 1946 and 1947.

Senator KERR. You produced more in 1941 and 1942 than you did in 1948 and 1949?

Mr. BULOVA. In 1941 and 1942 than we did in 1948 and 1949.

Senator KERR. What did you do with them?

Mr. BULOVA. What do you mean, what did we do with them?

Senator KERR. Were there not priorities in 1941, 1942, and 1943?

Mr. BULOVA. No; the priorities came along in 1942.

Senator KERR. You are talking about 1941 and 1942.

Mr. BULOVA. That is right.

Senator KERR. And 1943.

Mr. BULOVA. That is right. The Army took the production.

Senator KERR. The production of your factory was higher in units in 1941 and 1942 than it was in 1948 and 1949?

Mr. BULOVA. Our fiscal year ends March 31 and if you are referring to 1942, it really reflects 1941 production except 3 months in 1942.

Senator KERR. Will you give the committee a vertified statement of what they were for the fiscal year ending March 31, 1942; March 31, 1943; March 31, 1948, March 31, 1949; and March 31, 1950?

Mr. BULOVA. Yes; we shall be glad to do so.

(The information requested is as follows:)

Domestic production of Bulova watches in relation to consumer expenditures (adjusted for changes in retail prices)

Year	Domestic production of watch movements (number of movements) for fiscal years ending Mar. 31 of 1942, 1943, 1948, 1949, and 1950, respectively	Index of production of watch movements, 1941 100 percent	U. S. Department of Commerce index of personal expenditures for consumption goods and services (BLS Index), 1941 100 percent	Ratio of column 3 to column 4 in percent
(1)	(2)	(3)	(4)	(5)
1941	802,144	100	100	100
1942	[1] 530,350	66	100	66
1947	844,168	105	94	112
1948	948,436	118	134	88
1949	714,718	89	122	73

[1] During this fiscal year ending Mar. 31, 1943, our plants were being converted to war production but our movement production in that year reflected a carry-over of civilian watches from the calendar year 1941 which were finished during 1942

It should be noted that in periods of change, the production of watch movements generally declined to a greater degree or rose to a lesser degree than did consumer purchases of all goods and services. Also note that in 1949 the general level of consumer purchases dropped from 134 to 122 whereas watch production dropped from 118 to 89.

It should also be noted that production in 1949 was lower by 87,426 movements than production in 1941; and that production in 1949 was 25 percent lower than production in 1948.

These figures are certainly in line with the contentions of the National Committee for Repeal of Wartime Excise Taxes as to the effect of the tax on the relative position of the taxed industries.

We certify that the above figures on domestic production of watch movements by Bulova Watch Co. are correct.

FREDERICK WM. GREENFIELD & CO.,
Certified Public Accountants.
By F. H. GREENFIELD.

The CHAIRMAN. All right, thank you very much, gentlemen.

Mr. HENDERSON. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Dumas?

Mr. Dumas, you are with the Southern Bell Telephone & Telegraph Co.?

STATEMENT OF H. S. DUMAS, PRESIDENT, SOUTHERN BELL TELEPHONE & TELEGRAPH CO., REPRESENTING THE OPERATING COMPANIES OF THE BELL SYSTEM

Mr. DUMAS. Yes, I am president of the Southern Bell Telephone & Telegraph Co.

The CHAIRMAN. Your home is in Atlanta?

Mr. DUMAS. Yes, sir.

The CHAIRMAN. You may proceed. We are taking you out of order in order to accommodate you.

Mr. DUMAS. Thank you very much.

My name is H. S. Dumas. I am president of the Southern Bell Telephone & Telegraph Co. which is the major operating telephone company in the nine Southeastern States. My company is one of the operating companies of the Bell System. In appearing before you today, I have been asked to speak for all of these companies.

I deeply appreciate the opportunity to discuss taxes on this essential utility service, particularly since those taxes provided in House bill 8920, which is now before you, appear to us to be unfair to and discriminatory against the millions of telephone users throughout the United States. In saying this, I refer to both the excise-tax provisions of the bill and to the proposed increase in corporate-tax rates.

I should like to make it clear at the outset that the telephone companies are not now nor have they ever been opposed to paying their full share of taxes, whether they be Federal, State, or local taxes. I feel strongly, however, that the terms of this bill are unwise and destructive to an industry which serves this Nation efficiently and well. This industry has about 600,000 employees and the savings of more than a million Americans are invested in it.

House bill 8920 leaves telephone service carrying just about the heaviest excise taxes of any commodity, exclusive of liquor or tobacco. Let me call your attention to chart No. 1. You will note that telephone long-distance messages over 24 cents are in the very highest bracket and carry a tax of 20 percent along with such nonessentials as club dues and "ticket broker sales in excess of the regular price." The tax on these calls is double that on telegraph messages, transportation, cosmetics, and sporting goods.

The tax on local telephone service for business follows at 15 percent. This tax is 50 percent higher than the tax on such items as jewelry, furs, and admissions to theaters and is the same as the rate on cabarets and roof gardens. Telephone service is a business necessity, and it is difficult to understand why it should be taxed more heavily than luxury items. Many small businesses are struggling to stay in business and an excessive tax on a service which they cannot do without imposes an undue burden upon their chances for survival.

With regard to residence telephone service, it is almost unbelievable that this is proposed to be taxed at 10 percent, while short-haul transportation, water, gas, and certain uses of electrical energy are now tax-exempt, and many other items also listed in chart No. 2 are exempt under House bill 8920. One would think that residence telephone service is rated as a luxury, along with jewelry and furs and admission to theaters, since all are to be taxed at the same rate. But telephone service in the home is not a luxury—it is an essential like water, gas, and electricity. Often it is indispensable to employment in cases

where an employed person is subject to call. Particularly in case of illness, fire, accident, or other human emergencies, residence telephone service is a vital necessity. There are some 28½ million residence telephone users in the United States who are being taxed for this essential service at luxury rates.

In order to further point out to you that telephone service and its users are being discriminated against in the matter of excise taxes, I would invite your attention next to chart No. 2. This chart is designed to show the principal excise tax changes in House bill 8920. On the last page of this chart I have attempted to summarize by percentage reduction groups the tax decreases in these 39 items. Here we find 17 items on which the tax has been eliminated entirely. Other items show reductions of 60, 50, 33⅓, 30, and 25 percent. It is significant that the last three items, showing the smallest decreases, that is, 20 percent and 19.3 percent, are major items of telephone service, meaning that these items received the least consideration from the standpoint of percentage reduction.

I wish particularly to call your attention to the action of this Congress last year in passing legislation to assist in putting more telephones in our rural areas. It would certainly seem inconsistent now to continue to tax this same service at a luxury rate. Our company is wholeheartedly in favor of extending telephone service to more farmers. We are carrying forward a tremendous rural telephone construction program and are doing everything within our power to keep our rates as low as possible. But a tax of 10 percent certainly makes the whole rural telephone job harder to accomplish.

To sum up on excises, we feel that the local service and short-haul toll messages should be completely exempt. and that no class of telephone service should carry a higher rate than the 10 percent, which is which is imposed on such items as furs and jewelry.

Turning now to corporate taxes, the present rate of 38 percent already places an extreme burden on our business. Under House bill 8920, not only must telephone users pay more than their fair share in excises, but the telephone companies would be required along with other large corporations to pay their full share of still higher corporate taxes. The net effect is simply to continue to saddle an unfair and disproportionate part of the total tax load on telephone users, for whether taxes are paid directly or indirectly, in the last analysis they must all be paid by customers. That is particularly true in a regulated business as closely regulated as our own.

Senator MILLIKIN. There is no interval or gap of any kind; that is a direct and immediate increase to the customer, is it not?

Mr. DUMAS. That is right. I am speaking of the effect of the increase in corporate taxes.

Senator MILLIKIN. That is what I am talking about.

Senator TAFT. The Commission regulating your rates allows for these taxes and permits higher rates to do it?

Mr. DUMAS. There is no other way to get a fair return on our investment unless they do.

Let me explain how the corporate and excist taxes affect our customers when it is necessary to obtain increases in telephone rates, as we are having to do in order to meet tremendous increases in costs and to keep the telephone companies in a position to continue to serve the country well.

Today, for each $1 in additional net revenues, the companies must charge telephone customers $1.61 to offset the 38-percent Federal tax, and in addition the customer pays on that amount a minimum of 15 percent for excise taxes, or 24 cents more for a total of $1.85.

Under House bill 8920, for each $1 in additional net revenue, the companies would have to charge $1.70 to offset the 41-percent Federal tax. A residence customer taxed at a 10-percent minimum for excise taxes would pay another 17 cents for a total of $1.87, and a business customer taxed at a 15-percent minimum would pay an additional 26 cents for a total of $1.96.

Senator MILLIKIN. The telephone itself contains a lot of taxes?

Mr. DUMAS. Yes; indeed. This means out of this whole bill the telephone users are going to get an increase in their total expense instead of a decrease, which I think is the object of the bill.

The increase in the tax rate from 38 percent to 41 percent also increases the amount of taxation imposed on corporations, as a result of taxing intercorporate dividends.

There is one other feature of the tax structure which I should like to comment upon. In addition to the double taxation imposed upon stockholders on those dividends disbursed from net income after taxes, I note that House bill 8920 carries a new provision for withholding taxes on these dividends. While it is certainly a proper objective to make everybody pay his full share of taxes, I am of the belief that withholding from dividends will produce many hardship cases among elderly people who depend on dividends and who have no tax liability.

Senator MILLIKIN. How many stockholders does the Telephone Company have?

Mr. DUMAS. Over 900,000.

Senator MILLIKIN. What is the average number of shares held by the stockholders?

Mr. DUMAS. About 25 or 30 shares. We have over 400,000 who own less than 10 shares.

Senator MILLIKIN. What is the market price of your shares?

Mr. DUMAS. The last price was $150 a share and the dividend is $9.

Senator MILLIKIN. Your dividend is $9?

Mr. DUMAS. About 6 percent.

Senator MILLIKIN. How many stockholders do you have with less than 10 shares?

Mr. DUMAS. We have over 400,000 with less than 10 shares.

In conclusion, let me say that here is a great industry serving this entire Nation well. It is serving some 42 million customers of which number 28½ million are residence users. It has 600,000 employees who are dependent upon its progress for the security of their employment. The Bell System companies alone have nearly a million stockholders. If we come to times of generally lower business activity, the stability of our industry may well be affected by our service being taxed at luxury rates. At any rate, regardless of the interests of the employees and the stockholders, there can be no possible justification for continuing to tax at luxury rates a service which the entire public has come to regard as an absolute necessity.

Thank you, sir.

The CHAIRMAN. Are there any questions?

Senator CONNALLY. During the war did not your companies have increased business and increased revenue?

Mr. DUMAS. We were under very strict regulation as to use of materials during the war. We were under very strict regulation during the war and our revenues from local service did not increase at all. We did get some increase in long-distance service.

Senator CONNALLY. That is what I had in mind. My experience here during the war was that if you went down to see a fellow in a department, instead of writing a letter he was grabbing the phone and making a long-distance call which cost him maybe $10 or $12. You got the benefit of that.

Mr. DUMAS. Of course we hope he keeps on doing that, Senator. It is the cheapest thing you can buy.

Senator CONNALLY. Your theory is that it is necessary and you ought to do it, you ought to increase that?

Mr. DUMAS. I do not know of anything that gives you as much satisfaction as talking directly to somebody.

Senator CONNALLY. I know that, but frequently they use the long-distance telephone because the Government is paying for it when a letter would have been just as effective.

Have you any figures on what was the increase in your revenues from long-distance business during the war period?

Mr. DUMAS. No, sir; I do not have these figures.

Senator CONNALLY. It vastly increased, did it not?

Mr. DUMAS. Yes, indeed.

Senator CONNALLY. You made a lot more money out of long-distance telephone?

Mr. DUMAS. I might say that our total over-all income declined on account of the taxes during the war, which was very understandable.

Senator CONNALLY. Yes; everybody else's was, too, I reckon.

The telephone companies maintain a difference in their accounting between long-distance business and local business?

Mr. DUMAS. We do account for our revenues from long-distance business separately from the other. There is no difference in the accounting for expenses, however.

Senator TAFT. This is a matter of interest in this public regulation theory. There is no question of your proposition that no matter how high the Federal taxes are which are placed on net profits, the State regulatory commission must under the Constitution so fix the rates that what percentage of your profits is left to you will give you a 5- or 6-percent return, or whatever the return is on your capital? Is that an accepted, unquestioned principle?

Mr. DUMAS. I would not say it is unquestioned but I will say this: Unless that is followed, this country will go into the confiscation of property and I do not believe we are ready to do that.

Senator TAFT. Nevertheless, when we come along and levy a tax and increase the Federal tax on profits, the theory at least is that we are taxing the stockholder in not permitting him to get the same return as before.

Mr. DUMAS. If we do not get a reasonable return on our investment I do not see how we are going to sell our securities so that we can get the money to continue to build telephone plant.

Senator TAFT. That seems to be an argument against increasing the Federal taxes but I am not quite certain that if we, for instance, put an excise profits tax and take everything except 10 percent, the rate must still be fixed to get 10 percent.

Mr. DUMAS. We made no effort to get the rates adjusted during wartime, but this is not exactly wartime.

Senator TAFT. I agree that the tax is passed on, but the proposal or theory that they must forcibly be passed on in the case of every regulated industry is a new thought to me. Maybe it is so.

Mr. DUMAS. Well, we are supposed to be allowed a minimum fair return; that is, after taxes. If you increase our Federal taxes, that minimum fair return will certainly be decreased and we will have to ask for some increase in our revenues to offset that. We cannot live without it.

Senator TAFT. There are some nonregulated companies who cannot pass it on, who cannot get any more for their product.

Mr. DUMAS. I often have wished that I was in a nonregulated business, Senator.

Senator MARTIN. Is it not true that in several States application has been made for increase in rates by reason of increased cost of production and the applications have been held up now for several months and in some cases more than a year?

Mr. DUMAS. That is true, sir.

Senator MARTIN. While we have all believed in a reasonable return on utilities, there is not anything really to force the regulatory bodies in the different States to comply with that regulation; is there?

Mr. DUMAS. Only the fairness of the body and the constitution of the State.

The CHAIRMAN. Thank you very much, Mr. Dumas.

Mr. DUMAS. Thank you, Mr. Chairman.

(Charts Nos. 1 and 2 follow:)

CHART 1.—*Excise taxes as amended by House bill H. R. 8920 grouped according to rate of tax*

(Excluding: Excise taxes on liquor and tobacco, stamp taxes, and certain other taxes not readily expressed as a percentage)

Subject to rate of 20 percent:
- Telephone toll messages—more than 24 cents.
- Telephone and telegraph leased wires—in general.
- *Electric-light bulbs and tubes.
- *Club dues and initiation fees.
- *Leases of safe-deposit boxes.
- *Admissions—leases of boxes or seats.
- *Admissions—ticket-broker sales in excess of regular price.

Subject to rate of 15 percent:
- *Local telephone service—business.
- Cabarets, roof gardens, etc.—in general.

Subject to rate of 11 percent:
- *Firearms, shells, pistols, and revolvers.

Subject to rate of 10 percent:
- Local telephone service—residential.
- Telephone toll messages—less than 25 cents.
- Telegraph, cable, and radio messages—domestic.
- *Telegraph, cable, and radio messages—international.
- Transportation of persons (except commutation and short haul)—seats and berths.
- Luggage, toilet cases, etc.
- Jewelry:
  - In general.
  - Articles sold at auction at residence in excess of $100 (new tax).
  - Ornamental fountain pens and mechanical pencils, and pipes.

*Indicates no change under House bill H. R. 8920.

CHART 1.—*Excise taxes as amended by House bill H. R. 8920 grouped according to rate of tax*—Continued

Subject to rate of 10 percent—Continued
- Furs:
  - In general.
  - Articles sold at auction at residence in excess of $100 (new tax).
- Cosmetics—in general.
- General admissions (1 cent for each 10 cents or major fraction).
- Reduced admissions (except to horse or dog races)—same rate on amount paid.
- Photographic apparatus—cameras, films, and plates (except business type).
- *Refrigerators (other than household type), refrigerating apparatus, and air conditioners.
- *Sporting goods (other than children's toys and items used predominately by schools).
- *Electric, gas, and oil appliances (except for certain items exempted).
- *Radio and radio accessories (except for certain sales to U. S. Government).
- *Photographs and records.

Subject to rate of 8 percent: *Telephone and telegraph wire and equipment service.

Subject to rate of 7 percent:
- Refrigerators:
  - Household type.
  - Quick-freeze units (new tax).
- *Gasoline (assuming a retail price of 23 cents per gallon including a tax of 1½ cents).
- *Passenger automobiles and trailers, and motorcycles.

Subject to rate of 5 percent:
- Musical instruments.
- Business and store machines.
- *Automobile trucks, trailers, busses, and road tractors.

Subject to rate of 4½ percent:
- *Transportation of oil by pipeline.

Subject to rate of 3¾ percent:
- Automobile parts or accessories other than rebuilt or reconditioned parts.

Subject to rate of 3⅓ percent:
- Electrical energy.

Subject to rate of 1½ percent:
- Transportation of property (other than coal and oil by pipeline).

Presently taxed, but exempted under H. R. 8920:
- Luggage:
  - Handbags, wallets, key cases, etc.
  - Miscellaneous cases, kits, bags, etc.
- Jewelry:
  - Watches $65 and under and clocks $5 and under.
  - Certain handicraft kits 10 cents and under.
  - Advertising clock signs—clock not more than 30 percent of value of sign.
- Cosmetics:
  - Baby oils, powders, lotions, etc., and aromatic cachous.
  - Articles used in barber and beauty shops.
- Admissions:
  - Free (except to horse or dog races).
  - Activities conducted by educational, religious, and charitable organizations, etc.
  - Ballrooms where sale of refreshments is incidental.
- Automobile parts or accessories, rebuilt or reconditioned parts.
- Radio receiving sets, etc.—communication or navigation receivers and radio parts used in manufacture of receivers, if sold to United States Government.
- Sporting goods—children's toys and items used predominantly in schools.
- Certain electric, gas, and oil applicances used for household purposes.
- Certain other electric appliances.
- Photographic apparatus—cameras, films, and plates (business type).
- Firearms made by gunsmiths using second-hand actions.
- Leased wire services:
  - Certain services rendered to shut-in students.
  - Two-way communications used on service trucks by public utilities.
- Transportation of persons:
  - Fishing boat trips.
  - Travel to and from the Virgin Islands and Puerto Rico.

*Indicates no change under House bill H. R. 8920.

CHART 2.—*Principal excise tax changes in House bill H. R. 8920*

[Excluding excise taxes on liquor and tobacco]

	Present rates	House bill H. R. 8920	
		Rates	Percent decrease
Manufacturers' excise taxes:			
Certain electric, gas, and oil appliances used for household purposes.	10 percent	0	100
Certain electric fans and heaters	do	0	100
Parts and accessories for automobiles, trucks, etc.:			
Rebuilt or reconditioned	5 percent	0	100
Other than rebuilt or reconditioned	do	3¾ percent	25
Musical instruments	10 percent	5 percent	50
Radio receiving and navigation sets sold to U. S. Government, and parts for same	do	0	100
Cameras, lenses, etc.	25 percent		
Business type		0	100
Other		10 percent	60
Photographic films and plates	15 percent		
Business type		0	100
Other		10 percent	33.3
Household refrigerators	10 percent	7 percent	30
Quick-freeze units	0	do	[1]
Sporting goods—children's toys and items used predominantly by schools	10 percent	0	100
Business and store machines	do	5 percent	50
Matches, ordinary	2 cents per thousand.	1 cent per thousand.	50
Tires and inner tubes:			
Tires for toys, lawnmowers, baby buggies, etc.	5 cents per pound	0	100
Other tires	do	3¾ cents per pound.	25
Other tubes	9 cents per pound	6¾ cents per pound	25
Retailers' excise taxes			
Baby oils, powder, lotions, and aromatic cachous, and all toilet preparations used in barber shops and beauty parlors.	20 percent	0	100
All other toilet preparations	do	10 percent	50
Such luggage items as handbags, purses, pocketbooks, billfolds, and car, pass, and key cases.	do	0	100
Such remaining luggage items as toilet cases, brief cases, suitcases, trunks, etc.	do	10 percent	50
Furs	do	do	50
Jewelry:			
In general	do	do	50
Watches of not more than $65 and alarm clocks of not more than $5.	10 percent	0	100
Other clocks of not more than $5 and advertising clock signs where value of clock is not more than 30 percent of total.	20 percent	0	100
Miscellaneous taxes:			
General admissions	1 cent for each 5 cents or major fraction.	1 cent for each 10 cents or major fraction.	[2]
Free admissions (except to horse or dog races)	1 cent for each 5 cents or major fraction of value.	0	100
Reduced admissions (except to horse or dog races)	do	1 cent for each 10 cents or major fraction of actual amount paid.	[3]
Admissions to certain activities conducted by educational, religious, charitable, etc., organizations.	1 cent for each 5 cents or major fraction.	0	100
Cabarets, roof gardens, etc	20 percent		
Ballrooms, where sale of refreshments is incidental.		0	100
Other		15 percent	50
First transportation of coal	4 cents per short ton.	2 cents per short ton.	50
Transportation of other property	3 percent	1½ percent	50
Transportation of persons, in general (except commutation and short haul).	15 percent	10 percent	33 3
Transportation of persons, fishing boat trips and travel to and from the Virgin Islands and Puerto Rico.	do	0	100

[1] New tax.
[2] About 50.
[3] Indeterminate.

CHART 2.—*Principal excise tax changes in House bill H. R. 8920*—Continued

	Present rates	House bill H. R. 8920	
		Rates	Percent decrease
Miscellaneous taxes—Continued			
Domestic telegraph, cable, and radio dispatches	25 percent	10 percent	60
Leased wire service, in general (telephone and telegraph.	do	20 percent	20
Leased wire service to certain shut-in students, and 2-way communications used on service trucks by public utilities.	do	0	100
Toll telephone service—over 24 cents	do	20 percent	20
Local and all other telephone service	15 percent		
Business exchange service		15 percent	19 3
Residence exchange service		10 percent	
Toll service—under 25 cents		do	
All telephone service, average	18 48 percent	14.85 percent	19. 7

Following is a summary of the decreases appearing in the last column of reverse side, omitting the item where the percent decrease is indeterminate and the last item which is an average of all telephone items:

Showing decreases of 100 percent	17
Showing decreases of 60 percent	2
Showing decreases of 50 percent	10
Showing decreases of 33.3 percent	2
Showing decreases of 30 percent	1
Showing decreases of 25 percent	4
Showing decreases of 20 percent	2
Showing decreases of 19.3 percent	1

It is significant that the last three items, showing the smallest decreases, are major items of telephone service.

The CHAIRMAN. Mr. Benjamin C. Marsh.

STATEMENT OF BENJAMIN C. MARSH, EXECUTIVE SECRETARY, THE PEOPLE'S LOBBY, INC., WASHINGTON, D. C.

Mr. MARSH. Mr. Chairman and members of the committee, my name is Benjamin C. Marsh. I am executive secretary of the People's Lobby with offices here in Washington, D. C.

Mr. Chairman, in your announcement request was made that we hold ourselves to 5 minutes and that we not duplicate any of the statements made to the House Ways and Means Committee. I would like to ask, though, if I might submit in substantiation of the very brief statement I am going to make some facts and figures as part of the record, but of course not take the time to read it here.

The CHAIRMAN. Yes, sir; you may do so.

(The statement referred to follows:)

STATEMENT TO SENATE FINANCE COMMITTEE ON REVENUE REVISION BY BENJAMIN C. MARSH, EXECUTIVE SECRETARY, PEOPLE'S LOBBY, INC., WASHINGTON, D. C.

The urgent job of Congress is to restore integrity to the dollar, at once.

Inflation is a greater threat to the American economy than communism, and deficiteering is always inflationary, while in only 2 of the past 20 years, which include at least 8 of relatively high propserity, has the national budget been balanced.

In 1923, 5 years after the First World War, national expenditures were less than one-fifth those in the last year of that war.

In 1950, 5 years after World War II, national expenditures will be about 44 percent—more than two-fifths—as much as in the last year of that war.

At the close of the present fiscal year, the national debt will be about $258,000,000,000, 11½ times as large as in 1923.

The greatest achievement of the New Deal was to convince the American people of the unlimited capacity of posterity to pay the bill for the cupidity and stupidity of its time, so that figuring a 2 percent return it will take about $285,000,000,000 of capital to pay the annual interest on the national debt.

Our fiscal policies make it necessary to have a miracle to save us from Fascist controls, or to develop such self-discipline as we have not yet shown.

The device of cumulative and pyramiding debt we have utilized for close to two decades is primarily due to the obsession that we must rely upon the profit motive, what is auphemistically called private enterprise, to generate a surplus production, out of which government costs can be met by taxation.

Unter this dogma, or ideology, we must refrain from taxing profits too heavily lest capital be scared and refuse to subscribe for capital structure, while we must not tax highly paid labor, or well-heeled farmers too much or they can't buy the overstocked inventories.

The fact that about $5,000,000,000 a year is spent for advertising, though much of it is propaganda, shows the existence of surpluses, and price resistance of consumers.

We cannot pay high production costs price supports, and let well-paid labor have first claim upon corporate surpluses, which should be used to reduce the national debt, and consumption taxes.

We have probably between three and four million too many people in America—marginal farmers, coal miners, distributors, etc.—so that we have the unique paradox of a fairly steady number of people employed, but unemployment around 4,900,000 or past the danger point of 7½ of employables, unemployed.

This situation led some labor unions to favor tighteningtheir requirements, including initiation fees and dues, and to favor the plan of Senator Murray and Representative Douglas, to start Civilian Conservation Camps again, to keep each year's crop of about 700,000 young people looking for work, from jeopardizing their jobs.

From January 1949 to January 1950, employment in manufacturing and mining dropped 6.2 percent, but production dropped only 4.2 percent, with fewer workers.

A FISCAL POLICY TO FOSTER SOLVENCY

Your committee, with the Ways and Means Committee, is supposed to devise a fiscal policy to restore Uncle Sam to solvency. We suggest the following considerations:

1. During prosperity, a substantial payment should be made on the national debt.
2. If we are having prosperity, and we do not make such a payment, the Government is being either dishonestly or inefficiently run, or both.

SOURCES OF FEDERAL REVENUE

We recommend the following taxes to obtain the budget to comply with what a Joint Economic Report Subcommittee calls a revenue-expenditure policy, with this addition—that it include a substantial amount for reduction of the national debt.

1. Increase the tax rate slightly on incomes above $10,000, and retain rates below.
2. Increase tax rates on estates and gifts, as the President suggests.
3. Equalize the tax rate on corporate and other business profits, as the President suggests, but make them progressive up to 50 percent, on the excess of profits over $10,000,000.
4. Compel corporations to pay out a larger part of their net profits as dividends, so they will be subject to progressive personal income tax rates.
5. Levy a tax of one-half of 1 percent to 1 percent on the full value of land, exclusive of improvements thereon.
6. Tax all expenditures for propoganda advertising, as distinguished from bona fide advertising of goods and services.
7. Reduce depletion allowances for natural resources.
8. Tax profits of educational and church institutions derived from commercial enterprises.

9. Repeal the part exemption of income from annuities, since all persons over 65 are now allowed a second $600 exemption, and, if blind, a third.

Such a program will permit repeal of all excise taxes on transportation, communication, cheap movies, beer, cheap tobacco and products, and all other excise taxes on necessities of life, and on low-priced clothing and jewelry.

CAPITAL ACCUMULATION HAS BEEN NOTABLE

In the 28 years from 1919 to 1947 capital accumulation totaled $777,000,000,000, of which just over one-third ($262,000,000,000) came from current business savings, i. e., was surplus and undivided profits, which Dr. A. A. Berle calls "self-generated capital," while about one-fourth (26 percent) was current savings of individuals.

Starting with 1942 through 1948, total disposable income (income less taxes), has been 1,062.8 billion dollars, and personal savings have been 146.2 billion dollars—or more than half of the national debt. Personal savings were 13.7 percent, nearly one-seventh, of total disposable personal income received during these 7 years; though most of the savings were made by those with incomes over $3,000.

Economic Indicators (January 1950) reports that, with 1949 estimated, undistributed corporate profits for the three years 1947 to 1949, were 33.6 billion dollars, compared with 2.6 billion dollars in 1929, and 1.2 billion dollars in 1939, before war profits whetted the acquisitiveness of stockholders, and managers.

This does not include undistributed profits of unincorporated business, nor increases in the selling price of land, and such war increases were about $25,000,000,000. Economic Indicators (February 1950) reports that from 1939 to 1949:

(*a*) National income increased 207.8 percent; compensation of employees, 197.5 percent; proprietors' and rental income, 210.9 percent; net interest, 2.4 percent; corporate profits, 240 percent; dividend payments, 121 percent; undistributed profits, 600 percent.

(*b*) In 1939, employees' compensation was 66 percent of national income; in 1949, 63.7 percent.

(*c*) In the 4 years, 1946 to 1949, corporate profits after taxes were 71.2 billion dollars of which 29.1 billion dollars were paid in dividends, and 42.1 billion dollars retained as undistributed profits.

LARGE INCOMES ARE LARGELY FROM PROPERTY OWNERSHIP

In 1946 (latest figures available) the 6,373 persons reporting net incomes over $100,000 got 527.2 million dollars in dividends, about 9.4 percent (nearly one-tenth) of all dividends paid that year.

A progressive Federal income tax is an effective way to tax unearned income, more heavily than earned income.

In 1946, 74.6 percent of the income of the 9,997 persons with incomes from $50,000 to $100,000 was from ownership or control of property, and 86.7 percent of the income of the 6,373 persons with incomes of $100,000 to over $5,000,000.

The six persons with incomes of $5,000,000 and over had, in 1946, an aggregate gross income of $47,821,000, of which all but $43,000 was from property ownership.

Mr. Albert S. Goss, national master, the Grange, stated to the last Grange session: "In actual practice, the large stockholders, who control the policy of many corporations, prefer to have their money remain in the corporation, and pay 38 percent on it, rather than to receive it in dividends upon which they would have to pay 75 percent. Men of great wealth are escaping paying tremendous sums in income taxes, by the device of corporate ownership."

A subcommittee of the Congressional Joint Committee on the Economic Report, reported January 13, that up to 3 months previously, the Government had loans, guarantees, loan insurance programs and commitments, totaling about 32.4 billion dollars.

At least 12 billion dollars of excise taxes collected during the past 4 years, and 20 billion dollars more for retirement of the national debt, should have been collected by profits taxes; a total surplus, to 10.1 billion dollars, and permitted reduction of interest on the national debt by 400 million dollars a year.

The Scriptural injunction "Thou shalt not steal," applies to stealing from unborn children, as well as from those who can stop Government waste and inefficiency, by voting intelligently.

AMERICA CAN'T FILL TREASURY BY PROFITEERING ABROAD

There is a widespread misconception that under point 4 and loans abroad for reconstruction and other purposes, American investors can obtain huge profits, of which the Federal Treasury will get a substantial part.

A recent widely publicized book Peace by Investment, by Benjamin A. Javits, advocates foreign investments of $40,000,000 a year for 50 years, one-half to be invested directly by Americans, upon which the profits, the author states, will be "breathtaking."

Such profits will not help America's standing in the world, but will seem to justify expanding the cold war.

A depleted Treasury and a big debt are a constant threat to peaceful relations with the rest of the world.

A world-wide code of conduct for capital and concessions abroad, is essential to peace, and reducing costs of the cold war.

Mr. MARSH. Mr. Chairman, it seems to me that of all the gentlemen who have preceded me, with the possible exception of Mr. Henderson, few of them had any concern with the fact that we are in wild inflation. I am not going to give you a lot of facts and figures; your own staff could have given you all the information you have heard this morning. The question is, Has this committee the guts to realize that in peacetime we have to more than pay our way or we are going into the imperialism from which Great Britain is gradually—rather rapidly at present—emerging?

In my judgment what this committee does now on this tax bill will be only second in importance to the action of the United Nations in jointly resisting the unprovoked, and very provoking, attack of the North Koreans, for this reason: Every nation of the world knows that when a strong nation continuously "deficiteers," it is in the belief that it will be able to recoup its income from exploiting the people or the resources of the rest of the world.

A few years ago the Truman doctrine was enunciated. Since that time, 1,000,000,000 people, roughly two-fifths of the world population, have gone within the Soviet orbit. It was not due at all, in my judgment—not due entirely, I would say, in my judgment—to the lure of the Communist doctrine but the fear of exploitation, and little or nothing has been done to abate it.

In my judgment the House revenue bill is an act of perfidy. It repudiates all democratic doctrines. It will increase the deficit.

As I remember, last year our deficit increased 3.1 billion up to 257.4 billion dollars. For a time the Democratic Party had great success; its greatest achievement was convincing the American people of the unlimited capacity of posterity to pay for our present extravagances. So we are going to have a point 4 and Marshall plan program all over the world, but how are we going to pay for it?

I criticize a lot of things which the Russians do, very many, but at least I give them credit, they have their forced labor currently. We do not have. In 18 out of the last 20 years, and half of them quite prosperous, we have run behind, so that we are putting the bill on posterity.

Let me give you just a few facts. As I said when I started out, the question is, have you the guts in an election year? I mean, election doth make cowards of us all. Do you realize that we have to reverse the fiscal policy in effect since 1933?

The interest on the national debt is roughly 5.5 billion dollars. That is 4 percent or one twenty-fifth of the 135.4 billion dollars paid

out last year for wages, salaries, and all labor return. In other words, we mortgaged roughly 4 percent of last year's labor income in perpetuity, just to pay the interest on the national debt. You cannot reduce taxes in my judgment on most things.

Let me make this final suggestion, and let me repeat, this tax bill will have a great influence all over the world. You ought to increase taxes on personal incomes and profits to yield at least $5,000,000,000 more than any losses from repeal of excise taxes on the essentials of life. I quite agree some of them have to be repealed but it is no kindness to Americans to say, "We will not tax you now so heavily, we will pass the bills to posterity." Well, posterity is halfway here since 1933.

Those are my only suggestions, Mr. Chairman. I could give you reams of figures and you would not know any more than you did when you heard these gentlemen who testified before me. Most of that stuff was almost wholly elementary. Again it is a question of courage. Do you dare face the facts? Winston Churchill was hardboiled but he told the truth at the beginning of the war, you cannot win this war without blood, sweat, and tears. We can win the cold war without the blood, or much of it. If we had gone at it right, we would have won completely, without blood, but we have to have some sweat and tears and we cannot rely too much, as we have done for a long, long time, upon burdening posterity with our own bills.

If there are questions, I shall be glad to try to answer them. I think I have kept to the 5 minutes as you requested.

The CHAIRMAN. Are there any questions?

If not, we thank you.

Mr. MARSH. I am delighted to find such complete agreement. [Laughter.]

The CHAIRMAN. Mr. Walter P. Marshall.

STATEMENT OF WALTER P. MARSHALL, PRESIDENT, WESTERN UNION TELEGRAPH CO.

Mr. MARSHALL. Mr. Chairman, my name is Walter P. Marshall. I am president of the Western Union Telegraph Co. I should like to make a short statement and leave with the committee a more detailed statement of our position.

The CHAIRMAN. You may do so, Mr. Marshall. You appeared before the House Ways and Means Committee?

Mr. MARSHALL. Yes, sir.

I appreciate the opportunity to supplement the testimony presented by my company before the House committee on February 15, 1950, describing the critical position of the Nation's domestic telegraph industry, primarily due to the postwar application of a 25-percent excise tax on telegrams.

While, as directed by the committee, this brief presentation will not touch upon matters dealt with in our appearance before the House committee, I should like to repeat one statement made by Senator Ernest W. McFarland which was quoted at that time:

> While few realize it, the future of our kind of life is involved in the kind of communications policies we have. All over the world, the avenues of communications are in the hands of the state. Only in the United States do we have a free, privately owned system. We want to keep it that way.

The decision which Congress will make concerning the excise tax on domestic telegrams is not simply a policy decision regarding the small amount of tax revenue obtained from this source. The decision directly affects the fundamental question of national communications policy referred to by Senator McFarland.

A primary consideration for the future health of the industry and completion of its extensive mechanization and improvement program, in which we have invested over $80,000,000 since the war, is the complete removal of the excise tax on telegrams. This tax has been progressively destroying the company's volume and seriously jeopardizing its ability to compete effectively with the Government-subsidized and tax-free air-mail service, and the telephone and telegraph services of the telephone companies.

In commenting upon the telegraph company's basic plans for the future, Senator McFarland, in his capacity as chairman of the Communications Subcommittee of the Senate Interstate and Foreign Commerce Committee, also stated:

> Our committee must face the problem and determine first, to what extent Western Union is responsible for its own predicament, and the steps it is taking to correct it; second, the extent to which the competitors which you mention in your letter are contributing factors toward your situation; third, to what extent Congress itself is responsible in not adopting a better domestic and foreign communiciations policy; and fourth, the proposal of legislation leading to a solution of this problem.

Directly referring to the Communications Subcommittee's future consideration of these matters, Senator Herbert H. O'Conor, in introducing an amendment earlier this year dealing solely with the telegram tax and proposing its complete elimination, said:

> This session of Congress will have the responsibility of making critical determinations on questions of communications policy. Pending before our Senate Committee on Interstate and Foreign Commerce are a number of proposals to strengthen and expand our essential communications facilities. These questions will be given consideration and analysis, and a program reported to the Congress in due course. However, in order to give the Congress the opportunity to determine these important questions of public policy, this 25 percent supertax on the telegraph system must be suspended.

Complete repeal of the telegram tax is urgently needed to halt and reverse the trend of constantly declining telegraph volume which has created a crisis in the industry and destroyed the jobs of over 23,000 telegraph workers. Elimination of the tax will at the same time, as stated by Senator O'Conor, afford opportunity for the Congress to consider the problems of the vital communications industry, and determine the steps that must be taken to strengthen it.

In closing I should like to emphasize to you gentlemen the uniqueness of the problems created by the excise tax in Western Union's case, which are wholly unlike those existing in any other you are considering. While genuine hardship to the extent of operating deficits exceeding $4,000,000 in both 1948 and 1949 was created by revenue losses resulting from the tax, please bear in mind that under the most favorable conditions we are called upon to:

(1) Compete with Government-subsidized and tax-free air-mail service.

(2) Compete with Government-operated communications systems.

(3) Compete with the telephone and telegraph services of the telephone companies, where local telephone rates have been increased

two or three times while interstate telephone rates, where we compete, have been decreased.

Remember, too, that unlike the telephone or air-mail service, Western Union was required to subsidize the Government by handling its telegrams at a discount. Over the years and until 1947, when discontinued, this subsidy to the Government amounted to $63,000,000.

To reduce the tax to 10 percent as contemplated in H. R. 8920 would reduce Federal revenues by $20,250,000. To eliminate the tax completely would involve a further reduction of only $13,500,000 before considering:

(1) Offsetting corporate income taxes which would result from restoration of earnings for Western Union instead of deficits.

(2) Increased corporate income taxes from telegraph users. Since approximately 75 percent of the domestic telegraph revenue comes from business concerns, their telegraph excise tax payments are deductible in the computation of corporate income taxes. The amount of such excise tax reductions in corporate income tax statements may represent as much as $10,000,000 annually at present 38-percent tax levels.

Taxes on telegrams represent less than one-half of 1 percent of all excise tax collections. It, therefore, becomes obvious that the complete elimination of the tax on telegrams can have no material bearing on the Government's budget problem, whereas it has an all-important bearing on the industry's problem.

Believing that in so doing I am acting in the national interest, as well as in the interests of more than 42,000 telegraph employees, 4,600 pensioners, and 24,000 stockholders who for over 2 years have had no return on their investment in the company, I urge the complete repeal of the telegram tax.

(The detailed statement referred to follows:)

THE WESTERN UNION TELEGRAPH CO.

Statement by W. P. Marshall, President, Supplementing Testimony Before the Senate Finance Committee on the Subject of the Telegraph Excise Tax—July 6, 1950

The decision which Congress will make concerning the excise tax on domestic telegrams is not simply a policy decision regarding the relatively small amount of tax revenue obtained from this source. The decision directly affects a fundamental national policy, namely, private ownership or nationalization of the Nation's telegraph system. In brief, gentlemen, continuation of the tax burden upon the service of this essential utility could have the result of placing upon the Federal Government the responsibility for the operation and maintenance of the telegraph business of the Nation.

As you gentlemen well know, the 25 percent excise on this essential cost of doing business was enacted as a wartime measure. However, when hostilities ceased, this levy was continued. For 5 years, this country's telegraph system has struggled to overcome this burden. Every effort that management could devise to surmount and overcome the difficulties created by this retrogressive tax has been exerted. We have reduced costs, improved our plant, and made many other adjustments—all seeking to survive and serve better, despite the damaging effects of this tax burden. In recent months we have had a degree of success from this line of attack, but the unfortunate fact remains that our volume continues to decline and the future of the industry can be assured only by reversing that trend.

We have submitted to the Treasury and the executive departments, again and again, statistical studies which establish conclusively that the incidence of this tax has been a prime factor in creating deficits in the company's operations.

I should now like to develop certain operating and statistical justifications to support the general obserfations which I have made.

EFFECTS ON WESTERN UNION'S INCOME

The effect of the excise tax on the postwar operations of Western Union has been to create a crisis in the industry. The operating losses for the year 1948 reached a total of $4,171,803 and, for 1949, the deficit was of the magnitude of $4,459,014. These staggering losses occurred despite substantial reductions in cost of operations and an extensive mechanization and improvement program which was designed to improve service, reduce costs and put the company in a position to handle more efficiently an expanded volume. That these efforts have been fruitful in some degree from a current earnings standpoint is evident from the operating results for the first 5 months of this year. (I submit for the committee's consideration income statements for 1948 and 1949 and for the first 5 months of 1950.)

The Western Union Telegraph Co., operating results years 1948 and 1949 and January through May 1950

	Year 1948	Year 1949	5 months January–May 1950, inclusive
Operating revenues	$191,653,760	$179,601,386	$72,449,488
Operating revenue deductions			
Operating expenses	170,900,815	159,485,064	60,860,676
Depreciation and amortization	14,797,790	14,216,729	5,900,580
Social security taxes	2,407,209	2,467,043	1,444,768
Operating taxes	3,648,825	3,660,827	1,507,519
Uncollectible revenues	348,156	319,195	129,944
Telephone revenue deductions	24,215	22,712	9,075
Total	192,127,010	180,171,570	69,852,562
Net operating revenues	(473,250)	(570,184)	2,596,926
Noncommunication income	1,633,108	1,316,137	648,716
Gross ordinary income	1,159,858	745,953	3,245,642
Deductions from ordinary income:			
Rent for lease of plant	1,785,843	1,705,749	698,719
Interest on long term debt	3,681,914	3,248,993	1,230,107
Interest charged to construction (cr)	(526,688)	(145,764)	(27,580)
Other interest charges	43,500	47,877	19,028
Miscellaneous taxes	22,928	15,032	2,917
Other dedections	324,164	333,080	84,926
Total	5,331,661	5,204,967	2,058,117
Net ordinary income	(4,171,803)	(4,459,014)	1,187,525

NOTE —Parentheses indicate red figures.

With regard to the operating results for the first 5 months of this year, the company suffered heavy operating losses in January and February. While our operations in the succeeding 3 months were carried on at a profit, it must be borne in mind that the second quarter of the year is traditionally our best from an earnings standpoint. While advance estimates indicate that our June operations produced a profit, unhappily forcasts indicate that July will witness a return to deficit operation.

Let me emphasize too that even during the seasonally high months of March, April, and May, gross revenues were nearly $839,000 lower than during the same period of the previous year. For the 5 months ended May 31, 1950, our revenues were $2,331,813 less than in the same period of 1949, notwithstanding the extraordinarily high level of general business activity.

I must say quite frankly that the improvement in operating results which occurred during March, April, and May was brought about only by stringent expense control and restriction of expenditures to something even less than bare necessities. Obviously a satisfactory service cannot be maintained indefinitely on such a restricted expense basis. Of extreme importance in this connection too is the fact that the company must meet in December 1951 a bond maturity of nearly $16,000,000, making it evident that the company's earnings must improve if the industry is to remain sound, solvent, and progressive. It is an inescapable conclusion that the excise tax is a barrier to that essential improvement.

One final note bearing materially on recent operating results is the fact that current negotiations with the bargaining agent for the majority of our employees

are likely to involve additional wage costs of $2,000,000 annually, effective from July 1, 1950.

All of these factors point up the need for a high volume of revenues and the elimination of the 25-percent excise tax which is a major factor in depressing it.

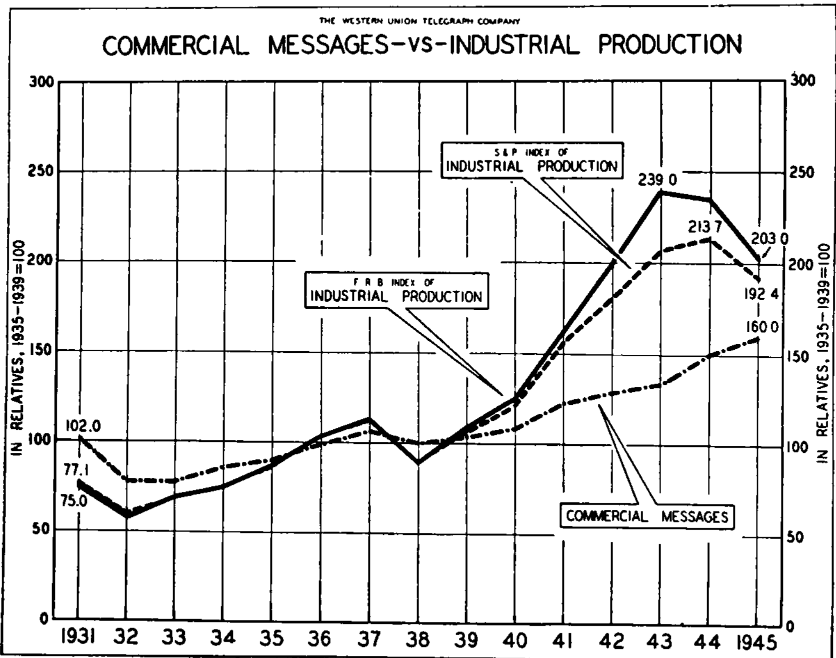
PUBLIC SUPPORT OF THE TELEGRAPH SYSTEM

One frequently hears the criticism that Western Union is an enterprise which because of competitive methods in the communications field cannot adequately be sustained by the country's economy. This is a completely insupportable and unwarranted conclusion. It is obvious that there is a need—an indispensable need—in the Nation's economy for a record communications industry. I would direct the committee's attention to the fact that during the calendar year 1949, the telegraph users paid to the company for its services a total of more than $216,000,000, including the tax. The total cost, including the tax, paid by the public in 1949 ($216,000,000) would have been sufficient to eliminate the deficit and produce instead a net income of more than $32,000,000. However, $36,-500,000 of the funds collected by Western Union from the public represented excise tax collections which were turned over to the Internal Revenue Bureau, leaving the company with a deficit of more than $4,400,000 for the year's operation. I should like to emphasize that in the event this tax is removed, it is not the company's intention to seek an increase in rates. Rather, it is our hope that increased volume resulting from the reduction in cost will cure the situation.

THE EFFECT OF THE TAX ON WESTERN UNION'S VOLUME

No precise formula can be stated which relates volume to price. However, the domestic message volume for Western Union since the war has shown a steady downward trend except for a short period in 1947 when, during the telephone strike, there was a temporary and nonrecurring increase in telegraph business. Eliminating the increase attributable to the telephone strike in 1947, the telegraph volume decreased in that year 4 percent below 1946. Again in 1948, domestic message volume showed a decrease of 7.1 percent from 1947.

The trend is further illustrated by the volume in 1949 compared to 1948, which showed a decline of 8.5 percent. Thus the message volume for 1949 was 18.3 percent below that of 1946 and in the first 5 months of this year volume has



fallen off another 3.5 percent compared to the same period a year ago. I should like to emphasize that this decline in telegraph volume is not consistent with either general business trends or that of telephone traffic.

Since the early part of 1947, the trend of general business as measured by the Federal Reserve Index and by the Standard & Poor's Index and the trend of telephone message volume have moved steadily upward, while the trend of domestic telegraph volume has been downward. (I submit for the consideration of the committee two charts which illustrate these trends.)

In addition to these analyses, the company has an abundance of subjective information showing quite clearly the marked consumer resistance to the present cost of telegraph communications. I shall show in a moment that the 25 percent tax is a major factor and that the removal of this tax would tend to reverse the trend.

THE COMPETITIVE ASPECTS OF THE TAX

Western Union receives 80 percent of its revenues from domestic telegraph messages, all of which are taxed at a rate of 25 percent, which is higher than the rate on any of the commodities in the so-called luxury category. The telephone company in contrast derives the major portion of its revenues from local service which is taxed at only 15 percent. The telephone company has always had a privileged position in comparison with Western Union because the major source of its revenue is obtained from local telephone service, taxed at lower rates ever since excise taxes were first imposed on communications.

Insofar as long distance telephone is concerned, a differential in favor of the telegraph company existed from 1932 until 1944 except for the short period between the Revenue Acts of 1941 and 1942.

Now, insofar as the so-called luxury excises are concerned, by virtue of the 1941–1942–1943 acts—the telegram tax was raised three times, and so-called luxury taxes but twice.

Clearly the consideration of discouraging the use of telegraph service was a major factor in dictating such harsher tax treatment of an essential service than was the case with night clubs and similar luxuries.

The telephone companies have met their rising costs by increasing their local telephone rates which are currently taxed at 15 percent. However, in the long distance field, taxed at 25 percent, where they compete with Western Union, telephone rates have been reduced, the last reduction being effective in 1946. On the other hand, the telegraph company was forced to meet its rising costs by increasing rates for telegrams all of which are taxed at 25 percent. Consequently, the impact of the 25-percent tax on telegrams has been more damaging to message volume because it has been added to rates which have been increased 28 percent.

In this connection it should be pointed out that at House committee hearings in 1947, and this year, a representative of the telephone system, while advocating the repeal of all communications taxes, expressed the preference, if complete elimination were not possible, for primary relief in the local field. In discussing with the House committee in 1947 the question of selective treatment for the telegraph business in the event an over-all elimination was not possible, the representative of the telephone company frankly recognized the serious problem confronting Western Union as warranting special consideration.

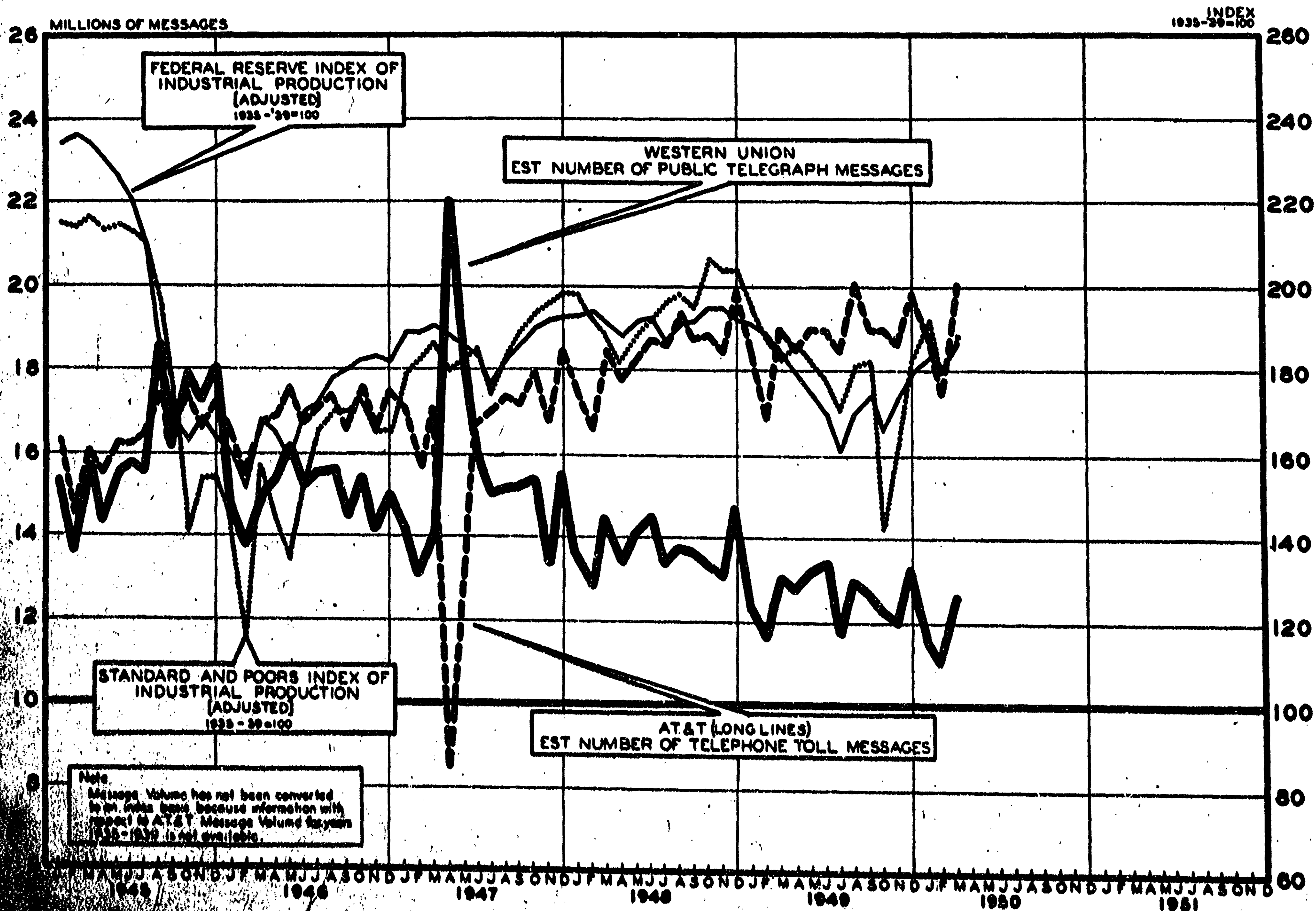
EFFECT OF THE TAX ON EMPLOYMENT

The downward trend of domestic telegraph volume due to the 25 percent tax has resulted in sharply reduced employment in the business. Labor accounts for 68 percent of the operating expenses and, as tax-depressed volume required commensurate reductions in labor, more than 23,000 experienced telegraph workers have lost their jobs since the war. The security of the present 42,300 telegraph workers and 4,600 pensioners is seriously threatened by the continuance of this volume-destroying tax. Union representatives of our employees have made strong representations to Congress for the repeal of this tax.

MANAGEMENT EFFORTS TO OFFSET DECLINE IN VOLUME

During 1949, costs compared to the previous year were reduced by more than $14,000,000 as the result of operational and other savings. Since 1945, the company has expended some $81,000,000 on mechanization and plant improvement which bring the new technology of communications to Western Union's operations. However, because of deficit operations due to the reduced volume, which I attribute primarily to the tax, the company has been forced virtually to suspend fur-

The Western Union Telegraph Company
Accounting Department
New York



ther mechanization. Even though the reduction of direct operating costs and other economies amounted to more than $14,000,000 in 1949, it should be obvious that the company cannot effectuate its future plans in the face of ever-continuing volume losses and deficits at the 1948 and 1949 rate of more than $4,000,000 annually. The elimination of the excise tax would be the equivalent of a 20-percent reduction of rates, which would provide a continuing stimulus to telegraph volume. Failing this, we might well be confronted with the alternatives of nationalization or creation of a giant monopoly of telephone and telegraph.

PROBABLE RESULTS FROM ELIMINATION OF THE EXCISE TAX

The Federal Communications Commission and the Treasury Department have in the past recognized that the imposition of the excise tax was having an adverse effect on the telegraph company's operations. In a Treasury Department study, as early as July 1947, it was pointed out that in the case of the telegraph service (and I quote) "The existence of the tax may curtail profits to a more important degree. The demand for telegraph service has been declining for some time relative to telephone service, and consumers may be more sensitive to the tax in the case of telegraph service. * * * In view of the unfavorable profit position of the industry, any reduction in profits because of the tax may have serious consequences."

The study also pointed out the inequitable effects of the tax on business. The Treasury conclusion in 1947, that, "Any reduction in profits because of the tax may have serious consequences," has been borne out by the fact that Western Union has suffered operating deficits in excess of $8,600,000 during the succeeding 2 years since this study was made.

More recently, the Federal Communications Commission has expressed a similar conclusion. In a letter of August 15, 1949, to the Secretary of the Treasury the Acting Chairman of the Federal Communications Commission pointed out "In the case of the Western Union Telegraph Co. the deterrent effects of the present Federal excise tax on domestic telegraph usage may have particularly serious consequences, since Western Union's financial situation is becoming increasingly critical." Copy of this letter is made part of this statement.

As I have stated before, there is no formula by which a precise determination can be made as to the effect of the elimination of this tax upon the volume of domestic telegraph traffic.

Based on best available data and experience, however, it is our estimate that an increase in revenue of about $10,000,000 annually might be expected from the elimination of the tax. Certainly the elimination of the tax should serve to reverse the trend and remove the dire threat inherent in ever-declining volume.

H. R. 8920

Let me say here that I have a deep sense of appreciation of the budget problem confronting this committee. We in Western Union are all too intimately acquainted with the evils of deficit operations. I must tell you, however, that in our judgment a 10 percent telegram tax as proposed in H. R. 8920 would only serve to perpetuate the existing serious difficulties which I have already outlined. We are confident that the Congress is aware of, and apparently is sympathetic to, Western Union's serious and unique problem, but the recommendation of a reduction from 25 percent to 10 percent is no cure.

To reduce the tax to 10 percent as contemplated in H. R. 8920 would reduce Federal revenues by $20,250,000. To completely eliminate the tax would only involve a further reduction of $13,500,000. Taxes on telegrams represent less than one-half of 1 percent of all excise-tax collections.

There would be important offsets, too, to the Federal revenue reduction resulting from complete elimination of the telegram tax. Since approximately 75 percent of the domestic telegraph revenue comes from business concerns, their telegraph excise-tax payments are deductible in the computation of corporate income taxes. The amount of such excise-tax reductions in corporate income-tax statements may represent as much as $10,000,000 annually at present 38 percent tax levels.

Another consideration is that heavy operating deficits incurred by Western Union because of tax-depressed volume have eliminated any Federal income-tax payments by the company and forced thousands of telgraph employees into unemployment.

It, therefore, becomes obvious that the complete elimination of the tax on telegrams can have no material bearing on the Government's budget problem whereas

it has an all-important bearing on the industry's problem. Failure to extend full telgram tax relief could involve future Federal expenditures in the millions if we consider the possibility that the industry might be taxed into the hands of Government. In this connection I remind you of current air-mail subsidy payments and post-office deficits.

Another unique consideration which I urge the committee to weigh is that unlike telephone the telegraph company competes directly with air mail which is not only heavily subsidized but tax free. In effect Western Union users are providing a subsidy for one of its major competitors with resulting untold damage to the Nation's telegraph system.

Still another consideration in this plea for long overdue justice is the fact that, unlike our telephone and air mail competitors, Western Union until 1947 was required to subsidize the Government by handling its telegrams at a discount. Discounts ranged from 20 to 60 percent of the rates charged the public and amounted to $63,000,000 over the years. It is worth mentioning that this subsidy exacted from Western Union is greater than its entire outstanding debt.

POSTWAR WESTERN UNION

The company was in a strong position to finance its postwar development and had reserves to meet its funded obligations. This healthy condition was abruptly changed on December 29, 1945, when the War Labor Board handed down wage awards increasing wage costs by $23,600,000 annually, and in addition, requiring retroactive wage payments totaling $31,000,000. The required annual cost of these wage awards exceeded the 1945 net income before Federal income taxes by nearly $4,000,000, and the retroactive wage payments reduced the company's cash reserves from $36,000,000 to $5,000,000. Other Government-ordered or sponsored wage awards which followed increased the company's wage levels a total of nearly $65,000,000 per annum since the end of the war. Despite all this, the company has spent over $80,000,000 out of current revenues, reserves and sale of assets to improve its facilities and quality of service and reduce its operating costs.

The company's plans for the future are to take the lead in the development of an efficient and expanded peacetime telegraph system which also will be indispensable in the event of an international emergency. Our basic plans are embodied in an exchange of correspondence with Senator McFarland, Chairman of the Communications Subcommittee of the Senate Interstate and Foreign Commerce Committee. This correspondence is contained in a special report which also includes a statement from the acting Chairman of the FCC concerning the burden of the excise tax upon the company. I submit copies of this report for the information of the members of this committee.

The plans suggested in this report may not be possible of fulfillment if the telegraph company must be faced with an excise tax, constantly destroying its volume and seriously jeopardizing its ability to compete effectively with the Government-subsidized and tax-free air-mail service and the telephone and telegraph services of the telephone companies. On the other hand, freed from the burden of the tax, the company will then be in a position to consolidate the gains it has achieved and to move forward with a dynamic program for the future. In the absence of complete relief, the question of the future of the Nation's telegraph service may become the problem of Government, and as Senator McFarland is quoted in this report, which is before you—

"While few realize it, the future of our kind of life is involved in the kind of communications policies we have. All over the world, the avenues of communications are in the hands of the state. Only in the United States do we have a free, privately owned system. We want to keep it that way."

I know of no one opposed to the elimination of this tax. Senator O'Conor, in introducing an amendment earlier this year dealing solely with the telegram tax and proposing its complete elimination, said:

"This session of Congress will have the responsibility of making critical determinations on questions of communications policy. Pending before our Senate Committee on Interstate and Foreign Commerce are a number of proposals to strengthen and expand our essential communications facilities. These questions will be given consideration and analysis, and a program reported to the Congress in due course. However, in order to give the Congress the opportunity to determine these important questions of public policy, this 25-percent supertax on the telegraph system must be suspended."

The Treasury Department has stated:

"In view of the unfavorable profit position of the industry, any reduction in profits because of the tax may have serious consequences."

The Acting Chairman of the Federal Communications Commission has commented similarly that,

"In the case of the Western Union Telegraph Co. the deterrent effects of the present Federal excise tax on domestic telegraph usage may have particularly serious consequences, since Western Union's financial situation is becoming increasingly critical."

Many Members of the House and Senate have advocated elimination of the telegram tax. Thousands of telegraph users have advocated its repeal and the unions representing our employees have similarly urged elimination of the telegram tax.

I repeat that the decision by the committee and the Congress with respect to the telegram excise tax could determine the "kind of communications policies we have." I therefore urge with all of the energy at my command that the telegram tax be repealed in full, particularly as the revenue consideration is such a minor one where the Federal budget is concerned.

A SPECIAL REPORT TO THE STOCKHOLDERS AND EMPLOYEES OF THE WESTERN UNION TELEGRAPH CO. ON THE FUTURE OF THE RECORD COMMUNICATION INDUSTRY

INCLUDING STATEMENTS OF: UNITED STATES SENATOR ERNEST W. MCFARLAND, CHAIRMAN, COMMUNICATIONS SUBCOMMITTEE, SENATE INTERSTATE AND FOREIGN COMMERCE COMMITTEE; HON. PAUL A WALKER, AS ACTING CHAIRMAN, FEDERAL COMMUNICATIONS COMMISSION; WALTER P. MARSHALL, PRESIDENT, THE WESTERN UNION TELEGRAPH CO.

OCTOBER 20, 1949.

To the Stockholders and Employees:

Shortly after I assumed my present office I had the opportunity to address the stockholders at the annual meeting on April 13, at which time I outlined in considerable detail the problems confronting the company with particular emphasis on the destructive effect of indiscriminate and uncoordinated governmental communication policies. This special report is to inform you of the progress made or proposals advanced by the management to solve these basic difficulties in the interests of national security, the general public, the stockholders, and the employees.

You will recall that among other matters to which I specifically called attention were:

1. The still-existing 25 percent tax imposed by Congress during the war to discourage users from availing themselves of telegraph service.

2. Government operation of its own telegraph systems competing with Western Union for Government traffic.

3. Wasteful duplication of record-communication facilities and services in the domestic and international fields.

4. Government application of minimum wage and overtime requirements of the Fair Labor Standards Act to thousands of telegraph agencies.

Obviously the solution to these problems involves basic questions of governmental policy requiring legislative treatment in major degree and it is with this broad perspective that the management has evolved the program detailed herein.

In the first session of the Eighty-first Congress just ended, a special subcommittee was appointed by Senator Edwin C. Johnson (Democrat of Colorado), chairman of the Senate Interstate and Foreign Commerce Committee "to make a full and complete study and investigation of * * * all matters relating to radio, telegraph, and telephone communications including the problems relating to American common carriers operating in the domestic and international fields, including the relationship of these problems to the national security of the United States." Senator Ernest W. McFarland (Democrat of Arizona), was designated chairman of this subcommittee.

The company formally proposed to Senator McFarland, on October 14, 1949, a comprehensive program to attain the declared objectives of the subcommittee. These objectives are quoted on the first page of the company's letter to Senator McFarland, which is reprinted in this report together with the Senator's reply of October 19. A summary of the company's proposals follows:

WESTERN UNION PROPOSALS

1. Adoption and implementation of a national policy directed toward a single system of domestic and international record communications, under private management and with appropriate Government regulation for the protection of

the public, with Western Union as the nucleus around which such a system would be developed, insuring more effective competition with voice and air-mail services.

2. Subject to appropriate enabling legislation and other essential considerations and negotiations, Western Union to offer to purchase the international telegraph facilities of the American Cable & Radio Corp., RCA Communications, Inc., and any other international telegraph carrier operating in the United States.

3. Subject to the approval and cooperation of the National Defense Establishment and Government policy considerations, Western Union to provide an integrated system of domestic communications, utilizing all new technological methods, geared to the military requirements of the present atomic era. Such a system would provide for maximum security in time of national crisis and be available in normal times for use by the general public and civilian agencies of the Government as well as the military.

4. Subject to financial negotiations and regulatory considerations, Western Union to purchase the telegraph business of the telephone company, including primarily such business known as Teletypewriter Exchange Service (TWX).

5. To the extent that required private capital may not be available to insure accomplishment of these objectives, long-term Government financing to be provided.

As stated in our letter to Senator McFarland, the effectuation of these proposals, together with the elimination of the telegram tax, would establish for this Nation a sound, solvent, and aggressive record communications system both in the domestic and the international fields, better serving the ends of national security and public interest.

GOVERNMENT COMPETITION

Included in this special report is a highly significant statement issued on October 13, 1949, by Senator McFarland, announcing the launching of an exhaustive inquiry by his subcommittee into Government operation of communications systems in competition with privately owned companies.

TAX ON TELEGRAPH USERS

Despite the urgent representations made by a special committee of the company's board of directors, created to deal with the problem at the highest Government levels, and the help of the Federal Communications Commission together with appeals to legislators by telegraph users, employees, pensioners, and stockholders the Congress failed to take action on the telegram tax in the session just adjourned.

While conceding the unique merits of our case, the Government's budget problems were advanced as the all-important consideration necessitating postponement of any tax relief until the next session of Congress.

You will be particularly interested in the letter of August 15, 1949, also reproduced herein, written by the Honorable Paul A. Walker as Acting Chairman of the Federal Communications Commission to the Secretary of the Treasury, since it contains the views of our regulatory agency with respect to competitive factors and the financial hardship created by this excise burden.

The adjournment of Congress will afford an excellent opportunity between now and January for personal contact by stockholders, employees, and pensioners with their individual Senators and Congressmen while the latter are at home. Such appeals, permitting thorough exploration of this important problem, will be most helpful in insuring action when the Congress reconvenes and will also provide the opportunity for discussing the progressive communications policy the company has advanced.

FAIR LABOR STANDARDS ACT

You are acquainted with the serious consequences attending threatened Government application of minimum wage and overtime requirements of the Fair Labor Standards Act to all telegraph agencies located in small retail and service establishments. I am now able to report that the company has been successful in obtaining FLSA exemption for telegraph agencies with telegraph revenues up to $500 per month. This exemption is contained in the bill which has been passed by Congress and awaits the President's signature.

It is worthy of report also, that this newly enacted legislation increasing the statutory wage minimum from 40 to 75 cents per hour included an amendment

proposed by the company which will empower the Wage and Hour Administrator to give special consideration to the uniqueness of telegraph messenger employment and prescribe wage rates lower than the statutory minimum for that class of employment. The company's existing minimum wage rate for messengers is 65 cents. An increase to 75 cents would have involved additional costs of $1,200,000 annually.

* * * * * * *

While the foregoing summarizes the essential features of the several letters reproduced in the remainder of this report, I hope that you will be able to find the time to read the report in its entirety, because of its unusual significance and importance.

* * * * * * *

I stated at the annual meeting of the stockholders that I would not have accepted my present office had I not had faith in Western Union's future and believed that it was possible to solve our problems. I am confident that the broad and far-reaching program the company has presented for the consideration of the Congress will resolve those problems, strengthen the country's vital record communication system and prove of incalculable benefit to the Nation and to the industry. With that confidence the management will pursue the program outlined and in that spirit it seeks your cooperation.

W. P. MARSHALL, *President.*

FUTURE COMMUNICATIONS POLICY RECOMMENDED BY COMPANY

THE WESTERN UNION TELEGRAPH CO.,
New York, N. Y., October 14, 1949.

HON. ERNEST W. MCFARLAND,
Chairman, Communications Subcommittee,
Committee on Interstate and Foreign Commerce,
United States Senate, Washington, D. C.

DEAR SENATOR MCFARLAND: In the several conferences you have had in recent months with representatives of international record communications carriers, we have discussed efficient communications as an essential and indispensable basis for the preservation of free and democratic institutions.

Nowhere have I seen a more profound and realistic statement of objectives than your remarks of June 4, 1949, from which I presume to quote the following:

"While few realize it, the future of our kind of life is involved in the kind of communications policies we have. All over the world, the avenues of communications are in the hands of the state. Only in the United States do we have a free, privately owned system. We want to keep it that way. In broadcasting, we have freedom of expression and opinion under a public-interest licensing system; in the common-carrier operation of telegraph, telephone, and cable whether by wire or by radio, we have privately owned operating companies. In neither case do we want the Government's finger in the pie."

As you have so aptly stated: "The future of our kind of life is involved in the kind of communications policies we have." This challenging statement has caused me as the chief executive of the greatest privately owned record-communications company in the world to undertake to reappraise our existing system with the view of ascertaining whether present facilities and the pattern of organization meet the basic requirements of the policy you have so clearly set forth.

In the conferences to which I have referred, all have agreed, I think, that technological development has advanced more rapidly than our capacity to deal with and take advantage of its proven potentialities for national security, service to the public, and the widest opportunity to promulgate information and ideas and to expedite commercial transactions. All are agreed, I believe, that the opportunities inherent in the science of communications for the advancement of American ideals and responsibilities are not now served by the existing institutional patterns of our competitive communications systems.

It is apparent, I think, that this Nation with its complex internal problems and its difficult world responsibilities, urgently requires a clear communications policy. Such a policy obviously must avoid domination from any source and offer free and complete access at the minimum possible cost to all who choose to communicate. It is no exaggeration to urge that the present and future security of the Nation may be dependent upon a wise and proper communications policy.

It is my firm conviction that fundamental American purposes can be advanced by a rational policy directed toward a single system of domestic and international record communications established and operated within the framework of our

traditions of private initiative with freedom from interference or dictation from any source, including Government.

We believe, of course that Western Union is the premier telegraph company of the world and must be the nucleus around which such a system should be developed. But for reasons which are well known to you, its continued survival, as well as its possibilities for future development to attain this objective, may be in jeopardy. Indeed, if this company is to fulfill its mission as an historic and century-old entity in the private-enterprise system, it is necessary that the Government immediately develop and implement a fundamental communications policy in accordance with the basic philosophy which you, as an informed public official, have developed.

The preceding general observations are, I know, meaningful to you as an expert on communications history and its present day technology. I would, therefore, proceed from these familiar general objectives to the more specific problems confronting our communications institutions. One further general observation seems appropriate and that is that the maintenance of essential communications under a system of properly regulated private management cannot long continue under existing Government policy, or lack of Government policies, primarily because of the diffuse and conflicting scheme of organization which the present Federal legislation and policies force upon the public and those engaged in communications enterprises.

The primary methods of quick and efficient communications are by voice, telegraph, and air mail. As you know, the system of telephony, an expanding and dynamic technique, competes directly with the telegraph system, not only on the basis of relative convenience of the user but because national policy permits it also to engage in the record business with large users. As a matter of national defense, our airlines receive substantial subsidies from the taxpayers in the form of air-mail payments, and this subsidized service places further pressure upon the domestic telegraph system in its efforts to render service and progress. In addition, the Government itself organizes, on the basis of dubious efficiency, its own facilities for governmental communications to the detriment of the private system which must operate under stringent Government regulation. Moreover, until recently, the telegraph system instead of getting a subsidy like the air mail, was compelled to subsidize the Government by giving Government agencies discounts from the rates charged the public. The aggregate amount of these discounts, in excess of $60,000,000, is approximately the amount of Western Union's present funded debt.

And as if the foregoing were not sufficient to jeopardize the existence of the telegraph system, the Government for wartime purposes levied a 25-percent superluxury tax to discourage users from availing themselves of its facilities. This tax has continued in effect although the primary purposes for which it was enacted have long since been achieved. (In this connection, I emphasize that if the funds collected by Western Union from the public for a telegraph service were available to the company for its operations, maintenance, and expansion the company could not only maintain its operations at a profit to its stockholders, but could substantially reduce its rates to consumers. In brief, this arithmetic proves that a solvent and prosperous telegraph industry, through this discriminatory tax burden, is being ruined by the diversion of 20 percent of its gross revenues from domestic users to the Federal Treasury.)

I review this situation because of your enlightened observations concerning the need for a definitive communications policy. For, as you have emphasized, if one important segment of the American communications system is forced by economic necessity to become a governmental enterprise, a basic concept of free and democratic principles will have been subverted. The time has arrived when the Congress must determine the future of the organization of our communications system.

I would therefore suggest certain basic considerations which I believe would serve to underwrite the objectives of the communications policy which you have advocated. First and paramount, this Nation should have a single record communications company under private management and with appropriate Government regulation for the protection of the public. For practical purposes, we have in this country an integrated system of voice communications. The record service should be given equivalent status. Under appropriate Federal regulation, such a utility in the record business could meet the competition of other services and become an increasingly important factor in the Nation's economic progress.

Even more basic in the development of a sound communications policy are considerations of national security. I direct to your attention a communication from the Secretary of Defense under date of August 27, 1949, in which he observed:

"It is impossible to overstress *the importance to the National Defense of speedy, reliable communications for which the basic channel is still the telegraph circuit.* This is an age in which any defensive action is carried out over vast distances by simultaneous effort on land, sea and in the air. The coordination and direction necessary for this defense can be insured only by the accurate and rapid flow of information through our lines of communication." [Italics added.]

Authoritative estimates indicate that during the last war this Nation expended in excess of two billion dollars for its communications needs. At present such strategic considerations must be a primary objective of all aspects of national policy. Insofar as communications are concerned, this strategical plan must envisage a network which will provide command circuits for tactical coordination of all services, circuits for logistic support, intelligence, weather information, transportation dispatching, radar detection, air alert and warning systems. These trunking circuits should for reasons of physical security be separate from those carrying voice communications. Western Union, as the record communications system of the Nation, has the engineering techniques, the experience, and with a properly integrated communications policy, based upon national need and internal security, could provide the facilities to achieve these purposes at a great economy to the Nation and in a manner compatible with the most rigid security requirements.

Another consideration, secondary only to the demands of national security, is the necessity for an adequately financed record communications system. Congress itself established a "chosen instrument" to serve the requirements of the public in the domestic telegraph field. It sponsored consolidation of Western Union and Postal, recognizing that in a field which is a natural monopoly, the public interest would be better served by unification of plant equipment and personnel, subject to appropriate regulation. However, experience under this merger legislation indicates that the Congress did not go the full distance and permitted a residue of competitive enterprises within the voice communications system and within the Federal Government itself. This character of competition, with the resulting diversion of traffic, together with the burdensome and volume-discouraging excise tax, has forced the company into continued deficit operation. It is a matter of simple arithmetic to establish that these feators have spelled the margin of difference between profit and loss. In spite of such difficulties, however, the company has gone forward with a mechanization program to the extent that it now operates fourteen reperforator relay centers, interconnected by carrier circuits. In addition, from its own reserves and operating funds, Western Union has established the first unit of a microbeam system which is now in operation and has pioneered the method of facsimile transmission now in use in nine large cities. These techniques so indispensable to national defense are not conjectural, but are operating on a day to day basis.

In order to meet the needs of national defense and to eliminate the expensive and overlapping governmental systems now in effect, Western Union should be permitted, encouraged and directed to extend these developments. Thus the country would benefit from the fruits of proven technology and avoid present wasteful competition and costly duplication.

Competition in the field of international communications is likewise wasteful, inefficient and contrary to public interest. The competing international carriers, most of them operating at a loss, are not adequate representatives of the American system, nor do they serve with desired efficiency the needs of this country, particularly in view of its new responsibilities of world leadership in an atomic era. Hence I urge an appropriate consolidation of international carriers to the end that a centralized and efficient service can be performed under appropriate Federal regulation. The effects of competitive activities in this field are well known to you and I need not elaborate the precarious position of our present international carriers.

Western Union is a century old. It stands as a symbol of American business development and has, through many adversities, contributed to the expansion of our industrial and agricultural economy. Because of the circumstances which I have discussed, it is now at a critical point in its history. Because of deficit operations, which are due in a large measure to Government policies, the management may be required to solicit the financial assistance of the RFC to accommodate its immediate needs. However, the company's management is not satisfied with only temporary relief to meet its immediate financial obligations. It urges upon the Congress, as the primary custodian of communications policy, a long-term solution which will be designed to meet the basic American objectives you have advocated.

Therefore, I would submit for your consideration as meeting the basic objectives the following proposals which Western Union is prepared to consider and achieve:

(1) Subject to the determination of a fair rate base by the Federal Communications Commission, and subject to the negotiation of a fair price and the financing thereof, Western Union would purchase the telegraph business of the American Telephone & Telegraph Co. and other telephone companies, including primarily such business known as TWX.

(2) Subject to appropriate enabling legislation, to develop with the National Defense Establishment an integrated system of domestic communications, utilizing all technological methods with which this company has had experience and which are acceptable to defense agencies. Such a system would provide for the maximum security in time of national crisis and be available for use by the public in times of peace. The company is prepared to submit engineering details to support such a proposal and to confer with communications officers of the several defense establishments to develop and coordinate such a system. This system can be designed to meet the maximum needs of all of the services at a minimum cost and in a manner consistent with the most rigid security requirements.

(3) Subject to appropriate enabling legislation and the negtiation of a fair and equitable price and the financing thereof, Western Union would offer to purchase the international telegraph facilities of the American Cable & Radio Corp., the RCA Communications, Inc., and any other international telegraph carrier operating in the United States.

The foregoing proposals would establish for this Nation a sound, solvent and aggressive record communications system both in the domsetic and the international field, and would permit effective competition between the three forms of rapid communication, telegraph, voice, and air mail. It would serve the ends of national security in a manner and to an extent not heretofore attained. From the point of view of providing effective competition in communications, I think these proposals offer the only practical solution. Competitive advance in the communications art can come only if each of the three principal forms of rapid communication, telegraph, voice, and air mail are in a strong competitive position with respect to each other. The time is long past when competing companies within these separate fields have any economic desirability. Western Union has been attempting to improve its competitive position by spending vast sums in technological improvement of its art. It cannot continue such expenditures under present handicaps.

If Western Union is compelled to merge either with the Government or with some competing form of service, the only possible effective competition in the communications field will be destroyed. Obviously this is a matter of congressional policy on a broad scale.

To attain the proposed goals, adequate financing will be necessary. The extent to which private capital will prove available on reasonable terms is conjectural at this time. To assure the availability of the required funds, we urge that Congress early in the next session, by amendment to the Reconstruction Finance Corporation Act or otherwise, authorize Federal credits for an appropriate term and at an appropriate rate. We suggest a term of 35 years, in lieu of the present 10-year limitation on RFC borrowings, and an interest rate designed to compensate the Government for the cost of the money borrowed.

In developing and strengthening the resources of this country, this last proposal does not lack precedent. In the fields of rural electrification, rural telephone service, merchant marine and other related areas, the Government has recognized national needs and has not been reluctant to make available the means to achieve them.

We believe that in an atomic era, the immediate improvement of our communications system by the introduction of new methods and better equipment is essential. We therefore urge the Congress to give this problem the highest priority so that the organization of our communications system may be equipped to meet any crisis. Western Union will be prepared to supply and support all of the details necessary to reach informed conclusions.

Because of your interest and leadership in this field, I believe that it will receive from you and your committee a sympathetic consideration of the problems we have submitted.

As a representative of management of Western Union, I would be remiss if I did not undertake to express to you our concern over the existing deficiencies in our communications systems. I feel encouraged to do so because of my personal knowledge that you have for some time undertaken to bring about conditions where a basic policy to meet the needs of our Nation would be achieved.

Sincerely,

W. P. MARSHALL.

SENATOR MCFARLAND'S COMMENTS ON COMPANY'S PROPOSAL

UNITED STATES SENATE,
COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE,
October 19, 1949.

Mr. WALTER P. MARSHALL,
Western Union Telegraph Co., New York, N. Y.

MY DEAR MR. MARSHALL: This will acknowledge receipt of your very interesting and informative letter of October 14.

While I would like to think otherwise, I am afraid the facts support your conclusion that unless a better policy is worked out for our communications systems, Western Union will be compelled to merge with a Government system or some competing form of service.

Having handled the telegraph-merger legislation in the domestic field, I fully understand the situation which confronted Western Union at that time; namely, that Postal was rapidly going under, which meant that it must be merged with Western Union or the Government would take over its operations. As was explained to me at that time, Western Union had little choice because it did not believe that it could survive against Government-operated competition. I am now aware that your company is operating with a large deficit and that this cannot long continue. I agree with you that we cannot afford to let a major telegraphic communications system go out of existence, both from the standpoint of national defense and from a commercial standpoint. Your principal competitor, the telephone system, may well be confronted with the same situation with which Western Union was confronted in regard to Postal. That is, merging with Postal or competing with a Government-operated system. I would not want to see either of these alternatives. I think that either would be bad because we would not have competition in the communications field if there were a merger of all types of communications. Government operation certainly would be bad because it probably would, in time, have the same result. I do not believe that any company can successfully compete with the Federal Government.

Your letter is an important contribution to the clarification of the issues, and I want you to know that I greatly appreciate your apprising our committee of the steps which you plan to take toward the solution of this problem. I hope you will be able to report material progress. I am hopeful that the current studies and conferences between the major carriers will result in a definite recommendation. At our last conference, it was indicated that these studies would be completed about the time of the convening of the second session of this Congress, in January. At that time our committee must face the problem and determine first, to what extent Western Union is responsible for its own predicament, and the steps it is taking to correct it; second, the extent to which the competitors which you mention in your letter are contributing factors toward your situation; third, to what extent Congress itself is responsible in not adopting a better domestic and foreign communications policy; and fourth, the proposal of legislation leading to a solution of this problem.

I would call your attention to the fact that existing law would permit you take over the TWX system of your competitor. Upon our return in January, I would appreciate a report from you as to what steps you have taken in this regard and what progress has been made. It was my opinion at the time we passed the merger legislation that such a merger of record communications was absolutely essential for the continued existence of Western Union. I realize that many other new problems are confronting you, as set forth in your letter. I have already instituted inquiries in regard to the operation of communications systems by Government agencies, the answers to which I am sure will be helpful to us in the consideration of this problem.

In order that all of the communications companies may be fully informed as to everything our committee is doing in the field of communications, I am taking the liberty of mailing copies of your letter and this reply to the interested companies.

Thanking you for the courtesy of writing me so informatively, and with best wishes, I remain

Sincerely yours,

ERNEST W. MCFARLAND.

Government-Operated Communications Systems

(Statement released by Senate Interstate and Foreign Commerce Committee, Washington, D. C., October 13, 1949)

Senator Ernest W. McFarland (Democrat of Arizona) announced today that the Interstate Commerce Subcommittee on Communications, headed by him, has launched a two-pronged inquiry to determine (*a*) the extent of Government operation of communications systems in competition with privately owned wire and radio telegraph companies, and (*b*) some method of working out a more equitable sharing of the radio frequency spectrum as between private and Government users.

The Arizona Senator said that letters have been sent to Secretary of Defense Louis Johnson, Secretary of State Dean Acheson, General Services Administrator Jess Larsen, and Capt. John S. Cross, chairman of the Interdepartmental Radio Advisory Committee asking for extensive information. Texts of the inquiries will not be made public at this time, McFarland said. The Army, Navy, and Air Force, the State Department, and the General Services Administration, formerly the Public Buildings Administration, operate extensive communications systems of their own. Senator McFarland said, General Services leases wire lines within the country to connect up Government offices throughout the United States and handles telegraph business for numerous Government agencies. The State Department has assigned to it for its own use radio frequencies for communications purposes overseas and also uses the facilities of the Navy and Army, as well as private communications companies. The three armed forces also maintain and operate their own communications services, both domestically and overseas.

"We want to find out two things," McFarland explained. "First, we want to learn whether operation of these communications systems by Government agencies is an economic and practical thing. Western Union, our only domestic telegraph company, is suffering severe financial losses. It has lost more than $5,000,000 in the first 8 months of this year. Unfortunately, because of the strategic national defense importance of communications, we cannot shrug this off as a natural consequence of the competitive-enterprise system; we can't let a major communications enterprise go down the drain. Similarly, our American companies engaged in overseas communications are far from healthy; some are also suffering substantial losses. All over the world, they are competing with Government-owned systems; today we are almost alone in maintaining privately owned competitive communications. Even Canada is now taking the final steps to nationalize its communications.

"It just doesn't make good sense to give lip service to the free-enterprise system and at the same time spend taxpayers' money for operation of Government systems to compete with the privately owned companies. Out committee wants to find out just what it costs to operate these Government systems, and whether it is actually cheaper for the taxpayer to operate them. We are going to learn, if possible, whether or not every proper charge is made against the cost of a message. If it turns out that it is more economical for the Government to carry on its own communications, we will have to give new and serious consideration to what should be done about the private companies, and who is going to serve the communications needs of the business and commerce of this country.

"The second aspect of this problem is use of radio frequencies. Everybody knows the radio spectrum is limited, there are only just so many usable frequencies. The Interdepartmental Radio Advisory Committee allocates frequencies as between Government users and private users. The frequencies allocated for private use are handled by the Federal Communications Commission which grants licenses for radio broadcasting, television, radio communications all over the world, marine and coastal communication, aviation, bus and truck use, taxicab use, amateur communications, inductive heating and scores of other uses. These demands for private use have increased a thousandfold in the last few years and the demand is always greater than the supply. But the FCC cannot allocate what it does not have. In getting frequency assignment for private licensing, it must compete with the demands of the Army, Navy, Air Force, and a dozen other Government departments.

"Some of us thought that the unification of the Armed Forces would result in a tremendous saving of frequencies by permitting a single communications service to handle the business. There is some doubt that it has turned out that way. Each service apparently thinks it must have its own frequencies to be operated by itself for command, tactical, and just plain everyday communications, although in peacetime no circuit is ever used to anywhere near capacity; some in fact are

merely reserved without any use. On top of that, the defense forces want frequencies for experimental work of a secret or confidential nature and other frequencies are being used for such purely military uses as sonic detection, guided missiles, radar for detection of aircraft, and similar uses.

"It is evident something must be done to strengthen both our domestic and international communications companies. Our study of United States communications during and after World War II has thoroughly demonstrated our dependency upon the strength of American commercial communications systems. It was their equipment and their know-how that enabled the Army and the Navy to build the greatest world-wide communication system ever known. That system is no longer in existence, and this Nation must rebuild such a communications network for its future defense needs."

The information requested this week, Senator McFarland said, is designed to present his committee with basic information. Early next session the committee expect to give definitive consideration to this over-all problem.

VIEWS OF FEDERAL COMMUNICATIONS COMMISSION REGARDING TELEGRAM TAX

FEDERAL COMMUNICATIONS COMMISSION,
Washington, D. C., August 15, 1949.

The Honorable SECRETARY OF THE TREASURY,
Washington, D. C.

MY DEAR MR. SNYDER: This refers to the Commission's letter to you, dated June 15, 1949, in which the Commission reiterated its prior recommendation that legislation should be enacted eliminating or substantially reducing the Federal excise taxes applicable to communication services. As you will recall, the Commission pointed out that in the case of the Western Union Telegraph Co. the deterrent effects of the present Federal excise tax on domestic telegraph usage may have particularly serious consequences, since Western Union's financial situation is becoming increasingly critical.

On July 7, 1949, Assistant Secretary Graham and members of his staff met with Commissioner Hyde and members of this Commission's staff to discuss our letter of June 15, 1949, with particular reference to the matter of the extent to which excise-tax relief might benefit Western Union and alleviate its present deficit operations. At the conclusion of this meeting, the Commission's representatives indicated that they would review all available data on this subject and would advise your Department as to their best estimates regarding this matter.

From our examination of the available data, it appears that removal of the tax on all communication services may increase toll telephone revenues about 10 percent and telegraph revenues about 3 to 5 percent. These estimates take account of the following factors:

1. During a recent transcontinental survey, a member of the Commission's engineering staff had occasion to discuss telegraph service problems with some 86 large business concerns. Many of these complained of the excise tax on communications and stated that a lifting of the tax would induce them to expand their use of communication services.

2. Reductions effected in interstate message toll telephone rates during the period from 1935 to 1945 appear to have had a stimulating effect on the public's use of this service. A removal of the excise tax should have a similar effect, particularly when reinforced by the stimulating impact of the continuing postwar expansion in the number of telephones in service.

3.. Removal of the tax on both toll telephone and telegraph will benefit telephone more than telegraph in terms of competitive pricing. This is illustrated in the attached table I, and results from the fact that the average charges for a toll telephone call of 24 miles and over, and for an interstate telephone call, are substantially higher than the charge for an average telegraph message. Thus, with the existing excise tax, the average telegram costs the user $1, whereas the average long-lines telephone call costs $2.50, a differential of $1.50; with the tax removed the differential would be cut to $1.20. The removal of the tax on both telephone and telegraph would therefore slightly improve the competitive position of telephone in relation to telegraph.

4. While removal of the tax on both telephone and telegraph would slightly improve the competitive position of long-distance telephone service, in relation to telegraph service, it should nevertheless result in some added revenues to Western Union. An area of telegraph business exists which is noncompetitive with telephone, since there is a need by certain types of users for a record com-

munication service and since, for certain purposes, "one way" message communication service is satisfactory. Some increased telegraph usage may be expected in this area, if the cost of the service is reduced.

5. During the latter half of 1946 Western Union's interstate telegraph rates were increased approximately 24 percent. The attached table II offers a comparison of the company's transmission revenues during the 5 months immediately preceding the rate increases with the same months in 1948 and 1949; comparison with 1947 is not feasible because of the telephone strike during April and May of 1947. It will be noted from the table that whereas a 24 percent increase mathematically applied to the company's 5-month 1946 revenues would have produced increased revenues of $14,815,000, the actual increase for the same period in 1948 was only $7,057,000, or 11.4 percent, and for 1949, $2,372,000, or 3.8 percent. The increased rates presumably had a marked effect in diverting traffic from telegraph, although the extent of such diversion cannot be measured precisely in view of other business factors which were simultaneously operative. Similarly, the removal of the excise tax, amounting to a 20-percent decrease in the charges to the public, should have a stimulating effect on traffic and result in a 3- to 5-percent increase in Western Union's gross revenues.

This estimated gain should increase Western Union's net operating revenues by approximately $3,000,000 to 5,000,000, after taking account of the increased cost of handling the larger traffic volume. While these amounts may not be sufficient to offset entirely Western Union's current deficit, which may be approximately $6,000,000 for the year 1949, the added revenues would aid the company at a critical time in its operations.

TABLE I.—*Charge for average message: Telephone and telegraph*

	Average revenue per message	Excise tax	Average revenue per message plus excise tax
Telegraph:			
Western Union: [1]			
Full rate	$0.87	$0.22	$1.09
Total domestic	.80	.20	1.00
Telephone.			
Long lines: [2]			
Average	2.00	.50	2.50
Business	2.22	.56	2.78
Residence	1.93	.48	2.41
Public and semipublic	1.13	.28	1.41
Bell system toll calls: [2]			
Average	1.21	.30	1.51
Business	1.34	.34	1.68
Residence	1.16	.29	1.45
Public and semipublic	.72	.18	.90

[1] For year 1948.
[2] For first quarter of 1949.

NOTE.—Message toll telephone service is furnished by the long-lines department of the American Telephone & Telegraph Co., the Bell system associated companies, and their connecting companies. "Long lines" toll business includes generally those interstate messages involving rate distances in excess of 40 miles, whose completion, in the main, requires the facilities of the long-lines department. "Bell system" toll business includes the above "long lines" messages, the shorter haul interstate toll messages, and intrastate toll messages, both latter classes being handled either entirely with the facilities of the associated companies or jointly with the facilities of their connecting companies.

TABLE II.—*Western Union transmission revenues, January to May 1946, 1948, and 1949*

	1946	1948	1949
January	$11,837,000	$13,753,000	$12,464,000
February	10,976,000	12,771,000	11,689,000
March	12,513,000	14,640,000	13,354,000
April	12,825,000	13,594,000	12,760,000
May	13,579,000	14,029,000	13,835,000
Total	61,730,000	68,787,000	64,102,000

1948 as percent of 1946, 111.4; 1949 as percent of 1946, 103.8.

Western Union is well along toward completion of a modernization program which is expected to improve the carrier's competitive position substantially, by reducing its costs of operation and by improving the speed and quality of its service. The full benefits of the program will not be realized, however, for at least two more years. The carrier has estimated that the full effectuation of this program will produce added savings in annual operating expenses in the general magnitude of $15,000,000. It is obviously important to Western Union to protect its cash position and prevent its credit standing from suffering further deterioration during this interim period before modernization is completed. When viewed in this light, any gain to Western Union resulting from a repeal of the excise tax assumes particular importance.

With respect to the matter of the possible effects of selective tax reduction (that is, removal of the tax on domestic telegraph service while continuing the tax on domestic toll telephone service), the benefit to Western Union would no doubt be considerably greater than in the case of a nondiscriminatory elimination of the tax. While we cannot precisely evaluate the amount of such additional revenues, it may be assumed that Western Union's revenues might rise as much as 15 percent with a resulting increase in its net operating revenues of about $15,000,000. Obviously, a gain of this magnitude, if realized, would improve Western Union's financial position considerably.

We trust that the foregoing will assist you in consideration of this problem. However, we wish to emphasize again that the estimates which we have made herein represent at most our best judgment in the matter. The measurement of the specific effects of any change in pricing is at best a difficult problem, and in this case reference could not be made to any recent telegraph rate reduction as a guide in appraising the probable effects of removal of the excise tax.

If we can be of any further assistance, we shall be happy to cooperate.

Sincerely yours,

PAUL A. WALKER, *Acting Chairman.*

The CHAIRMAN. Are there any questions?

Senator CONNALLY. I have one question.

I notice that you state you poured $80,000,000 back into the company since the war; is that right?

Mr. MARSHALL. Yes, sir.

Senator CONNALLY. Did that come from individuals or where did that money come from?

Mr. MARSHALL. It came out of depreciation reserve and the sale of assets.

Senator CONNALLY. Of the company?

Mr. MARSHALL. Yes.

Senator CONNALLY. So you did not make anything by that transaction?

Mr. MARSHALL. Did not make anything?

Senator CONNALLY. Yes. It was a switching of your assets.

Mr. MARSHALL. Some of it and some of it came from the depreciation reserves.

The CHAIRMAN. Are there any other questions?

Thank you very much, Mr. Marshall, for your appearance.

Mr. MARSHALL. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. R. V. Fletcher.

STATEMENT OF R. V. FLETCHER, SPECIAL COUNSEL, ASSOCIATION OF AMERICAN RAILROADS, WASHINGTON, D. C.

Mr. FLETCHER. Mr. Chairman, I would like to say that I propose to present this matter on behalf of the class I railroads of the United States in the form of an oral statement which will simply be a synopsis and a brief discussion of my mimeographed statement which I should like to file with the committee and distribute at this time, if I may.

The CHAIRMAN. Yes, sir; you may do so. Do you wish to put your whole statement in the record?

Mr. FLETCHER. I should like to have the whole statement incorporated in the record following what I conceive to be the policy of the committee.

The CHAIRMAN. Yes, sir; that may be done.

Mr. FLETCHER. I expect to mention only the high lights of this statement and refer to the statement for detail.

The CHAIRMAN. Your whole statement will be incorporated in the record.

(The statement referred to is as follows:)

STATEMENT BEFORE THE SENATE FINANCE COMMITTEE ON BEHALF OF THE ASSOCIATION OF AMERICAN RAILROADS BY R. V. FLETCHER, SPECIAL COUNSEL, JULY 6, 1950, ON H. R. 8920

My name is R. V. Flethcer. For many years I was vice president and general counsel of the Association of American Railroads, for a short time president of that association, and now represent it in the capacity of special counsel. My office is in the Transportation Building, Washington, D. C.

As is well known to your committee, the Association of American Railroads is an unincorporated nonprofit organization with a membership which comprises virtually all of the class I railroads of the United States. Its member roads operate over 95 percent of the railroad mileage in the country and their operating revenues constitute over 95 percent of the total operating revenues of all railroads in the country.

It is fair to say, I think, that no industry would have greater reason than does the railroad industry to welcome some measure of relief from the burden of taxation. The current financial situation of the railroads was discussed at length and in detail before the Subcommittee on Domestic Land and Water Transportation of the Senate Interstate and Foreign Commerce Committee no longer ago than April 4 and 6, 1950, by Dr. J. H. Parmelee, vice president of the association and director of its bureau of railway economics. I shall, of course, not repeat here his comprehensive testimony, or even undertake to summarize it. It is a fair epitomization, I think, to say, in a word, that he showed the situation of the railroads today to be that of an industry completely essential to the domestic economy and indispensible to the natonal defense, conservatively financed and efficiently operated, yet unable even in this time of high business activity, to realize net earnings sufficient to attract investment capital essential to the continuing improvement of the railroad plant. No industry, then, stands in greater need of tax relief. But the railroads find no relief in H. R. 8920. To the contrary, they find in this bill heavy new and additional tax burdens. They are therefore opposed to the bill.

THE TRANSPORTATION EXCISE TAXES

To be sure H. R. 8920 provides, in sections 171 and 172, for reduction of the excise tax on passenger transportation from 15 to 10 percent, and for reduction of the freight-transportation tax from 3 percent generally, and 4 cents per short ton on coal, to 1½ percent generally, and 2 cents per short ton on coal. But neither the passenger tax nor the freight tax is repealed.

These transportation excise taxes are not, of course, imposed upon the carriers. They are the liabilities of the users of common-carrier transportation. With respect to them, the railroads and other for-hire carriers are merely tax collectors, who, at no inconsiderable expense to themselves, are required to exact from their patrons and remit to the Treasury taxes which at one and the same time operate to drive their traffic away to private means of transportation and to increase their costs, through their effect upon prices.

The railroads regard longer retention, in whole or in part, of the transportation excise taxes as wholly indefensible. These taxes stand preeminent, in our view, among the wartime exactions which call for outright repeal. Having regard for the fact that perhaps 60 percent of passenger travel is for business purposes, it is indisputable that both the passenger and the freight taxes operate to increase the cost to the consumer of practically every article or commodity dealt in on the

American market. Their repeal would effect an across-the-board measure of excise-tax relief to the whole of the producing and consuming public.

I am admonished not to repeat here testimony already adduced before the Ways and Means Committee, and shall not do so. But I may be permitted to say, I take it, that the transportation excise taxes are not only a burden upon the entire producing and consuming public but also are highly discriminatory in their impact. They plainly discriminate as between common carriage, which is subject to tax, and private carriage, which is exempt. They discriminate between long-haul and short-haul carriage to common markets. Furthermore, they are subject to avoidance through payment of transportation charges outside the country and are thus discriminatory against those not in position to avoid them in that manner—principally, it may be noted, small businesses not located in close proximity to the border.

The railroads do not believe that the proposed reduction of these taxes, as distinguished from their repeal, will in any substantial measure cure the discrimination against the public agencies of transport which inheres in the exaction of taxes upon freight charges and passenger fares. So long as a tax upon charges paid to for-hire carriers is retained, just so long will an incentive be offered for diversion to private carriage. The railroads, therefore, see little or no benefit to them in the treatment of the transportation taxes in H. R. 8920. They are of course not blind to the revenue considerations which are bound to be taken into account in dealing with tax relief today. They are nevertheless persuaded that in the field of excise taxes none call so urgently for outright repeal.

THE CORPORATE TAX RATE

As against whatever shadowy, indirect, and unassured benefit H. R. 8920 might bestow upon the railroads as a result of reduction of the excise taxes imposed upon their patrons, the bill provides for direct and immediate tax increases which the industry cannot afford. The combined normal and surtax corporate rate for corporations having income approximating $167,000 is to be increased from 38 to 41 percent. It should be observed here that a class I railroad—by definition a road having gross income of $1,000,000 or more—would be in parlous circumstances indeed if its taxable income failed to approximate $167,000.

As matters stand today the railroads are compelled to look primarily to earnings as a source of funds for the upkeep and improvement of their properties. I shall speak in a moment of the inadequacy of depreciation reserves to provide for necessary replacement of worn-out or obsolete facilities. As for new capital it is scarcely available, except for the purchase of unencumbered new equipment, by reason of the low level of net earnings (less than 3 percent upon depreciated investment in 1949). Under the going rate of 38 percent it takes $1.61 of net income to produce $1 available for capital expenditures. Under the rate provided by H. R. 8920 of 41 percent, it would require $1.69 of net to produce $1 clear. Thus a very bad matter would be made very much worse. The public, as distinguished from any private interest, is vitally concerned in this matter. The proposed corporate rate increase cannot fail to work against the continuing adequacy of the railroad plant to meet the needs of commerce and the exigencies of national emergency.

INADEQUACY OF DEPRECIATION RESERVES

It requires no argument before this committee to demonstrate that,not withstanding the impressive development of other modes of transportation, the railroads remain of primary essentiality to the requirements of the Nation. The economy and the national defense alike require, as I have indicated already, that they be so maintained and their facilities so improved as to provide at all times the highest quality of service at the lowest possible cost. This entails, of course, the replacement of worn-out and obsolete facilities with new and improved facilities.

Construction indices compiled by the Bureau of Valuation of the Interstate Commerce Commission show that, as compared with the prewar year 1939, the cost of railroad equipment has increased by over 66 percent and the cost of road property by over 96 percent. It is clear, therefore, that depreciation accruals on facilities acquired at prewar price levels have not provided—and cannot provide—sufficient funds for replacements and improvements at the current high level of costs. For example, in the 4-year period 1946–49, capital expenditures averaged a little more than $1,000,000,000 per annum, whereas depreciation allowances in that period averaged about $384,000,000 per annum.

The system of regulation under which the railroads operate not only requires that the prices of their services be fixed but also affects nearly all of their other

activities. Under that system the railroads, during the 29-year period 1921–49, have had to function on an average rate of return on depreciated investment of approximately 3.62 percent. For the 1940's, including the peak traffic war years, the rate of return averaged 4.11 percent, while in the decade ending with 1939 the average was only 2.30 percent. During the 1940's public utilities earned from 6.2 to 8.7 percent on their net worth, and in other industry outside the regulated group earnings have ranged as high as 15 percent and more. A 6-percent return for railroads, currently regarded as the minimum necessary for operating efficiency and financial stability, has been realized in only 1 year (1942) of the entire 29-year period.

The railroads are unique in their necessities and they require at least some measure of tax relief in order to make earnings more readily available for the upkeep of the railroad plant. Two modest proposals have been advanced to this end. Neither finds any recognition in H. R. 8920. I shall outline them briefly. They are not suggested as alternatives one to the other. Our position is that both should be adopted.

The first of the two proposals is that the Internal Revenue Code be amended to permit the taxpayer to amortize 50 percent of the cost of depreciable property acquired after the close of the year preceding the amendment, at an annual rate not greater than 20 percent of the amortizable amount (10 percent of the cost) nor less than the applicable rate of depreciation. The remainder of the cost would continue to be depreciated at the applicable rate, as heretofore.

The second proposal looks to amendment of the code to permit any railroad corporation subject to part I of the Interstate Commerce Act, at its election, to deduct from gross income in arriving at its net income subject to tax an amount not in excess of 25 percent of its net taxable income computed without the benefit of such deduction, provided it shall have deposited such amount in a separate reserve fund for capital expenditures. This proposal contemplates that the fund so reserved shall be utilized, within a period 3 years from the date of deposit, for expenditures which, under the then applicable accounting classification prescribed for railroads by the Interstate Commerce Commission, are properly chargeable to accounts recording investment in property devoted to transportation service. To the extent of such expenditures from the reserve fund, the cost basis of the property acquired would be reduced for all income-tax purposes, including the computation of allowances for depreciation and the ascertainment of gain or loss on sale or retirement. Funds deposited but not expended for the purposes specified within the period prescribed would revert to taxable income and be subject to tax at the rate applicable in the year of deposit.

Your committee will perceive that these proposals look to tax deferment rather than tax forgiveness. The amortization proposal would merely afford to the taxpayer an election to accelerate deductions which must be foregone in future years, and the second proposal, by its provision for reduction of basis, is designed merely to spread the tax burden Yet these proposals, if adopted, would at least make available when particularly required a larger part of net earnings with which to improve the railroad plan.

It will be appreciated that in principle these proposals are in line with the following statement at page 30 of the report of the Joint Committee on the Economic Report, Eighty-first Congress, second session, Senate Report No. 1843:

"Of course, other aspects of the corporate-tax system also adversely affect the incentives as well as the sources for investment funds. In particular, we believe the tax policy should permit depreciation over a shorter period of years to encourage replacement of outmoded equipment with newer, cost-reducing equipment."

The importance of this matter to the railroads as compared with other transportation agencies is heightened by the large private investment required for the rendition of their transportation service.

LOSSES UPON RETIREMENT OR ABANDONMENT

H. R. 8920, far from recognizing the principle underlying the foregoing proposals, looks in the opposite direction. That portion of section 209 changing the basis for computing gains and losses from the sale, exchange, or abandonment of property used in the trade or business would impose an additional and particularly severe burden on railroads.

The proposed change purports to correct the situation brought about by the Revenue Act of 1942, which added section 117 (j) to the code. This section gave the taxpayer the option of treating the sale or exchange of business property as either an ordinary gain or loss or as a capital gain or loss. We understand that

this amendment was enacted to correct inequities occasioned by the inflation of price levels which, in many cases, produced taxable income when business property was sold or exchanged. The Secretary of the Treasury, in his testimony before the Ways and Means Committee of the House, characterized the option as a one-way street. But the House bill does not revert to the procedure in effect prior to 1942, when the results of such sales or exchanges were treated as ordinary gains or losses. On the contrary, it would treat all such transactions as capital gains or losses. In addition, it would add to the capital gains or losses category the gain or loss incurred in the abandonment of business property.

Railroads have been in the transportation business for more than 100 years. Railroad facilities are constantly—day by day—being replaced with new and improved facilities. With the changing times, facilities which previously had served to forward the upbuilding of the country are from time to time found to be no longer necessary in the public interest, and are abandoned. All abandonments and many of the replacements result in losses. If such losses are treated as capital losses, the railroads will be deprived of tax deductions for ordinary and necessary business expense. This is inevitable because the railroads are devoted to the business of transportation and seldom, if ever, are in the position of having capital gains to offset losses on the sale, exchange, or abandonment of business property. While we do not advocate any change in the existing code provisions, if the option must be eliminated, then, in simple justice, we believe this end should be accomplished by reinstating the provisions of the code as they existed prior to 1942 and thus provide that the sales, exchanges, or abandonments of business property shall be treated as involving ordinary gains or losses.

THE PENALTY FOR FILING CONSOLIDATED RETURNS

Although H. R. 8920 would increase the corporate-tax rate by 3 percent it provides no relief from the 2 percent penalty for the filing of consolidated returns by corporations affiliated through 95 percent stock ownership. It would result that many railroad corporations would be subjected to an effective rate of 43 percent, or required to forego a consolidated return.

Consolidated returns, of course, are based upon the equitable principle of levying taxes according to the true net income of a single enterprise, even though the business be operated through more than one corporation. Thus consolidated returns are designed to provide fair and reasonable treatment to affiliated taxpayers. They are, we understand, favorably regarded by the Treasury from an administrative standpoint.

It would seem clear that the adoption of a practice calculated to do equity and at the same time to be of advantage to the Treasury in administration of the law ought not to be subjected to a penalty, which as a practical matter may frequently prohibit its use.

These observations run to the situation of all affiliated corporations, and we agree with others that the penalty should be removed with respect to all. We think it clear, however, that the principle of levying the tax according to the true net income of a single enterprise, even though the business be operated through more than one corporation, is peculiarly applicable to the situation of the railroads.

Historically, the railroads have been obliged in many instances to utilize multiple corporate set-ups in bringing their systems together. While public convenience and necessity require that railroads operate across State lines, provisions of law in some States have necessitated, as a practical matter, the existence of a subsidiary company. For instance, where the State prohibited public-utility property from being owned by a foreign corporation or refused to grant the power of condemnation to foreign utilities, it is apparent that a corporation had to be created under the laws of that State. As a result the major railroad systems of this country have developed, not only by mergers, but by a process of leasing operating property from subsidiaries, such subsidiaries being vested with title to the property. The lines of these lessor companies are operated as a part of the railroad system of the lessee and in many cases the lessee owns all the stock of the lessor company. Considered together, the lessor and the lessee constitute one economic unit. The lessee carries on the railroad business, while the lessor merely receives rental from the lessee. To determine the true net income of two such taxpayers a consolidated return must be filed, and there is no reason whatever for the imposition of a 2-percent high rate under such circumstances.

We urge provision for repeal of the penalty as to all corporations or, in any event, as to the railroads. As indicated, this is a matter the importance of which would of course be magnified by an increase in the corporate tax rate, such as is provided

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for in H. R. 8920. Under the bill the rate under a consolidated return would reach the unprecedented height of 43 percent.

I might add that, by parity of reasoning with the foregoing, provision should be made (1) for inclusion of long-term lessor companies in consolidated returns without regard to stock ownership and (2) for deduction by a lessee under certain long-term leases for loss on retirement and for allowance of depreciation on the leased property. This committee and its staff are fully conversant with these matters and I shall not elaborate them here.

WITHHOLDING ON DIVIDENDS

Undersection 601 of H. R. 8920, a corporation would be required to withhold and return to the Government 10 percent of every dividend payment and furnish the payee with a statement showing the gross amount of such dividend and the amount of the withholding.

We are in complete agreement with the premise that taxes should be paid upon all taxable income. But, we do not believe that complex and expensive collection procedures should be imposed upon one class of taxpayers to insure compliance with the law by another class. This is particularly true in the instant case.

The railroads would not object to reporting the total amount of all dividend payments in lieu of the present requirement to report only payments of $100 or more. And taxpayers would not be unduly burdened if required to itemize the dividends received. Surely, with both sides of the account before it, the Bureau of Internal Revenue should be able to detect any avoidance or evasion of the tax

INTEREST ON REFUNDS AND DEFICIENCIES

The reduction from 6 percent to 3 percent in the rate of interest on overpayments of taxes, as provided in section 602 of H. R. 8920, without a corresponding change in the 6 percent rate assessed on underpayments violates every concept of equity.

Our tax laws are so complex that it is a practical impossibility to prepare a tax return for any large corporation which will be acceptable in all respects to the Commissioner of Internal Revenue. Realistically, there is no justification for any element of penalty in the rate imposed upon the taxpayer. The Commissioner frequently transfers income and deductions from one year to another, thus making for overpayments, on the one hand, and underpayments, on the other. The taxpayer would be penalized by the assessment of 6 percent interest on the underpayment while receiving but 3 percent interest on the overpayment.

Of even more importance is the well-known fact that the audit and settlement of corporate tax returns lags many years behind the date upon which those returns are filed and the tax paid. And, for the most part, this is not the fault of the taxpayer. At the present time, the tax returns of many railroads are open for one or more years of the war period. Matters arising in connection with the determination of invested capital needed for the computing of the excess profits tax remain to be settled. Should the Commissioner reduce the invested capital, there will be a resulting deficiency in excess profits tax bearing interest at 6 percent and an overpayment of the income tax, on which the taxpayer will receive but 3 percent interest. The total amount of the income will not have been changed but switching it from one class of tax to another will necessarily result in both a deficiency and an overassessment.

The House committee report says that a 6-percent interest rate is out of line with the price which the Government generally pays for the use of money. It may with equal force be observed that it is out of line with the price which industry generally pays for the use of money.

We have no objection to a reduction in the interest rate, but we do respectfully submit that if any change is made it should be in both the rate payable on deficiencies and the rate payable on overpayments.

SECTIONS 22 (B) (9) AND 22 (B) (10) OF THE CODE

The attention of your committee is respectfully called to the fact that section 22 (b) (9) and section 22 (b) (10) of the Internal Revenue Code, as now written, will expire December 31, 1950. By virtue of extension from time to time, these sections have been in effect for many years, section 22 (b) (9) since 1939 and section 22 (b) (10) since 1942. Certainly a sufficient "trial period" has elapsed, and no criticism of the operation of these provisions has ever come to our notice. In our view, both sections ought now to be made permanent parts of the code. At all events, they ought not to be permitted to expire by default.

Section 22 (b) (9) provides for excluding from taxable income so-called gain realized by a corporation upon the purchase of its bonds at a price less than par, provided the corporation agrees to a reduction in the basis of its assets for depreciation and other income tax purposes by the amount of the gain so excluded from taxable income.

Section 22 (b) (10) provides for excluding from taxable income so-called gain attributable to the modification or cancellation of any indebtedness of a railroad corporation in a judicial reorganization.

Taxwise, the effect of section 22 (b) (9) is merely to spread theoretical income over a period of time through reduced allowances for depreciation and for loss upon disposition of the property. At the same time, it removes an impediment to strengthening the financial position of a corporation through debt reduction.

While the section applies to corporations generally, its enactment was brought about largely as a result of representations made to Congress on behalf of the railroads. During the depression of the 1930's, railroad securities were selling at distress prices, and an opportunity was thus afforded to bring capital structures in line with reality through purchases in the open market and without resort to bankruptcy. But the railroads which were in a position to do so were precluded from carrying out such a plan for fear of the application to the transaction of the principle announced in *United States* v. *Kirby Lumber Co.* (284 U. S. 1), with the probable result that the discount involved in reduction of debt would be treated as taxable income. When the current low level of railroad earnings is taken into consideration, it is manifest that section 22 (b) (9) may be as important in the future as it has proved to be in the past.

Ten years of experience with the section, as a temporary part of the code and subject to a time limitation which was last year extended for the fifth time, has demonstrated conclusively that the section serves a useful purpose. Seldom has the Congress passed so often on the advisability of and need for such an isolated provision of the tax law. No abuse of the section has occurred, if indeed any is possible. No loopholes or evasive possibilites have resulted from the continuation of the section in the law. The section operates to enhance the tax revenues as a result of reduction of the taxpayer's fixed charges. It seems clear that section 22 (b) (9) should be made a permanent part of the Internal Revenue Code.

Section 22 (b) (10) of the code, as previously stated, provides for excluding from taxable income so-called gain attributable to the modification or cancellation of indebtedness of a railroad corporation in a judicial reorganization through continuance of the original corporation.

Section 22 (b) (10) was first enacted as a part of the Revenue Act of 1942. At the same time, sections 112 (b) (9) and 113 (a) (20) applicable to reorganization through a new corporation, were added to the code.

These several provisions are correlated and have the effect of placing on a uniform basis taxwise railroad reorganizations whether accomplished through the medium of a new corporation or through continuance of the original corporation. However, in spite of this correlation, section 22 (b) (10) was made subject to a time limitation and will now expire according to its terms on December 31, 1950, while the provisions relative to reorganizations through the medium of a new corporation were enacted without time limitation.

We know of no logical reason for the difference in treatment. There appears to be no reason why section 22 (b) (10) should not be made a permanent part of the code. If that be not done, its further extension is imperative in order to prevent discrimination against railroads which, for reasons beyond their control, are still in the process of reorganization.

Mr. FLETCHER. Mr. Chairman and members of the committee, my name is R. V. Fletcher. I am a lawyer. I live in Washington and I am special counsel for the Association of American Railroads.

This association represents about 95 percent of the mileage and about 95 percent of the revenues of the class I railroads of the United States. I believe it is understood that a class I railroad is a railroad that has gross revenues of as much as $1,000,000 a year.

As far as I know, Mr. Chairman, this is the only statement that will be made on behalf of the railroads, an industry which is ordinarily supposed to be the second largest industry in the Nation, exceeded in respect to volume only by the agricultural industry, and it has about 1,300,000 employees at the present time. A few of them are on strike

right now but not so many at this moment. Therefore it is a matter of some importance. If I should go a little over 5 minutes, Mr. Chairman, I hope you will be patient with me.

The CHAIRMAN. All right, you go ahead, Judge.

Mr. FLETCHER. Of course it is not necessary for me to state that the railroad industry is an essential industry in the sense that it is absolutely necessary for the economic welfare of the Nation in time of peace and absolutely necessary in a more dramatic and striking form for the defense of the Nation if unhappily we should be engaged again in war.

Nobody has ever questioned, I suppose, the fact that the railroad industry is the backbone of the transportation system and although other forms of transportation have taken a great deal of business and are performing a very useful and necessary service, still it remains true that nearly two-thirds of the freight traffic of the country is transported by railroads and it is still the most important passenger carrier, meaning thereby the most important in the field of regulated common carriers.

I think it is equally true, Mr. Chairman, that the public welfare demands and our economic welfare demands that these railroads should remain privately owned and privately operated. I say there is no sentiment, practically no sentiment, in the country in favor of public ownership and operation of the railroads because experience has shown that the railroads under public control, as they were in World War I, are not particularly efficient and they certainly were expensively operated. causing a drain on the Federal Treasury in very large amounts, whereas in the second World War where under the wise policy of the Govrnment they were left in private hands, they were able to make large contributions to the revenues of the country in the way of taxes, and in no way were they a charge upon the public treasury.

Another reason why private ownership of railroads is exceedingly important is because nobody who has studied the question doubts that if the railroads are taken over it would mean also the taking over of transport on the highway, transport in the air, and transport by water, because Government would scarcely brook competition with other forms of tranportation, and that would be of course a long step toward the socialization of industry and the destruction of our so-called free-enterprise system which all of us cherish and hope will continue. Therefore I think it is quite important to the country that the railroad industry should be at least treated fairly in connection with tax problems as well as other problems.

In spite of the fact that the railroad industry has this importance and is essential to the welfare of the country in time of peace and in time of war, it is far from being prosperous at the present time. I do not know any line of endeavor anywhere in the Nation that needs to spend more money than the railroad industry does at the present time to modernize its equipment and to modernize its roadway as well. Large amounts of money ought to be spent in order to make the railroads efficient servants of industry as well as being able to hold their own in a very intensely competitive situation. My own opinion is that the railroads might very well spend $1,000,000,000 a year for the next 5 or 10 years in improving their service and making it possible to effect economies, possibly leading to a reduction in rates and cer-

tainly leading to rehabilitation in public esteem as important transportation agencies.

Now, that will not be accomplished unless we are able to restore railroad credit. I use the word "restore" advisedly because I think railroad credit at the present time is at a minimum. I do not know of any type of railroad securities that can be sold profitably except those that have to do with the purchase of equipment. Equipment trust obligations are currently sold at fair prices and with reasonable rates of interest because of certain reasons which I could explain if the committee was interested in it. They are preferential obligations. In case of bankruptcy they come ahead of everything else except labor cost, labor charges, and for that reason they sell pretty well.

But the railroad industry does not want to be borrowing money. The whole tendency has been in recent years toward reducing its funded debt. I am very happy to say that has been accomplished to a very marked degree. My recollection is that in 1932, let us say, taking that as a year for measuring the progress that was made along the line of debt reduction, the funded debt of the railroads I think was $11,800,000,000. That indebtedness has now been reduced by more than $3,000,000,000 until now the funded interest-bearing debt of the railroads has been reduced to $8,600,000,000.

That is my reason for making these suggestions with respect to the present bill which we have under consideration and which I must say candidly is a grievous disappointment to the railroad industry. I should think perhaps that so far as this particular industry is concerned they would be better off without any change in the present law than they would if H. R. 8920 becomes the law.

Coming down now to some of the matters I wish to present to the committee—coming down to this question of excise taxes—of course the railroads do not pay the excise tax, it is paid by its customers. In the matter of collecting the tax and reporting to the Government there is a very considerable amount of detailed labor and expense in keeping the books and so forth. The reason why the excise tax upon transportation is an objectionable one from the railroads' point of view is that it has a tendency to drive business to private transportation. The tax on passenger tickets in all forms of regulated and public transportation is 15 percent. This bill proposes to reduce it to 10 percent.

All of you are aware of the fact that that tax of 15 percent was put on in the war years not for the purpose of raising revenue for the Government. That was never the thought of those who advocated it. It was for the purpose of discouraging passenger travel, as you well remember. The railroads, the airplanes, the busses were overwhelmed with people who wanted to travel, some of them without any very good reason for doing so, I dare say, and the tax of 15 percent was put on there to make them stay at home.

Now we come to a time when there is fierce competition for passenger travel and certainly the reason for putting the tax on has disappeared.

Senator KERR. Will you tell the committee at this point how much increase there has been, percentagewise, in passenger-transportation cost during the same preiod of time? .

Mr. FLETCHER. Taking them as a whole, you mean?

Senator KERR. Yes.

Mr. FLETCHER. The railroads have raised their passenger rates from 2 cents a mile until now it averages about 2½ cents a mile. I could not give it to you in dollars.

Senator KERR. What is it percentagewise?

Mr. FLETCHER. This is a pretty wild guess, Senator, as I have not made any figures on it, but I should think in addition to the 15 percent it has been increased probably 20 percent. I might be wrong about that, somewhere between 10 and 20 percent.

On the freight transportation the rate of taxation is 3 percent. This rate it is proposed to reduce to 1½ percent.

There is a special tax of 4 cents a ton on coal and they propose in the bill to reduce it to 2 cents a ton.

The effect of these taxes, Mr. Chairman, is to bring about transportation not by regulated and public utilities but by private transportation. People use their private automobiles a great deal more than I dare say they would if this tax did not rest upon passenger transportation. If the tax did not rest on freight transportation, there would be a less tendency for those who are interested in the transportation of freight to use the public highways by their private trucks.

I think there is another angle of it that might possibly be considered as far as the public welfare is concerned. I think we have too many trucks on the highway now. That is a railroad man's point of view perhaps, but if you were to encourage, if you continued to encourage, the increased use of privately owned trucks upon the highways, you inconvenience the public materially, it seems to me, and of course retard the development and welfare of the public utilities.

Senator CONNALLY. Judge, this is something I do not know anything about, so I am asking you. Have you heard of any plan or scheme for avoidance of the tax on transportation of property through the use of Canadian agents?

Mr. FLETCHER. Yes. I know something about that. I do not know that I am able to discuss it very intelligently but I do know that a great many people have been arranging whereby they pay their freight charges and their passenger fares also in Canada and they use the American railroads so that they do not have to pay the tax. They just send the money to Windsor and buy their tickets and pay their freight bills there.

Senator TAFT. This bill corrects that.

Mr. FLETCHER. It corrects that or attempts to correct it. I do not know whether it is going to work very well or not but it is an effort to correct it certainly.[1]

Senator CONNALLY. What about on the property they ship? Do they do the same thing?

Mr. FLETCHER. They have been doing it to a considerable extent. I think this bill would correct that.[1] It ought to be corrected. It is a tremendous discrimination against those who pay the charges in the United States and it deprives the Government of revenue.

I do not want to take too much time on this matter of excise taxes but I do say that so far as the wrong and injury done to the regulated and public transportation companies are concerned, I do not think

[1] Subsequent consideration indicates that H. R. 8920 does not undertake to deal with the Canadian situation.

this reduction that they have made of 5 percent in passenger and 1½ percent in freight is going to do any good at all from that point of view. It of course may relieve the burden somewhat on the citizens who have to use these transportation agencies, but so far as preventing the diversion of business from the regulated industries to the privately owned cars and trucks upon the highway, I do not think it is going to have any effect.

Here is a man who says, "Well, if I want to go from here to Chicago I have to pay 15 percent on the fare. I will take my private automobile." Day after tomorrow, if the tax is reduced to 10 percent, he still has to pay a very considerable amount. Is that going to deter him from taking his private automobile and using it for that journey? I should think not.

I should imagine that a reduction of from 15 percent to 10 percent will not have any effect, any appreciable effect I mean, on the thing the railroads complain about, namely, that through the taxing process the business is diverted from the publicly regulated forms of transportation to the private forms of transportation.

Senator TAFT. Do you think the railroads would put back any more local trains? The reason I have traveled all over Ohio in an automobile is because there were no trains.

Mr. FLETCHER. That is true, Senator. I dare say you are quite correct. I should hope it might have that effect. Whether it will put them all back or not, I would not be able to say. No train has ever been taken off that was a profitable train.

I have tried a lot of cases before State commissions in my earlier days and my more active days, when I was a little more alert than I am now. I used to go before State commissions and ask the commission to remove trains. We would have a great flock of people come down from the towns and object to it. I asked every one of them how they traveled there and every one of them came in his automobile.

I remember once in Iowa, if I may mention that, when I was trying to get a train taken off in Iowa some of the people came up and objected. I said, "Nobody uses the train, do they?" "No; but about 5 or 6 days in the year the roads get so cluttered up with ice and snow that the automobiles cannot run, and then what are we going to do?"

Well, that is beside the point.

Senator MARTIN. Mr. Chairman, I have hurriedly gone through Mr. Fletcher's statement and I wonder if we could have a comparison of the deficit for the Government-operated railroads during World War I and the receipts from taxes that the Government received in World War II.

Mr. FLETCHER. I do not have those figures here, Senator.

Senator MARTIN. I think it is a pretty important subject.

Senator KERR. Would you add to that question, Senator, a further request to supply the committee with information as to the comparative rates paid during the Government operation in World War I and collected by the carriers in World War II?

Mr. FLETCHER. I think the rates were higher in World War I.

Senator KERR. The record will show.

Senator MARTIN. I think it ought to go in. I think it will be helpful.

Mr. FLETCHER. In order not to delay the matter, if I should address a letter tomorrow to the committee giving that information, would that be satisfactory?

The CHAIRMAN. Yes, sir; that will be satisfactory.

(The information referred to follows:)

ASSOCIATION OF AMERICAN RAILROADS,
Washington D. C., July 7, 1950.

The Honorable WALTER F. GEORGE,
Chairman, Committee on Finance,
United States Senate, Washington, D. C.

MY DEAR SENATOR GEORGE: In my appearance before the committee on yesterday, discussing the tax bill, certain questions were propounded to me by Senators Martin and Kerr the answers to which I was unable to give by reason of not having the data before me.

I asked for and was given permission to write a letter to the committee embodying answers to these questions, which related to a comparison of revenues and rates as between World War I and World War II.

I take pleasure in handing you a statement prepared by our Bureau of Railway Economics answering these questions. I should be greatly obliged if you could have this statement made a part of the record.

Very truly yours,

R. V. FLETCHER.

QUESTION 1

How much did Government operation of the railroads in World War I cost the Federal Treasury over and above receipts?

Answer

In the First World War, the Government signed contracts with the several railway companies, agreeing to pay them annual rentals for the use of their properties. These rentals were based upon the actual annual net earnings of each railroad over a test period of 3 years, July 1, 1914, to June 30, 1917. In addition, the Government agreed to make good any undermaintenance of the properties, and to make up reductions in inventories during the period. Government operation extended from January 1, 1918, to February 29, 1920. Upon the return of the railroads to their owners, on March 1, 1920, the Government agreed to guarantee the railroads the same rate of earnings for a period of 6 months.

The revenues of the railroads during the period of government operation accrued to the Government. They proved insufficient to meet the rentals. The deficiency, plus the other payments listed below, amounted to $1,641,867,000 for the whole control and guaranty period.

Excess of rentals over receipts	$788, 657, 000
Guaranty period (Mar. 1 to Aug. 31, 1920)	528, 986, 000
Net payments for undermaintenance, etc	186, 044, 000
Replacement of materials and supplies	101, 055, 000
Short line railroads	732, 000
Express company	36, 393, 000
Total	1, 641, 867, 000

The foregoing amounts do not include the administrative cost of the United States Railroad Administration, amounting to $34,807,000, nor was allowance made for certain interest and miscellaneous receipts collected by the Administration, amounting to $98,921,000. Including those two items, the net cost to the Government was a little more than $1,575,000,000.

QUESTION 2

How much money was paid by the railroads in the form of Federal taxes in the Second World War?

Answer

In the period from December 1, 1941 to August 31, 1945, class I railways paid $4,140,000,000 in Federal income taxes, and approximately $100,000,000 in other Federal taxes. In addition, they paid $783,000,000 in payroll taxes for support of the employee retirement and unemployment insurance systems set up by Federal statute. Railroad employees also contribute to the support of the retirement system, but not to the unemployment insurance system.

QUESTION 3

How did the rates, both freight and passenger, in the period of Federal control during the First World War compare with similar rates, both freight and passenger, in World War II?

Answer

While exact measures of rate and fare levels at specific points in time are not available, average revenue received by the railroads per ton-mile of freight and per passenger-mile offer approximate indications of those levels. The averages for the 3 years of Federal control (1918–20) and the 4 years of the Second World War (1942–45) are set out in the following table. For purposes of comparison, the years preceding each of those periods (1917 and 1941) are included.

Revenue per ton-mile

	Cents		Cents
1917	0.715	1942	0.932
1918	.849	1943	933
1919	.973	1944	949
1920	1.052	1945	.959
1941	.935		

Revenue per passenger-mile

	Cents		Cents
1917	2.090	1942	1.916
1918	2.414	1943	1.882
1919	2.540	1944	1.874
1920	2.745	1945	1.871
1941	1.753		

The results are as follows: During the First World War, when railroads were Government-operated, average revenue per ton-mile increased 47.1 percent from 1917 to 1920. In the Second World War, when railroads conducted their own operations, average revenue per ton-mile increased 2.6 percent, from 1941 to 1945.

Average revenue per passenger mile increased 31.3 percent during the First World War, from 1917 to 1920, and increased 6.7 percent during the Second World War, from 1941 to 1945.

Senator KERR. You say the funded debt decreased from 11.8 billion dollars to 8 billion dollars, Judge?

Mr. FLETCHER. In round numbers, yes; from 11.8 billion dollars to 8.6 billion dollars I believe, something over 3 billion dollars.

Senator KERR. Could you give the committee detailed information as to how that indebtedness was reduced?

Mr. FLETCHER. Yes; that can be done. Part of it was due to the fact that in the reorganization of railroads that went into bankruptcy there was some reduction in their funded debt under the orders of the Court and the Interstate Commerce Commission as the result of those bankruptcy proceedings, but the greater amount of it was done by reason of the fact that during the period of the war when there were some surpluses for railroads they bought in their own outstanding bonds, interest-bearing obligations, at a discount, which the law permitted, a matter which I should hope to mention a little later in connection with another subject. Most of the reduction came from that fact.

Senator KERR. Came from the railroads buying their own securities?

Mr. FLETCHER. Yes, sir.

Senator KERR. Can you say at about what percentage of the face value they bought them in?

Mr. FLETCHER. It varied so much, Senator. I would guess around 25 percent discount.

Senator KERR. In other words, what would you say the railroads invested percentagewise in dollars and cents in the reduction of their funded debt of three and one-third billion dollars?

Mr. FLETCHER. I would say 25 percent, if I understand your question.

Now passing away from this question of excise taxes which has been discussed so carefully here this morning by other interests, I content myself with saying that we are strongly in favor of abolishing the tax on transportation for the reasons that I have tried to state and we are very much dissatisfied with the small reductions that have been made.

This bill provides of course that any corporation that has an income of more than $167,000 annually, taxable income, shall have its tax rate increased from 38 percent to 41 percent. I read the statement made by the Secretary, a very able statement by a very able and worthy man, and he stated that corporations generally were quite prosperous and that they had a large volume of business which was increasing all the time. He mentioned particularly—and I want to mention that, too—as one index of prosperity the fact that their working capital had been greatly increased in recent times, although 300 percent. That might be true of corporations generally but I think it is a matter of common knowledge as far as the railroads are concerned no such prosperity has attended their efforts. What money they made they made in the war period and the income has been going down ever since, I mean the net income.

Let us take, for instance, this matter of working capital. I have some figures here which show that in the matter of working capital in the year 1945, just about the time the war closed, the class I railroads of the United States had in their treasury in the form of working capital $1,600,000,000. On the 31st day of January 1949 that working capital had decreased to $645,000,000. In other words, instead of increasing three times, as the Secretary said of general business, it had been reduced two-thirds in amount so that the working capital was only one-third of what it was in 1945.

That working capital has been used almost entirely in the matter of improving the plant, improving the roadway, improving the equipment, and therefore whenever the argument is employed, if it has force and weight, as made by the Secretary, that business generally is so much better than it was and that corporations have been thriving and prospering to a high degree, it does not apply to the railroad industry. The converse and the reverse is true.

As a matter of fact, these railroads, many of them at least, instead of paying 41 percent on their taxable income over and above $167,000, will pay 43 percent, a matter that is not peculiar to the railroads exactly but markedly true in the case of railroads more than others because you have to pay a 2 percent penalty for making a consolidated return.

All over this country we have railroads that might be called parent roads and there are other railroads that are subsidiaries of the parent railroad; that situation historically Senator, grows out of the fact that for a long time a great many states passed laws which required a railroad company to incorporate under the laws of the State where they operated.

Take your State, Senator Connally, Texas. They had a law down there that not only must you be a Texas corporation if you operate in Texas but you must have your principal operating office in the State of Texas and I think your principal accounting office must be in the State of Texas.

Senator CONNALLY. That was done of course to make it easier to regulate the railroads, so that they would not get into the Federal courts and dodge the State courts and dodge the State laws. They passed that law to make them incorporate in the State so as to make them subject to State jurisdiction.

Mr. FLETCHER. That probably arose during a period when it was considered pretty bad on the ordinary citizen for his opponent to go into the Federal court.

Senator CONNALLY. That is right.

Mr. FLETCHER. That does not apply any more.

Senator CONNALLY. No, not since the decisions we have received.

Mr. FLETCHER. I find plaintiffs have been seeking refuge in the Federal courts recently.

Now statutes of that kind prevailed everywhere. In my home State, and I call Mississippi my home State because that is where I began the practice of law, they had a provision in the constitution that no railroads could operate in the State unless they were incorporated in the State of Mississippi. So it was throughout the country at that time. It became necessary for the railroads to form these subsidiary corporations.

Furthermore, there are activities which are really transportation activities that sometimes require the organization of subsidiaries by reason of the restrictions upon the charter of the original railroad company. I worked for a long time, most of my active life really, for the Illinois Central Railroad when I was one of their counsel in Chicago. They had a very restricted charter. They were not allowed to operate except in the particular region described in the charter, nor were they allowed to engage in any activities except those that were directly connected with transportation. They had to have subsidiary corporations of various kinds. One of them was a subsidiary corporation that owned a coal mine to furnish coal to the railroad—necessary fuel for transportation.

Now equitably—and I do not use the word "equitably" in the sense that a lawyer would use it but in a popular sense—these parent corporations and the subsidiary corporations represent but a single enterprise and therefore it is fair and just that they should be allowed to make a consolidated return, but to do so they are penalized 2 percent.

So many of the railroads find themselves in a situation where it is desirable to make a consolidated return that I say in the case of a great many railroads instead of 41 percent being the rate, it will be 43 percent. Of course the situation would be benefited somewhat if you would take off the penalty for making consolidated returns. At one time corporations were not allowed to make consolidated returns. It was largely I think at the instance of the railroads that they were permitted to do so upon a representation such as I have tried to make here as to the necessity for organizing the subsidiaries, but the 2 percent penalty worked quite a hardship and will increase that rate to a very great extent.

I do not think, Mr. Chairman, that I would be justified in discussing this matter at too great length. I dare say that industry will generally present their views more persuasively than I can hope to do on the matter of increasing the tax on corporations from a maximum of 38 to a maximum of 41 percent.

By the way, very few railroads, if they have any revenue at all, will fall below the $167,000 deadline. I think very few.

I do not suppose, Mr. Chairman, it will be quite in order for me to make a speech here on the subject of the injustice of taxing twice the poor, unhappy fellow who owns stock in a corporation, once by taxing the profits of the corporation and the second time when he receives his scanty dividends. That I think is the most indefensible taxing policy I can conceive of. I do not intend to go into that but that will be taken care of elsewhere if it is pertinent at all at this time.

I want to mention another matter which this bill has to do with, which we think is a very great hardship upon the railroads. You know this bill that comes from the House provides that business gains and losses shall be considered only as capital gains and losses and not ordinary gains and losses.

I hope you understand that I am not a professional tax lawyer. My knowledge of taxation is not as complete as I would like it to be, but as the law stands now, as I understand it, losses and gains that result from the sale, exchange, and abandonment of property may at the option of the taxpayer be considered either as ordinary gains and losses chargeable to taxable income or may at the option of the taxpayer be considered capital gains and losses and subject only to a tax which is one-half of the ordinary income tax rate.

Senator CONNALLY. Within certain periods.

Mr. FLETCHER. Within certain periods.

Now the House bill provides that all of these losses and gains having to do with the sale or exchange or abandonment of property shall be treated as capital gains or losses. If I am not mistaken, this matter of abandonment of property was placed in that category for the first time in the House bill. But the Secretary pointed out, and I can see force in his statement, that this was what somebody called a one-way street. Here was a man who had sold his property at a tremendous profit and he would much prefer to have it considered as a capital gain so that he would have to pay only half as much income tax on it as he otherwise would if it were considered an ordinary gain. There was another man who had sold property at a loss. Instead of having it considered as a capital loss, he would elect to have it considered as an ordinary loss and it gave to the taxpayer, the Secretary thought, an unfair advantage.

He pointed out that this could be remedied in two ways and one of the ways he suggested was that they should consider all of these gains and losses resulting from the sale or abandonment or exchange of property as ordinary gains and losses, as it stood before the year 1942. I would have no objection from the viewpoint of an advocate of the railroad cause to having it done that way. It seems to me that might be perfectly fair, and that is the way it was done, Mr. Chairman, prior to 1942.

But in 1942 the Congress was convinced that by reason of the great inflation in values, sometimes when sales were made it was unfair to add the whole amount of profit to ordinary taxable income.

Senator CONNALLY. Under that law at that time suppose a man had property that he had had for 20 years and then he sold it at a big profit, would all of the profit go in or would it be prorated among the years?

Mr. FLETCHER. I think it all went in.

As I say, I am not the tax lawyer that I ought to be.

Senator KERR. It comes in for taxation purposes during the year in which the sale was made.

Mr. FLETCHER. Yes, sir.

Now in the case of railroads, this change in law——

Senator KERR. You are talking about if 209 (d) were taken out?

Mr. FLETCHER. That is right. Either leave it as it is now, which would not please the Secretary, or put it back to where it was in 1942 which would please the Secretary. Either one of these solutions would please the railroads.

As the matter stands now, the railroads are a hundred years old. I admit they have a good deal of obsolete property; possibly a little more accurate term would be to say obsolescent property, but they need to have it replaced by other property and therefore much of it has to be disposed of.

Senator Taft, when he was here a moment ago, mentioned the fact that a great many trains had been taken off in his home State of Ohio. I suspect that might lead to a discontinuance of passenger stations, possibly in some cases freight depots. Some of those things need to be sold and disposed of.

In the matter of equipment the crying need of the railroads is to have modern passenger cars and modern freight cars as well. They are buying now a great many new freight cars of better construction and leading, we hope, to much improvement in the matter of loss and damage to freight in shipment. But under this law of course these losses could not be taken into account in determining taxable income; they could only be matched against capital gains.

We do not have any capital gains in the railroads. The railroads are not in the business of buying and selling property. There are no capital gains of any consequence to absorb these losses and therefore the railroads are deprived of the privilege which is allowed under the present law of deducting these losses from taxable income. That becomes, it seems to me, a very serious matter. I hope the committee will give consideration to putting the law back to where it was in 1942 or else leaving it as it is now.

One reason why I mention this is because the railroads are much disturbed at the present time by the insufficient depreciation charges which they are permitted to deduct. That grows out of the fact that the depreciation charges of course are based upon the service life of a piece of property which was purchased in the prewar days at a very low price. The theory of depreciation is that you ought to accumulate in your depreciation reserve enough money to replace the property that is disappearing.

Think of this. You have depreciation now on a freight car that cost $2,000 prewartime which will cost you now $5,000. Why we have some figures here that show in the years 1945 to 1949, a 5-year period, the railroads expended on an average about $1,000,000,000 a year for improvements, additions, and betterments. As a matter of fact, however, their depreciation charges were only, I think, $394,000.

There needs to be some reform in that respect. The railroads have suggested to the Congress that it might be a good idea to allow them to accelerate their depreciation in view of the fact that the present depreciation charges are so inadequate to meet the cost of replacements. We have the suggestion presented to the Congress that that could be done by allowing the railroads, for example to take one-half of the amount which they expended in the year prior to the amendment for new equipment or new facilities of any kind and depreciate that one-half at the rate of 20 percent annually; in other words, wipe it out in 5 years, letting the other half go according to normal rates.

Another suggestion, which always appealed to me as having merit, is along this line: That if the railroads set aside in a special reserve fund a certain amount for the purchase of new equipment or acquiring of new highway facilities, roadway facilities, that they should be permitted to deduct the amount so set aside to the extent of 25 percent of the taxable income in a reserve fund which could be deducted from taxable income with the provision, however, that if they did not spend it within 3 years for the purposes stated, namely purchase of new facilities, it should then be taxed at current rates, and with the further provision that the assets of the company should be reduced by the amount they set aside and use for that purpose. I will not elaborate on this because it is elaborated in my manuscript.

Instead of that the House comes along and makes this change here in the method of treating losses and gain which is just the reverse of the suggestions made by the railroads.

Senator KERR. What is the usual period of time for depreciating a new investment?

Mr. FLETCHER. I depends on the character. Equipment assumes generally a life of 20 to 25 years.

Senator KERR. That is with reference to cars and rolling stock.

Mr. FLETCHER. The building would be quite different.

Senator KERR. What if it were fixed so that with respect to investment in new inventory, whether rolling stock, buildings, or roadbed, the rate of depreciation could be accelerated?

Mr. FLETCHER. That is what I was trying to explain. In an effort to be as brief as possible I tried to explain that the theory was that one-half of the amount so expended in new equipment, for the purchase of new facilities of any sort, might be depreciated at the rate of 20 percent, wipe out one-half of the investment in 5 years. They allowed us to do that during the war to a certain extent, you will remember.

Now, Mr. Chairman, there is another thing which I think I can mention very, very briefly. This idea of making the taxpayer pay 6 percent on deficiencies and letting the Government pay 3 percent on overpayments is a thing which was condemned by the Secretary yesterday.

Senator CONNALLY. He agreed that they ought to be the same.

Mr. FLETCHER. He thought they ought to be the same.

The CHAIRMAN. I think the Secretary of the Treasury abandoned that theory in the bill yesterday.

Mr. FLETCHER. I do not know if he ever was responsible for it.

The CHAIRMAN. I do not think so.

Mr. FLETCHER. I do not know whether the word "abandon" is quite correct. I am not quarrelling with the chairman.

The CHAIRMAN. At least he did not sponsor it.

Mr. FLETCHER. In my manuscript we point out some instances which become fantastic.

The CHAIRMAN. I think maybe you might regard that as out. We will have a uniform rate on the assessment of deficiencies as well as refunds, whatever the rate is.

Mr. FLETCHER. Now, Mr. Chairman, I wish it were possible for this committee to take care of a situation which is quite important. Section 22 (b) (9) permits corporations—and that has a bearing on the question asked by the Senator here—to buy in securities at a discount.

The CHAIRMAN. Those sections expire in December.

Mr. FLETCHER. Yes, they do.

The CHAIRMAN. We may be able to deal with that.

Mr. FLETCHER. I hope you will make it permanent, in other words.

The CHAIRMAN. At least I think we will be able to extend it. It ought to be extended I think, if not permanently, at least for a longer period that 1 year or 2, because you probably are going to need that again, are you not?

Mr. FLETCHER. We are going to need it all the time.

Senator CONNALLY. I think it is a good policy to adopt.

Mr. FLETCHER. Mr. Chairman, I hope you will be able to correct this matter of discriminatory interest rates on deficiencies and so forth and that we may be able to get these two measures, one of them having to do with the thing I just mentioned and the other having to do with the reorganizations.

The CHAIRMAN. Yes, sections 22 (b) (9) and (10).

Mr. FLETCHER. That completes my statement.

The CHAIRMAN. Thank you, Judge.

Mr. FLETCHER. Thank you for your patience.

The CHAIRMAN. We have three additional witnesses for today. If those witnesses wish to come back, we will recess until 2:30 this afternoon.

(Whereupon, at 12:55 p. m. the committee recessed to reconvene at 2:30 p. m. of the same day.)

AFTERNOON SESSION

The committee reconvened at 2:30 p. m., upon the expiration of the recess.

The CHAIRMAN. We will have to commence the afternoon session of our hearings without delay. I hope some of the other members of the committee will be able to get back, but it is very difficult in these afternoon sessions.

Mr. Kitchen? You may have a seat, sir. You are appearing for the United Fresh Fruit and Vegetable Association?

STATEMENT OF C. W. KITCHEN, EXECUTIVE VICE PRESIDENT, UNITED FRESH FRUIT AND VEGETABLE ASSOCIATION, WASHINGTON 9, D. C.

Mr. KITCHEN. That is right.

The CHAIRMAN. Just have a seat. We are very glad to have you. Of course, your statement will be in the record, and the other members of the committee will be able to read it. In the meantime, possibly some of the others will be in.

Mr. KITCHEN. May I proceed and read the statement? Perhaps that would be best, in the interests of time.

The CHAIRMAN. Yes.

Mr. KITCHEN. Mr. Chairman and members of the committee:

My name is C. W. Kitchen, and I am executive vice president of the United Fresh Fruit and Vegetable Association. This is a national trade association with more than 2,000 members residing in all of the States, and who are engaged in growing, packing, shipping, and distributing fresh fruits and vegetables.

My statement is limited to one phase of the bill you are considering. We respectfully request that the wartime excise taxes imposed on communications and transportation be repealed. We appreciate and are grateful for the reductions in these items approved by the House of Representatives. In our opinion, however, these taxes are especially burdensome, and to some extent discriminatory, on the fresh fruit and vegetable industry. They are in effect an added cost upon foods which comprise roughly about one-third of the American diet.

In 1949 this industry shipped 837,592 carloads by rail. It is estimated that an equivalent quantity was moved by motortruck and water carriers.

Fresh fruits and vegetables are highly perishable. Except in a few instances the Government has not supported farm prices for these commodities. Their distribution and merchandising requires fast transportation, much of it with additional charges for refrigeration, and fast communication. Most of these commodities must be sent to market when they are harvested. They must be sold for whatever price they will bring in the market.

In selling perishable commodities of this kind, the mail is too slow. Shipments are made from the west coast to the east coast and from Florida and Texas to Canada. Business must be transacted by telephone and telegraph. Such facilities are not luxuries in this business.

A spot check was made of 70 of our shipper members, located in various parts of the country. This check revealed that in 1949 they paid a total of $356,280.79 for telephone and telegraph service. The tax on this business amounted to $74,160.90. The tax, being on a percentage basis, weighs more heavily on producers and shippers farthest from their markets. These taxes add to the cost of food. They must be borne by the producer, the distributor or the consumer.

The tax on transportation of property (reduced by the House from 3 percent to 1½ percent) was imposed as a war revenue measure. This tax, being on a percentage basis, also discriminates against the producer and shipper located farthest from the principal consuming centers. Freight rates and charges on fresh fruits and vegetables have been increased about 50 percent since 1946. This excise tax, therefore, has cost much more since the war than during the war. The transportation tax on freight adds to the cost of these foods. We believe this tax should be removed on food if it is not possible to repeal it on the transportation of all property.

We request also the repeal, or at least a further reduction, of the tax on transportation of persons. This tax was imposed, we understand, in part to discourage civilian travel during the war. This tax now tends to curtail travel by rail at a time when the railroads are

suffering from staggering deficits in the operation of passenger services. During 1949 the class I railroads reported a loss of $649,262,265 in their passenger service operations which is the highest loss reported in their history. The fresh fruit and vegetable industry is concerned with these deficits because they must be absorbed from freight revenues. It may be of interest to note that the last major freight rate increase granted in 1948 was designed to produce additional rail revenue in an amount nearly equal to the loss in passenger services.

I have made a very brief statement, Mr. Chairman, merely to bring before you the importance to this industry, handling these perishable commodities, of the two taxes on transportation and communications. They weigh very heavily upon us.

We feel if there is any way of accomplishing it, they should be repealed.

Senator MILLIKIN. You spend a lot of money in telegrams, do you not?

Mr. KITCHEN. As pointed out, Senator, these are perishable commodities, and they must be sold when they are ready, and telephone and telegraph are about the only possible means of communication. The cost runs very high, as you know.

The CHAIRMAN. Well, Mr. Kitchen, we appreciate very much your appearance here.

Mr. KITCHEN. Thank you.

The CHAIRMAN. Miss Kathryn Casey? Is Miss Casey present?

Mr. Marcosson, certified public accountant?

If there is no one here speaking for either, their statements may be inserted in lieu of their appearance.

(The statements are as follows:)

STATEMENT OF KATHRYN CASEY, ASSISTANT SECRETARY AND GENERAL COUNSEL INTERNATIONAL APPLE ASSOCIATION

This statement is filed by me as assistant secretary and general counsel of the International Apple Association on behalf of the more than 1,400 members of the association who bear the burden of the communication and transportation tax.

The International Apple Association is a nonprofit membership organization of growers, shippers, and distributors, having its principal offices in Rochester, N. Y. Through its membership located in all the important producing and distributing markets in the United States, it represents approximately 90 percent of the major commercial apple and pear growers and shipper organizations, individual shippers and farmers, cooperatives, wholesale dealers, distributors and exporters and importers. While it is primarily an organization of apple and pear growers and distributors, it also numbers, among its members, producers and shippers of other fruits and vegetables with an overlapping interest. Through its membership in 25 foreign countries, including Canada, the United Kingdom, Continental Europe, South America, and South Africa, it is international in scope and is representative of the foreign apple and pear industries as well as those of the United States. It is now in its fifty-seventh year and is one of the oldest horticultural trade associations in the United States.

Fruits and vegetables, in spite of the advances made by science in overcoming climatic disadvantages, must be grown where they will thrive and it is not possible artifically completely to remedy soil conditions so as to enable plants to grow in all areas. For that reason, it is an economic necessity, since 60 percent of the consumers are located in the Northeastern States—that is north of the James River and east of the Mississippi River—to transport these commodities to the consumer and the factor of transportation is paramount. The average rail haul on perishable commodities is in excess of 1,400 miles and, because of the temperature range during both winter and summer, requires specialized equipment.

Fruits and vegetables have nothing but a potential value to the producer until they are shipped to market to the consumer who will eventually use them. The

very efficiency of our transportation system has to a degree necessitated the use of the telephone and telegraph in order to profitably market perishable commodities. Because of their perishability and the uncertainty as to overlapping of harvest dates, it is frequently necessary to divert cars after they have started for their destination. In order to do this economically, it is essential that diversion be made at the first and best possible point. This cannot be accomplished by anything other than the use of the telephone and the telegraph.

The total annual volume of perishable commodities marketed in the United States is estimated by the United States Department of Agriculture at approximately 2,000,000 railway carloads (or carlot equivalent). This is approximately 35,000,000 tons. It is estimated that perishable commodities pay between 5 and 6 percent of the total of all freight paid in the United States. This is due in part to the fact that these commodities have a higher than average line haul and also because these commodities require protective services for which there is an additional transportation charge. Based on figures of the Treasury Department, the total excise taxes on transportation of property in 1949 has been estimated as not less than $316,000,000. On this basis the perishable fruit and vegetable industry is paying close to $19,000,000 per year in taxes or approximately $9.48 per car.

Again, according to the United States Treasury Department, estimates of the excise tax collected on communications for the year 1949 are placed at approximately $255,000,000. Assuming that the perishable industry used wire communication only to the same degree that other commodities do, on the basis of 35,000,000 tons, valued at retail at approximately $9,000,000,000, this would indicate that the minimum communication tax on that volume of perishable commodities was approximately $8,000,000. However, it is well known that the perishable industry uses telephone and telegraph communication to a greater extent, of necessity, than any other commodity. However, using the figure $8,000,000 amounts to $2 per car. The total of both the transportation and communication tax therefore, amounts to approximately $9.50 per car.

We regard these taxes—the transportation tax as well as the communication tax—as a tax on doing business since the nature of the perishable commodity industry requires extensive use of the telephone and telegraph as a normal method of transacting business. In addition, as pointed out, it is impossible to change the producing area in order to take advantage of a lesser line haul to the consuming market. Therefore, these two taxes combined result in a total of approximately $27,000,000 of working capital being eliminated from the perishable commodity industry. Other industries so not feel the burden of these taxes of the extent that the perishable commodity industry does since the need for rapid communication is not as essential for other industries as it is in our own. Again, other industries can cushion increased freight rates and transportation taxes by moving closer to the consuming area. This the perishable commodity is unable to do.

The excise taxes on transportation and communication were enacted originally as a means to discourage the use of transportation and communication facilities during the emergency war period. The purpose for which they were enacted has long since disappeared and at the present time they represent a tax which is increasing the cost of living as far as perishable commodities are concerned.

Accordingly, I wish to urge on the Senate Finance Committee that every consideration be given to eliminating entirely these taxes which in relation to the fruit and vegetable industry are discriminatory and burdensome and which also adversely affect the consumer by directly increasing the cost of the commodity.

STATEMENT OF MARK MARCOSSON, C. P. A., NEW YORK, N. Y.

I am a certified public accountant and tax specialist, with considerable experience in the fur and jewelry industries. In the course of that experience, my attention has been directed several times to the interpretation placed on section 2405 of the Internal Code by the Bureau of Internal Revenue.

This section relates to the tax treatment on installment and conditional sales for purposes of the retailers' excise tax, where title is retained by the vendor as a security device and payment is made in installments. When the retailers' excise taxes were first enacted in 1941, it was provided that if a sales contract were made, delivery took place and a part of the consideration were paid before the effective date of the tax, no tax would attach to the payments made after the effective date, although title had not passed. Please note that all three con-

ditions had to be met if an installment sale were thus to escape the tax as completed prior to the effective date.

In the fur industry and to a lesser extent in the jewelry industry, there is a type of transaction that is sometimes called a deposit or lay-away sale, although in truth it is not a sale at all. A customer will select an article, give a deposit so that the retailer will put the article aside for him, and complete the sale by taking delivery and making payment at a later date.

It has never been supposed that such sales were installment sales, unless at the time of the making of the deposit, there was a definite arrangement for installment payments. In most cases there are no such arrangements, and the customer, on completing the sale, pays the entire balance in cash. In such cases no retailer would consider the sale complete until delivery had been made.

But the Bureau of Internal Revenue has ruled that all of such sales are installment sales, and that the tax at the rate in effect at the time the deposit is paid applies to all future payments, regardless of their number or date.

This ruling has been a severe handicap to the fur trade in particular during the past season when so much publicity was given to the prospect of a reduction in the tax rate. Some retailers, in reliance upon the Bureau's ruling, refused to accept deposits from customers for future delivery without specifying that all future payments on such sales would be taxable at the 20 percent rate, although some offered to themselves refund any tax reduction enacted before a specified date. (Such offer was likewise of dubious legality.) Others, either in ignorance or defiance, have advertised that customers making such deposits would pay tax at the rate in effect at the time of delivery.

The House Ways and Means Committee has attempted to clear up this situation by providing in section 105 of the bill as reported that "an article shall be considered as sold prior to such first day if the right of possession thereto passed to the purchaser before such day."

I would recommend that this committee consider seriously whether or not this provision is genuinely satisfactory. It introduces a new concept, "the right of possession."

This is not a phrase that has been used before in fixing tax effects, and its meaning may be subjected to varying interpretations. In the case of a sale on open account, for example, it may well be claimed that the true tax date is the date of an order and not the date of delivery.

The Bureau of Internal Revenue, which is under heavy pressure to protect the revenue, will understandably interpret this provision in the manner calculated to produce the most revenue, and will place that interpretation on the section which will result in the earliest possible "right of possession." This is not meant as a criticism of the Bureau.

If, as seems likely, actual enactment of the new revenue act is delayed past July 21, 1950, the effective date of the reductions will be September 1, 1950, and the possibility of a strict interpretation of "the right of possession" may therefore again make it difficult or impossible for retailers to accept deposits during the month of August, a most important month to retail furriers.

It seems to me that two alternatives to the "right of possession" rule exist, either of which would be preferable. The first is to make the tax take effect on delivery, actual or constructive. Deilivery as a concept is one with which both taxpayers and the Bureau of Internal Revenue are thoroughly familiar. It should eliminate all doubt as to what is intended.

The second possibility is to amend the definition of installment sale contained in section 2405 of the Internal Revenue Code to make it plain that it shall not apply to any sale in which full payment is made in less than three installments, or some similar criterion. The purpose would be to eliminate from classification as installment sales those which are universally not considered by businessmen to be such, and to place such other sales under the ordinary rule now in effect that the tax attaches at the time of passage of title.

This does not seem to be a very important matter at this time when so many grave affairs affecting the welfare and existence of the Nation are under consideration. Yet the smooth and effective administration of the tax laws is indeed important, and anything that will contribute to the elimination of unnecessary friction between the payers and the collectors of taxes is not without desirability.

The CHAIRMAN. You may come forward, Mr. Green, and we will be glad to hear from you now. Just have a seat and give the committee your full name and state for whom you are appearing.

STATEMENT OF JULIUS GREEN, NEW YORK, N. Y., CHAIRMAN, NATIONAL FUR TAX COMMITTEE

Mr. GREEN. My name is Julius Green. I reside at 450 West End Avenue, New York City. I am the chairman of the National Fur Tax Committee, taking in the following organizations: Associated Fur Manufacturers, Inc., Fur Garment Traveling Salesmen Association, American Fur Merchants, Fur Brokers Association of America, Fur Dressers and Fur Dyers Association, Inc., Fur Dressers Guild, Inc., Master Furriers Guild of Greater New York, Southwestern Furs, Inc., Fur Wholesalers Association, Inc., Association of Southern Furriers and Trappers, Fur Trimming Salesmen's Association, Inc.

The CHAIRMAN. Are you yourself a manufacturer, Mr. Green?

Mr. GREEN. I am a manufacturer, sir.

The CHAIRMAN. But you are speaking for all these industries?

Mr. GREEN. I am speaking for all these industries. I am, as I said, their national chairman.

The CHAIRMAN. Yes, sir.

Mr. GREEN. I appeared before the Ways and Means Committee, and I presented a brief there with all the details. I would not like to trespass upon your valuable time. I would just like to say to you that conditions have progressively worsened since February in our industry. Idleness is widespread, and there is almost a complete standstill in the industry. There seems to be a buyers' strike in full measure. The consumers have got wind that there is going to be tax relief or elimination, and they are all waiting.

In the meantime the fur industry is suffering more than any other of the 27 industries.

Ours is an industry made up of small-business men, trappers, farmers, breeders, dressers, dyers, and all these various small traders. It is an undercapitalized industry. And the prevailing condition is so hard that most of them have lost, if not their entire capital, the greatest part of their capital.

Unless we get some relief immediately, I don t know what is going to happen.

We have today a situation where at least half of the workers are on the streets and on unemployment relief. The manufacturers are praying that by the August sales, which is our traditional opening of the season, we can get relief.

The CHAIRMAN. When is the opening of the season, Mr. Green?

Mr. GREEN. August 1. That is the traditional opening of the season. If the opening sales can't proclaim tax relief, the entire structure will just topple over.

I just took along a few figures. Of course, all these figures are available to me. I just jotted them down on a slip of paper, here.

For instance, in January 1949 the tax collections were $9,473,000. In 1950 they were $7,544,000. In February 1949 they were $9,826,000, and in the same month in 1950 they were $6,792,000. In March of 1949 they were $6,173,000, and in March 1950 they were $4,504,000, In April 1949 they were $3,564,000, and in the same month in 1950 they were $2,779,000. In May of 1949 they were $2,791,000, and in May this year they were $2,469,000.

These sales were not legitimate sales. They were distressed sales, so to say. While the Government got the 20 percent, the manufacturer gave his merchandise 60 or 70 cents on the dollar.

The CHAIRMAN. The manufacturer reduced his prices.

Mr. GREEN. That is right. Now, I can reread the statement that I submitted to the Ways and Means Committee, if you would like. That is what most of the gentlemen did today, because really, so far as the basic condition is concerned, it is the same, with the exception that it has worsened insofar as the collections are concerned, and the labor situation is very bad.

The CHAIRMAN. Well, we will have available, of course, your statement as made before the Ways and Means Committee.

Mr. GREEN. I have one statement here which I would be glad to let you have. Or if you want me to read some parts of it, I would be very glad to do so.

Senator MILLIKIN. Mr. Chairman, I believe the committee is very well informed on the distress of the fur business.

The CHAIRMAN. Yes; I think so. It has been before us in one way or the other now for a year and a half.

Mr. GREEN. Mr. Chairman, we were the first ones to feel the pinch of the excise taxes.

The CHAIRMAN. You were; yes.

Mr. GREEN. We have continued to be oppressed all along. We are doubly discriminated against, because a woman can go in and buy a cloth coat trimmed lavishly with fine furs, minks or sables, and pay as high as a thousand dollars, and that is tax-free; and on the other hand if she were to go out and buy a mouton lamb or a coney coat, or rabbit, or any of the cheaper furs, which are anywhere from $49.50 up, she has to pay 20 percent. A girl will not, you know, buy a coat for $50 and pay $10 for no value received, regardless of how patriotic she is. That is why our industry has suffered more than any of the others.

The CHAIRMAN. You think the House bill that only cuts your rate in half would be helpful?

Mr. GREEN. Mr. Chairman and gentlemen, I would say we would be very happy to accept the House bill as reported out, in order to get some relief immediately; or else we won't be here when the relief will come. There is no use in kidding ourselves. We have to have the relief as quickly as possible, or else the operation will be successful but the patient will be dead.

The CHAIRMAN. Thank you very much, Mr. Green.

Mr. GREEN. Thank you, Mr. Chairman.

The CHAIRMAN. Have either of the other witnesses reported?

Miss CASEY. Mr. Marcosson?

Is there any other witness who would like to make a statement now, whether scheduled today or later in the week?

If so, we would be very glad to have you.

If not, we will recess until tomorrow morning at 10 o'clock.

(Whereupon, at 2:55 p. m., the committee recessed to reconvene Friday, July 7, 1950, at 10 a. m.)

REVENUE REVISIONS OF 1950

FRIDAY, JULY 7, 1950

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D. C.

The committee met, pursuant to recess, at 10 a. m., in room 312, Senate Office Building, Senator Walter F. George (chairman) presiding.

Present: Senators George, Connally, Byrd, Johnson, Hoey, Kerr, Myers, Millikin, Taft, and Butler.

Also present: Mrs. Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will please come to order.

For the record I offer a statement by Mr. Clinton M. Hester of Washington, D. C., which he is submitting in lieu of personal appearance. Mr. Hester is interested in the reduction or the elimination of the $1 wartime emergency excise tax on beer.

(The letter referred to is as follows:)

WASHINGTON 5, D. C., *July 6, 1950.*

Hon. WALTER GEORGE,
Chairman, Senate Finance Committee,
United States Senate, Washington, D. C.

DEAR MR. CHAIRMAN: In response to our request for an opportunity to appear at the hearings to be held by your committee on the tax bill and testify for the repeal of the $1 wartime emergency excise tax on beer, we are in receipt of a wire from Elizabeth B. Springer, clerk of your committee, advising that the committee has adopted a policy not to hear witnesses who appeared before the House Ways and Means Committee on the tax bill unless the witness has new material to offer to the committee in which event the testimony of the witness will be limited to 5 minutes.

We are pleased to have your assurance that our testimony before the House Ways and Means Committee will be studied by the Senate Finance Committee. Under the circumstances, we shall be only too glad to defer to the wishes of the committee and waive our right to submit additional testimony. We should like to take this opportunity, however, to point out several reasons why we believe that the $1 wartime emergency excise tax on beer should be the first to be reduced by the Congress, and we shall be grateful if you will be so kind as to incorporate this letter in the record of your hearings.

Our case briefly is that the law of diminishing returns is now applicable in the excise taxation of beer and accordingly that the Government would receive more in revenue if the wartime $1 emergency excise tax were repealed than it is now receiving; and that repeal of the $1 tax would benefit the low-income or workingman group to the extent of approximately $15 per family per year; that is, would mean a savings to each family of that amount.

Certainly the workingman who consumes beer as one of the most important foods in his daily life should be entitled to first consideration in the reduction of excise taxes. Beer, to him as food, is of much greater importance than furs, jewelry, cosmetics, luggage, transportation, long-distance telephone and telegraph, which he uses rarely, if at all. Please do not misunderstand us. We favor and urge the repeal of all wartime excise taxes, but in your consideration of this subject matter, we believe that the workingman in the low-income groups should be the first to be entitled to relief in excise taxes.

As you know, we are Washington counsel for the United States Brewers Foundation. This is the second oldest trade association in the United States. It was established in 1862 and except for slight change of name has been in continuous existence since that date. Its members manufacture over 80 percent of the beer produced in the United States.

Respectfully yours,

CLINTON M. HESTER.

The CHAIRMAN. The committee on taxation, Automobile Manufacturers Association offers a letter with reference to the Federal excise taxes on motor vehicles and related automotive excises in lieu of a personal appearance before the committee.

(The letter referred to follows:)

COMMITTEE ON TAXATION,
AUTOMOBILE MANUFACTURERS ASSOCIATION,
Washington 6, D. C., June 30, 1950.

Senator WALTER F. GEORGE,
Chairman, Finance Committee,
United States Senate, Washington 25, D. C.

DEAR SENATOR GEORGE: In the interest of 44,000,000 users of our products, as well as that of our industry, and with the wish to be helpful to your committee in its current difficult task, may we bring to your attention the facts concerning a heavy and discriminatory burden of taxation now borne by a large segment of our people—many of them in the low income group—and a situation which, if not corrected, will in time have an important bearing upon our economy.

The Federal excise taxes on motor vehicles, and related automotive excises, were, as you know, first imposed on a "temporary" basis in 1932, to help pay the costs of the unemployment emergency. They were increased slightly in 1940. Then they were raised to their present level in 1941, specifically to discourage the production, purchase, and use of automotive vehicles.

We asked the House Ways and Means Committee on behalf of our customers to put an end to these "temporary" and "wartime" taxes. We showed, in the attached brief, that the many excise taxes levied by the Federal Government against the car owner and truck operator met perfectly President Truman's stated criteria for relief: They are still at wartime levels, they threaten to depress business, they burden consumption, they fall with particular weight on low-income groups, and they add to the cost of living by increasing business costs.

We felt we demonstrated fully the need and the justice of repealing the consumer-paid Federal taxes on cars, trucks, busses, tires, tubes, parts, accessories, and gasoline and oil. We showed that the taxes ultimately would reduce sales and employment and thus reduce the tax revenue of the Federal Government. But the only relief granted motor-vehicle owners by the House tax bill (H. R. 8920) would reduce the rates 25 percent on parts, accessories, tires, and tubes, and exempt rebuilt parts. What the bill proposes is actually something less than 5 percent of what we feel is a long overdue correction of an inequitable and discriminatory tax.

Not only was the need for reduction in the automotive excise taxes almost completely ignored, but the bill, through its increase in the income tax of corporations, would increase the already heavy burden of taxes borne by the public.

We were glad to observe that the House Ways and Means Committee recognized the need to reduce the Federal taxes on transportation and communication, but we find it difficult to understand why similar relief was not extended to the many millions of people to whom the privately owned automobile and truck is the major and often the sole form of necessary transportation.

We hope that when your committee reviews the House bill, the committee will give full consideration to the merits of the unquestionably strong case against the automotive excises. For that purpose, we ask that this letter and the attached brief be made a part of the committee record.

Sincerely yours,

A. E. BARIT,
Chairman, Committee on Taxation.

The CHAIRMAN. Also, I offer a statement submitted by the Department of the Navy relating to sections 143 and 144 of the tax bill with respect to amusements in military establishments.

(The letter referred to follows:)

THE SECRETARY OF THE NAVY,
Washington, July 5, 1950.

Hon. WALTER F. GEORGE,
Chairman of the Committee on Finance,
United States Senate.

DEAR MR. CHAIRMAN: With reference to the bill H. R. 8920, to reduce excise taxes, and for other purposes, the Department of the Navy, on behalf of the Department of Defense, desires to submit a report opposing enactment of section 143 and section 144 thereof insofar as they would impose Federal occupational taxes on the authorized morale, welfare, and recreational outlet activities of the Armed Forces.

The taxes proposed to be extended by these sections of the bill to these Federal activities are those now imposed on retail dealers in liquors, or malt liquors, and on operators of coin-operated amusement devices, and, whenever any charge whatsoever is made, on bowling alleys, billiard and pool tables, as provided by sections 3250 (b), 3250 (e), 3267, and 3268, chapter 27, of the Internal Revenue Code.

The impact of such taxes would be so harmful to the continued operation of these Federal activities that the Armed Forces desire to make known their unified position in opposition to this extension.

The Congress, as a part of its duty in the maintenance of the Armed Forces, has seen fit to provide over the years funds to be used in purchase of equipment for morale, welfare, and recreational outlets for the personnel. Further, the President has considered the welfare and morale of the armed services to be of such importance that he issued Executive Order No. 10013, dated October 27, 1948, which is quoted in part as follows:

"It is hereby declared to be the policy of the Government to encourage and promote the religious, moral, and recreational welfare and character guidance of persons in the Armed Forces and thereby to enhance the military repparedness and security of the Nation."

Welfare, morale, and recreational programs for the Armed Forces are necessary and essential as inducements to enlistments; to build better military character and, hence, better citizens; to promote the general physical, mental, and moral well-being; to compensate for overseas duty, duty at isolated stations, and for numerous temporary duty periods away from home; to compensate for separation from families; to compensate, in a degree, for the differences in rates of military and civilian pay; and, in general, to provide the essentials of all phases of welfare and recreation which would otherwise be denied to personnel of the armed services.

Since the armed services exchange regulations have been placed into effect, there has been a marked decrease in the profits from exchanges which, in turn, has resulted in less nonappropriated funds for morale, welfare, and recreational purposes. Nonappropriated funds available and currently being generated are not sufficient to furnish all the facilities required for essential welfare and recreation, and, to such extent, must be supplemented by appropriated funds.

The Armed Forces did agree, as a matter of policy, to pay the Federal retailers' excise tax, which tax is measured by a unit of sale. It has further been agreed, by way of policy, to pay the special excise tax imposed on the operation of the so-called slot machines. It is not considered desirable, however, that instrumentalities of the Armed Forces pay an occupational tax for the privilege of providing morale and recreational outlets necessary to the general welfare of the services.

In connection with the payment of excise taxes measured by units of sale, it was argued by the proponents of imposition of the Federal retailer's excise tax that the selling of commodities tax-free to personnel of the Armed Forces was unfair to private business interests. This argument does not and cannot apply to the authorized operations of instrumentalities of the United States to furnish controlled and regulated morale and recreational outlets for the betterment of discipline and general welfare of service personnel.

There is a distinct difference between the imposition of excise taxes imposed on sales of commodities, and measured by units of sale, and the imposition of occupational taxes on military organizations engaged in responsible duties of providing morale, welfare, and recreational outlets for personnel of the military establishments.

Excise taxes measured by a unit of sale can be passed to the purchaser in the exact amount of the tax imposed, and, furthermore, no tax liability occurs until a sale actually takes place; therefore, if no sales are made, no tax liability occurs

and no funds of any type are burdened with the payment of taxes. The occupational taxes, now proposed to be imposed on instrumentalities of the United States, would place a direct drain on funds of the Armed Forces. Messrooms and clubrooms for personnel of the Armed Forces are maintained to have readily available entertainment, morale, welfare, social, and recreational outlets for personnel of the Armed Forces who, by military and naval law, are in a duty status 24 hours a day. It would be the common occurrence, rather than the exception, that if such entertainment and recreational outlets were not made available by the Armed Forces, there would be no adequate location available for promotion of general good will and comradeship among the members of the Armed Forces. The lack of controlled and regulated locations for entertainment would immediately react to the detriment of the general welfare and discipline of the Armed Forces.

The equipment of the club and mess rooms includes pool tables, bowling alleys, billiard tables, coin-operated games of skill and coin-operated musical instruments, soft-drink and beer bars for dispensing of refreshments, all of which is either Government-owned equipment or owned by Government instrumentalities operated without profit on a nonrevenue raising basis. There have been some exceptions where a small fee has been charged for the use of equipment, but the basis of the fee was not for revenue but for the purpose of generating sufficient funds to keep the equipment and facilities in good repair and in a continuous, usable condition.

The operations of the clubs and messes are primarily nonrevenue producing. The payment of the Federal occupational tax, as a condition precedent to the privilege of engaging in authorized activities for the promotion of good discipline and general welfare of the personnel of the Armed Forces, would, therefore, be a burden on the nonappropriated welfare and recreation funds, or else a substantial charge would have to be made to continue the equipment in operation. Any further drain in welfare and recreation funds might force a discontinuance of various welfare and recreational facilities. A high service charge for use of such facilities would probably result in failure of many service personnel to use these facilities. It is probable that the closing of welfare and recreational facilities, or the imposition of a service charge for their use, would result in many personnel seeking entertainment and recreation in locations over which the Armed Forces have no jurisdiction to control through regulatory measures. The increased use, by the serviceman, of entertainment and recreational outlets in areas outside the jurisdiction of the Armed Forces would add further burdens on the Armed Forces from a disciplinary standpoint and would adversely affect the morale and general welfare of all service personnel.

The relatively small added revenue from the imposition of Federal occupational taxes on these morale, welfare, and recreational activities would be more than offset by the detrimental effect on these activities, and by added administrative costs due to increased disciplinary problems resulting from servicemen seeking entertainment in locations outside of the regulatory jurisdiction of the Armed Forces.

For the foregoing reasons, it is requested that your committee amend these sections to exempt the activities of the Armed Forces from the imposition of Federal occupational taxes.

This letter has been coordinated within the Department of Defense in accordance with procedures prescribed by the Secretary of Defense.

A copy of this report has been sent to the Bureau of the Budget, but there has been insufficient time to obtain advice from the Bureau of the Budget as to the relationship of this report to the program of the President.

Sincerely yours,

JOHN F. FLOBERG,
Assistant Secretary of the Navy for Air.

The CHAIRMAN. I offer for the record also a statement of the Jewelry Industry Tax Committee and the Jewelers Vigilance Committee. These statements, urging the repeal of the excise taxes on jewelry, are offered in lieu of a personal appearance.

(The statements referred to follow:)

Excise Taxes on Jewelry

Memorandum submitted by the Jewelry Industry Tax Committee, New York 19, N. Y.

PETITION FOR FAVORABLE AND PROMPT ACTION ON H. R. 8920 NOW BEING CONSIDERED BY THE COMMITTEE

The Jewelry Industry Tax Committee is composed of representatives of the entire jewelry industry in the United States, about 30,000 concerns which, with few exceptions, come under the Government's classification of "small business." The total is composed of retailers, wholesalers, importers, and manufacturers located in almost every community in the country. The word "jewelry" as hereinafter used, designates jewelry, precious stones, watches, clocks, silverware, frings, cuff links, tie clips, pins, necklaces, and many other similar items. This petition is also filed on behalf of the American public, the buyers of jewelry, and on behalf of the hundreds of thousands of men, women, and children who depend or their livlihood on the production and sale of jewelry and kindred items.

Your committee is respectfully referred to the brief presented to the House Ways and Means Committee on February 16, 1950, which can be found on page 1217, volume 1, of the reports of Hearings on Revenue Revision of 1950. The brief indicated the discriminatory aspect of the retail excise tax on jewelry and the fact that the limited number of industries affected by the retail excise tax was placed at a decided disadvantage in the commercial world.

The elimination of the 20-percent excise tax on retail sales of jewelry and kindred items would mean increased business, resulting in greater return to the Government from income and payroll taxes which would, in a substantial amount, replace the revenue from the retail excise tax.

The retail excise taxes were temporarily imposed with sound reason during wartime when, for the good of the country, it was deemed expedient to put a brake upon the production and sale of items in these groups (*a*) to curtail the use of matériel and labor during wartime; (*b*) to discourage spending and thus increase savings and the purchase of war bonds by the public. The tax was not imposed as a revenue-producing measure. It is manifestly unfair to the businesses affected to retain these taxes at this time from a revenue approach.

The brief recited that the retail excise tax on jewelry has caused reduced sales, resulting in increased unit costs of production and increased overhead. Reduced sales mean lower profits, resulting in the payment of lower income and corporate taxes. Reduced sales curtail employment in every branch of the industry, which increase payment by the Government for unemployment relief and reduce collections for social security. Elimination of the retail excise taxes would correct these situations and would result in increased sales, increased employment, increased income and payroll taxes, and decreased unemployment relief.

The Jewelry Industry Tax Committee has earnestly and consistently pleaded for elimination of the retail excise taxes on jewelry because they are wholly unfair, wholly unjustified, and wholly discriminatory. The statement of the President and the wide publicity given to the contemplated action of Congress to grant relief have seriously affected the volume of business throughout the industry, creating a crisis with many concerns. Recognizing the present status, we urge prompt action so that relief will be obtained at the earliest possible date.

Memorandum Used in Connection With Presentation of Auctioneers' Situation

Because of the vast difference in conditions today from those prevalent when the Bureau of Internal Revenue declared its position in relation to sales of jewelry by auctioneers under the Revenue Act of 1918, the following is presented for your consideration:

For some time past, the retail jeweler has been faced with an unfortunate situation from a competitive standpoint in connection with the sale of privately owned jewelry, by either individuals or estates. At the present time, if such an owner of jewelry wishes to dispose of same and takes it to a retail jeweler who sells it for him, either on a commission brokerage or profit basis, the Federal excise tax must be paid. If, on the other hand, this individual takes the same jewelry to an auctioneer, who carries no inventory, no excise tax applies on such sale whether the article is sold to a dealer for resale or to a consumer for use. Such a situation

is not alone unfair to the retail jeweler but also to the private owner, who might prefer to place his jewelry in a retail store on consignment at a given price rather than to sell at auction at whatever price the piece may bring. The retailer, who accepts a piece of jewelry from a private owner for sale at a given price on a commission basis, acts as an agent for others to the same degree as an auctioneer, who sells to the highest bidder.

Section 905 of the Revenue Act of 1918 as evidenced by article 18 of regulation 48, approved May 2, 1919, provides in part:

"An auctioneer or broker is a dealer within the meaning of the act in respect to all sales made by him of articles in which he has title, but not in respect to articles which he is selling as an agent."

It is understood that the Department has stated the following in connection therewith:

"An auctioneer who is primarily engaged in the business of acting as an agent for others is not considered to be a retailer with respect to articles sold on behalf of persons or the estates of individuals who are not, or were not prior to death, engaged in the business of selling at retail. However, sales by such an auctioneer of taxable articles on behalf of a person engaged in selling at retail, or on behalf of the estate of a deceased person who was so engaged, are subject to tax. An auctioneer regularly engaged in the business of selling articles to which he has title is considered to be a retailer and all sales of taxable articles made by him are taxable, regardless of whether such articles are the property of an individual or are owned by the auctioneer."

Under the present interpretation, the determination that a sale is "at retail," or made by a retailer, seems to depend on whether the seller carries an inventory of his own in addition to selling on a commission basis, rather than the question as to whether the article is purchased for use as distinguished from a purchase for resale.

Section 2403 (a) of the Internal Revenue Code provides that:

"Every person who sells at retail any article taxable under this chapter shall make monthly returns."

Since this applies to "every person who sells at retail," the question again arises as to "What is a sale at retail?", and whether or not the determining factor should be, "Is the purchase made for consumption?", rather than, "Is the sale made by a business concern carrying no inventory, acting as an agent?"

The sales of jewelry by auctioneers for the account of private owners at the time of the enactment of the Revenue Act of 1918 were very small indeed in comparison with the volume of this business being done today. Now, there are important auction houses located in many of the large cities throughout the country who do a considerable business in jewelry items. One of the outstanding firms specializing in this type of business is the Parke-Bernet Galleries, Inc., 50 West Fifty-seventh Street, New York, N. Y. As an illustration of the volume of business done by the galleries, enclosed herewith is clipping from the New York Times, June 30, 1946, showing total sales of $6,684,045 for the season 1945–46. The total amount of jewelry sales included in these figures is not available. However, the article mentions two sales of jewelry totaling $779,852. In addition, a sale was conducted on May 1, 1946 (clipping enclosed from the publication Jewelry, May 20, 1946) which amounted to $267,125, making a total of $1,046,977 for these three sales alone, and there were others during the year. One of the advertisements announcing the last-mentioned sale is enclosed, illustrating the emphasis placed on the fact that all of the jewelry items were "exempt from the 20 percent Federal excise tax." While, undoubtedly, some of these items collected a considerable amount in excise taxes on the purchases made by individuals for private use, if such tax applied to all sales made by business concerns to consumers for use, and not for resale.

Enclosed herewith also please find priced catalog (showing amount each lot brought at the sale and indicating ownership), the name of owner being mentioned in some instances and in others, simply stating "New York private owner." Among the many important pieces, it is also interesting to note the very modern, gold choker collar, lot 136 (New York private owner) and lot 175 (New York private owner) consisting of 400 unset, loose diamonds. Attention is directed to the first page of the catalog reading: "Superb diamond and other precious stone jewelry all from private owners including Madame Edmond Terrien." During the past few years, many well-to-do foreigners have entered the United States bringing large quantities of jewelry, legally duty free. Having kept such jewelry

in their possession for the required 3-year period, they are now in a position to sell this jewelry through auctioneers, it being not only duty free but also free from the payment of excise tax.

Considering the vast difference between the situation as it exists today and as it was in 1918, and also the wording of section 2403 (a) of the Internal Revenue Code, would it not be reasonable in interpreting "sales at retail" to be those "for consumption or use," rather than the type of business concerns by whom such sales may have been made? It is strongly felt that every commercial sale of jewelry for consumption or use should be considered to be a retail sale on which the excise tax should be paid, regardless of the nature of the business firm making such sale. Should such an interpretation be made, an auctioneer could readily secure an exemption certificate from buyers of any items purchased for resale, in like manner as is today employed by retail outlets. Under the present interpretation, the loss in revenue to the Government from sales made through auctioneers, tax free, since section 2403 (a) of the Internal Revenue Code has been in effect, has amounted to very large sums.

It is realized that this condition can be remedied by legislation, but this would be a slow process since Congress is about to adjourn and will not reconvene for many months. It is, therefore, respectfully suggested, that, due to the tremendous changes in conditions from 1918 to the present time as outlined above, the Government might well benefit by the collection of excise taxes on large sums involved in auctioneers' sales for consumption; and the unfair competitive situation in the industry corrected by a Treasury regulation reinterpreting the law so that sales at retail be understood as those for consumption or use, regardless of the type of business concern making the sale.

Respectfully submitted.

JEWELERS VIGILANCE COMMITTEE, INC.,
(Signed) P. IRVING GRINBERG, *Executive Vice Chairman.*

The CHAIRMAN. Also, I offer for the record a letter from Floyd G. Blair, treasurer of the Philharmonic-Symphony Society of New York, relating to the excise tax.

(The letter referred to follows:)

THE PHILHARMONIC-SYMPHONY SOCIETY OF NEW YORK,
New York 19, N. Y., July 6, 1950.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: I am delivering herewith to Mrs. Springer 50 copies of the revised statement made by me as treasurer of the Philharmonic-Symphony Society of New York with reference to the Federal admissions-tax problem. It is substantially the same statement filed with the Ways and Means Committee except that there have been included the final figures for the year ended May 31, 1950, instead of estimates. I have also left out some material with regard to the orchestras as a group as I understand they are filing their own statement.

As you know, we are asking that the exemption formerly specifically provided for in the law be restored to us. It is vital to our continued existence. We are ready to bear any share of the financial burden of the Government in connection with a possible war but the blunt fact is that as a charitable, educational, and entirely nonprofit institution, we cannot stand up under the requirement of paying $112,000 admissions taxes into the Federal Treasury. If you want symphony orchestras to survive and to continue to perform the services they perform in concert halls and over the air across the United States, the burden of the tax must be lifted.

I should like to have had the pleasure of appearing personally before the committee but I felt that it was not fair to take up your time when the issue was so clear and the question had been so thoroughly explored before the Ways and Means Committee.

With kindest regards,

Sincerely yours,

FLOYD G. BLAIR, *Treasurer.*

[Copy of telegram]

JULY 5, 1950.

Mrs. ELIZABETH B. SPRINGER,
Clerk, Finance Committee, Washington, D. C.:

Appreciate your telegram of July 3 with regard to the hearings on tax bill H. R. 8920. It is vital to the Philharmonic-Symphony Society of New York that the action of the House in reinstating the exemption of symphony societies from the admissions tax be concurred in by the Senate. I feel that we made an adequate presentation of the facts before the Ways and Means Committee and that it would not be fair to Senator George and his associates to take up time at the present hearing to present new material. Since the hearings before the Ways and Means Committee we have received final figures for the year ending May 31. Accordingly I have revised the statement previously filed to include the latest results. Will deliver to you on Friday, 50 copies of such revised statement which you may wish to have inserted in the Record. I know Senator George appreciates how important this matter is to organizations such as the Philharmonic and that my personal appearance would under the circumstances be an inappropriate encroachment upon the time of the committee.

FLOYD G. BLAIR,
Treasurer, The Philharmonic-Symphony Society of New York.

STATEMENT OF THE PHILHARMONIC-SYMPHONY SOCIETY OF NEW YORK, INC., RE FEDERAL ADMISSIONS TAX

INTRODUCTORY STATEMENT

The Philharmonic-Symphony Society of New York, Inc. (hereinafter referred to as the "Philharmonic") is a philanthropic, educational and nonprofit corporation organized under the laws of the State of New York. The Philharmonic is the oldest symphony orchestra in the United States, being in the midst of its one hundred and eighth season. The society has more than 800 members, approximately 7,000 regular ticket subscribers and during a season plays to audiences in the concert hall aggregating approximately 300,000 people. Its concerts on Sunday afternoon are broadcast throughout the Nation, attracting over 10,000,000 listeners to each concert. Nearly 10,000 individuals scattered across the entire country and from all walks of life have become radio members of the society and receive programs, booklets, and information about the orchestra and countless thousands bought more than 1,000,000 of its recordings last year. The Philharmonic also conducts a special series of concerts for children and young people in an effort to interest the school children of New York in symphonic music. The society also gives two series of concerts on Saturday nights which, while open to the general public, are primarily intended for the older student group. Prices of tickets for these concerts average about one-third less than the prices for other evening concerts. While most of the concerts are given in Carnegie Hall, New York City, the orchestra usually gives a few concerts in other cities and on occasions tours the country for several weeks before or after the close of the regular season. For 8 weeks during the summer the orchestra gives concerts 5 nights a week at the Lewisohn Stadium in New York City. These concerts are financed and managed under the guiding genius of Mrs. Charles S. Guggenheimer, a director of the Philharmonic, operating through a separate organization known as Stadium Concerts, Inc. Tickets for the concerts are sold at popular prices, many at 30 cents (including 5 cents tax), audiences range from 3,000 to 18,000 and for the 8-week season aggregate approximately 300,000 individuals.

For many years the Philharmonic was operated at a heavy loss, the deficits being met year after year by large donations chiefly from a few public-spirited people of great wealth. During the last decade and a half, due to the increasing impact of taxation, especially during and since the war, such donations have been cut very materially and in the last few years have practically disappeared. Anticipating the changed situation, the management of the Philharmonic was among the first to explore and develop new sources of income, notably fees for broadcasting and royalties for recordings. Nevertheless, the Philharmonic ended this year with an operating deficit of $173,157.39 and, after contributions, income from investments, miscellaneous income such as radio memberships and the like, with a final over-all deficit of $81,513.26. Despite the fact that the society is a purely cultural and educational society, not operated for profit, it was required to collect from its subscribers and purchasers of tickets and pay over to the

Federal Government wartime Federal admissions taxes aggregating $112,631.03. Its continued existence in jeopardy, the Philharmonic, along with other similar societies, is appealing to the Congress for relief from this unwarranted burden.

A REVIEW OF RECENT LEGISLATION

Until 1941 the tickets sold by symphony societies had never been subject to admissions taxes. Although section 1700 (a) of the Internal Revenue Code imposed a tax on the amount paid for admission to any place other than those operated by or under control of the War Department or Navy Department, section 1701 created an exemption in favor of the symphony societies. That section provided in part that:

"No tax shall be levied under this subchapter in respect of—

"(a) *Religious, educational or charitable institutions.*—* * * any admissions all the proceeds of which inure (1) exclusively to the benefit of religious, educational, or charitable institutions, societies or organizations, societies for the prevention of cruelty to children or animals, or societies or organizations conducted for the sole purpose of maintaining symphony orchestras and receiving substantial support from voluntary contributions * * * and no part of the net earnings thereof inures to the benefit of any private stockholder or individual:

The Revenue Act of 1941 by its section 541 (b) repealed the effect of section 1701 of the code by merely providing:

"(b) *Termination of exemptions.*—Section 1701 of the revenue code (relating to exemptions for admissions tax) shall not apply with respect to amounts paid on or after the effective date of this part for admissions."

When the exemption of symphony orchestras was removed from the code the rate of the admissions tax was 10 percent. While it was felt that the addition of that amount to the cost of their tickets might well adversely affect their income, they realized that the war made emergency demands on everyone and accordingly no substantial opposition was offered to the change in the law. Subsequently, however, in 1943, when it was proposed to increase the rate of the admissions tax from 10 to 30 percent, representatives of the symphony societies presented their views to the Congress vigorously opposing the increase so far as their societies were concerned. Nevertheless, when the rate of the admissions tax was increased from 10 to 20 percent, the symphony societies along with others, were subjected to the increase. However, in a letter addressed by the then Secretary of the Treasury, Mr. Henry Morgenthau, Jr., to Mr. Harry Harkness Flagler, then a member of the board of directors of the Philharmonic, Mr. Morgenthau assured Mr. Flagler that "the increased rate of admissions tax was proposed as a wartime revenue measure" and that it was intended that the increase "shall continue only until approximately 6 months after the termination of the war." Notwithstanding, the symphony societies are still subject to the 20 percent tax.

THE FINANCIAL POSITION OF THE PHILHARMONIC

In 1942 the future of the Philharmonic hung in the balance. The country was in the midst of war, deficits were substantial, and the outlook was dark. However, the continued existence of the orchestra for at least another year was made possible by a special gift of $75,000 made by a public-spirited citizen which was reinforced by an emergency guaranty fund of $50,000. These funds were rapidly exhausted. Fortunately the Columbia Broadcasting System, which for some years had been broadcasting the Sunday afternoon concerts on a sustaining basis, persuaded the United States Rubber Co., to commercially sponsor the broadcasts. This brought in sufficient additional income to bridge the gap. The rubber company continued its commercial sponsorship for 4 years, enabling the orchestra to meet the requirements of its budget which included substantial increases in salaries to the musicians and a costly new pension plan. The broadcasts again went on a sustaining basis in 1947–48, and the orchestra operated at a substantial loss. For the season 1948–49 the Sunday broadcasts were commercially sponsored by the Standard Oil Co.. New Jersey. The additional income once more provided the society with revenue sufficient to meet its requirements. During the season just ended the orchestra was back on a sustaining basis with the resulting loss of income.

Unfortunately the Philharmonic is not heavily endowed. Its endowment and pension fund securities yielded the society last year an income of $33,036.45. It received from the activities of its women's auxiliary board $26,518.22. In addition special concerts and other events promoted by the women's organization produced substantial results and helped defray the cost of pensions. Radio memberships grossed $35,011.26. Contributions from a few individuals, principally directors

of the society, brought in $30,800. Income from record royalties, while nearly five times larger then 10 years ago, was substantially down from the high of a year ago. Subscriptions and ticket sales were also down, so that the society received from all sources a gross income of $902,221.62. Expenditures for the year, though closely controlled and cut to the bone were $983,734.88 giving us a final deficit of $81.513.26.

In common with most businesses, the expenses of the Philharmonic in recent years have increased materially. Since 1941 when the admissions-tax exemption was removed, the salaries of the musicians alone have risen from $338,134.20 to $452,196. A trusteed pension plan has been established for the benefit of the musicians and the office staff which, together with the former voluntary plan, absorbs about 10 percent of the society's income. It is interesting to note that in 1941–42 the average cost of a concert was $6,392.57, the average income $3,871.53 and the average deficit $2,501.04. Last year the average cost was $8,536.05, the average income $5,114, leaving a deficit for each concert of $3,422.05. Accordingly, every time the Philharmonic opens the doors of Carnegie Hall to give a concert for the benefit of the public, it does so with the realization that, even with the house sold out, it faces a deficit of approximately 40 percent of the cost of the concert which must be covered by income from other sources.

From the foregoing it is apparent that unless its income and expenditures are brought into balance the Philharmonic faces a most serious situation. It is convinced that prices now being charged for tickets (which include the 20 percent tax) cannot be further raised without danger of alienating its supporters and actual loss of income. An emergency reserve of $57,009.76 and a special reserve of $15,000 have been wiped out by this year's loss. Having explored and exploited all sources of income currently available to it, its expenditures being reduced to the minimum consistent with the proper operation of its affairs, the society has left two alternatives. First, it can appeal to its supporters and to the public for additional contributions. To offset the deficits it will be necessary to raise $100,000 to $125,000 extra each year. While such an appeal might be successful to meet a single emergency, for example, a possible suspension of the orchestra, it may well be doubted whether such funds would be forthcoming year after year to meet constantly recurring losses. Second, if the Federal admissions tax were removed and the society were restored to its former status, it hopes that its subscribers and purchasers of tickets would be willing to continue to pay the gross prices which they are now paying. The society thus would receive additional income of approximately $110,000, which is it hoped would approximately offset the annual deficit.

CONCLUSION

1. Symphony societies were formerly specifically exempted from the admissions tax and have never been subject to income or other Federal taxes. The 20-percent tax was imposed during the war as an emergency measure. It is unsound to tax philanthropic, educational, and nonprofit organizations. The tax should be repealed in its entirety.

2. Contributions to symphony orchestras are classed as "charitable contributions" under the Federal Income Tax Code and Regulations. It is inconsistent to impose an indirect tax on the operation of these institutions by compelling them to collect and pay over to the Federal Government a tax of 20 percent of a large portion of their income.

3. The revenue which the Federal Government receives from this source is relatively small indeed, but of great importance to the symphony societies. If the tax were removed, it would provide them with a source of additional income vital to their continued existence. It would insure the continuance of the invaluable cultural and educational benefits flowing from the maintenance of symphony societies in the United States and, incidentally, the continued employment of the thousands of musicians, members of the American Federation of Musicians, who constitute the principal employees of the societies.

4. Due to the difficult financial situation of all symphony orchestras, there is an increasing tendency to seek municipal grants to meet their deficits. The Philharmonic believes that, so far as possible, the symphony orchestras should stand on their own feet. A tax of 20 percent of the proceeds of their ticket sales is unjustified, increases seriously their problems, and pushes them nearer and nearer to Government operation.

5. The Philharmonic is not asking for any revolutionary change in the tax structure. The tax was a wartime emergency tax. It was unsound in principle but accepted as a wartime burden. That burden can no longer be sustained. It

is urged that the Senate concur in the re-enactment of that portion of section 1701 (a) of the Internal Revenue Code which granted an exemption from the admissions tax to:

"Societies or organizations conducted for the sole purpose of maintaining symphony orchestras and receiving substantial support from voluntary contributions * * * and no part of the net earnings thereof inures to the benefit of any private stockholder or individual."

THE PHILHARMONIC SYMPHONY SOCIETY OF NEW YORK., INC.
FLOYD G. BLAIR, *Treasurer.*

JULY 5, 1950.

The CHAIRMAN. Also, I offer for the record five statements relating to the excise tax on cigars, submitted by the Cigar Manufacturers Association of America, Inc., the Lancaster County Tobacco Growers Cooperative Association; the Florida and Georgia Cigar Leaf Tobacco Association; E. Regensburg & Sons, Inc.; and Representative J. Hardin Peterson.

(The statements referred to follow:)

CIGAR MANUFACTURERS ASSOCIATION OF AMERICA, INC.,
New York, N. Y., July 6, 1950.

Hon. WALTER F. GEORGE,
Chairman, Committee on Finance, United States Senate,
Washington, D. C.

DEAR SENATOR: Enclosed herewith is a brief statement of the cigar industry's case for excise tax reduction and accompanying documentary evidence which we request be made a part of the record of the pending hearing on excise taxes.

Our request is in deference to your committee's pronouncement that it desired oral testimony of only those industries which had not appeared before the Ways and Means Committee or whose request for tax relief had not been granted by the House committee.

Since full and complete testimony of the cigar industry's plight and of the inequity of the present tax schedule was presented to the Ways and Means Committee, in the interest of expedition, the cigar industry rests upon the record made before that committee.

Respectfully yours,

SAMUEL BLUMBERG, *General Counsel.*

UNITED STATES SENATE, COMMITTEE ON FINANCE, IN THE MATTER OF PROPOSED EXCISE TAX SCHEDULE ON CIGARS CONTAINED IN H. R. 8920

Memorandum of Cigar Manufacturers Association of America, Inc.

This association comprises 80 members located in various cigar-manufacturing areas of the United States producing in excess of 75 percent of the total production of cigars both in unit and dollar volume. Its members include small, medium-sized, and large firms, some making cigars solely by hand, some by machine, and some by combined method. The cigars manufactured by its members retail at prices within all seven of the present revenue classes.

I

While the proposed new schedule of taxes on cigars contained in H. R. 8920 is acceptable to the industry, the rates set forth in H. R. 4665, introduced by Congressman Ribicoff of Connecticut (a copy of which rates appear on p. 7 of the brochure entitled "Cigar Taxes Must Be Reduced"), are more realistic and more nearly approach the needs of the industry. This association, therefore, endorses H. R. 4665 and in any event the new tax schedule and rates applicable to cigars proposed in H. R. 8920.

The facts of the industry's case for reduction of the tax rates on cigars and revision of the tax bracket system is contained in a booklet entitled "Cigar Taxes Must Be Reduced" which is presented herewith and offered for the record.

A one-page summary of this booklet entitled, "This Tells at a Glance Why Cigar Taxes Must Be Reduced," is also offered for the record. Since the printing of this booklet, in addition to the letters of endorsement which appear under item 2 of the booklet, additional endorsements of the proposed revised tax schedule

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were received from the Lancaster County Tobacco Growers' Cooperative Association, of Pennsylvania, and Florida and Georgia Cigar Leaf Tobacco Association, of Florida, photostatic copies of which are offered for the record.

II

Since representatives of this association appeared at the hearings before the Ways and Means Committee, conditions in the cigar industry continue alarmingly distressing. Figures released by the Commissioner of Internal Revenue for the first 5 months of 1950 show a decline of almost 3 percent in unit volume of cigars as compared with the first 5 months of 1949, with a larger decrease in dollar volume. In the light of the fact that sales in 1949 were more than 3 percent below 1948, the trend continues downward.

The law of diminishing returns is catching up with this industry. The Treasury is getting less revenue each year because the dollar value of the indsutry is going down. Cigar prices cannot be reduced under present costs including excise taxes. This is another factor which is forcing the smaller cigar manufacturer out of business.

First quarter earnings for three of the largest cigar manufacturers reveal that 1950 earnings are practically nil. The earnings per share for these companies are:

	1949	1950
Company A	$0.22	$0.1
Company B	.26	1
Company C	.11	3

As an indication of what is happening, two of these companies each paid income taxes in 1948 in excess of 1.5 million dollars, yet in 1950 their tax will be almost nothing. This condition is even more prevalent throughout the smaller companies, some of whom have already been forced to liquidate, and others are in distress.

III

Not to burden unduly this committee with a repetition of the testimony offered by this industry in support of its proposal for reduction of its cigar taxes and revision of the tax schedule, we beg leave to refer to the testimony of Mr. Edward J. Regensburg, president of this association, given before the Ways and Means Committee on February 17, 1950, a copy of which for reference is hereto annexed. We also beg leave to refer to the testimony of Hon. J. Hardin Peterson, Representative of the State of Florida, First Congressional District, a copy of which likewise is annexed hereto.

Accordingly, Cigar Manufacturers Association of America, Inc., urge upon your committee the adoption of its proposal (contained in H. R. 4665) and in any event the proposed new tax schedule for cigars contained in H. R. 8920, since it distributes the tax burden equitably within the industry, gives assurance to the Government of revenue anticipated when the present tax law was enacted, and finally permits the stabilization of the cigar industry.

Respectfully submitted.

CIGAR MANUFACTURERS ASSOCIATION OF AMERICA INC.,
By ED. J. REGENSBURG, *President.*

LANCASTER COUNTY TOBACCO GROWERS' COOPERATIVE ASSOCIATION,
Lancaster, Pa., February 15, 1950.

CIGAR MANUFACTURERS ASSOCIATION,
350 Fifth Avenue, New York, N. Y.

GENTLEMEN: The Lancaster County Tobacco Growers' Cooperative Association is a growers' cooperative located in Lancaster, Pa. Our membership consisting of over 500 farmers is the only association of Pennsylvania cigar leaf tobacco farmers, of which there are upward of 6,000 in this area growing in excess of 37,000 acres of cigar leaf tobacco.

Pennsylvania tobacco is the largest single cigar tobacco crop grown in continental United States. We depend entirely upon the income derived from our farms and the growing of cigar leaf tobacco for our main source of income. Most

of the tobacco grown by us is made into cigars by manufacturers located in the State of Pennsylvania.

We are greatly worried over the threat to our industry in the recent falling off of cigar consumption which particularly affected the York County cigar manufacturers in the vicinity of our farms. We are of the opinion that a major factor for this condition has been the inability of the cigar industry to adjust itself to a peacetime economy due to the enormous tax burden imposed upon it. It is the considered judgment of this association that the rates and method of cigar excise taxation set forth in the Ribicoff bill (H. R. 4665) is equitable and would make for greater stability of the cigar industry.

Unless the cigar industry is granted prompt relief by a reduction in excise taxes, it and the farmers upon whom it is dependent will be irreparably damaged and our investments seriously jeopardized.

Accordingly, we strongly endorse the Ribicoff bill (H. R. 4665) and urge its adoption.

Respectfully,

LANCASTER COUNTY TOBACCO GROWERS' COOPERATIVE ASSOCIATION,
By C. L. NESTLEROTH, *Acting Manager.*

FLORIDA AND GEORGIA CIGAR LEAF TOBACCO ASSOCIATION,
Quincy, Fla., February 14, 1950.

CIGAR MANUFACTURERS ASSOCIATION OF AMERICA,
Care of Mr. Edward J. Regensburg, President,
350 Fifth Avenue, New York, N. Y.

DEAR SIR: We have been informed that Congressman Ribicoff of Connecticut is proposing a bill to be introduced into the Congress of the United States known as H. R. 4665, which provides for the reduction of the excise tax on cigars.

This association, comprised of over 250 farmers who grow cigar shade leaf tobacco in Florida and Georgia, heartily endorses this move. We feel that the present excise tax on cigars is most inequitable and works a hardship not only upon the consumer but those of us who grow the tobacco. As farmers we feel that anything that handicaps the use of tobacco certainly works an injustice upon us. We feel that the proposed bill represents a perfect blending of justice and practical necessity.

If we can be of further assistance in the matter kindly contact us.

Very truly yours,

FLORIDA-GEORGIA CIGAR LEAF TOBACCO ASSOCIATION.
By ROBERT GARDNER.

STATEMENT OF EDWARD J. REGENSBURG

Mr. Chairman and gentlemen of the committee, my name is Edward J. Regensburg, and I am the vice president of E. Regensburg & Sons, Inc., manufacturers of cigars since 1867. I am also the president of the Cigar Manufacturers Association of America, a trade association, national in scope, and whose members produce in unit and dollar volume well over 70 percent of the total production of cigars.

When I appeared before the Ways and Means Committee in June of 1947, I stated that conditions in the cigar industry were bad; since that time conditions have become worse. Proof of this statement may be found in the latest available figures of the Treasury Department which show that in December 1949 unit sales were down over 12 percent below that of December 1948, and dollar sales were down almost 16 percent.

At the outset I should like to state to this committee that the cigar industry is not asking for outright repeal of the excise taxes on cigars, but rather is asking for a much-needed adjustment in the cigar excises. Our request which has the endorsement of the farmers, the leaf packers, the manufacturers, the distributors, the retailers, and the suppliers of our materials, is twofold. We are requesting:

1. A reduction in the tax rate so that the cigar industry will pay approximately the amount which Secretary Morgenthau sought from this industry in 1942 as a wartime measure, and
2. A change in the bracket system of cigar taxation which will result in a more equitable distribution of the tax burden among the various retail prices and permit a greater flexibility in the pricing of cigars.

To accomplish this, our association some time ago made a study of the subject and devised a schedule which we believe accomplishes these purposes. Our revised schedule, embodied in the Ribicoff bill (H. R. 4665), is set forth on the last page of our brochure, Cigar Taxes Must Be Reduced, which we filed with this committee.

We are asking for a reduction of the tax because our industry is suffering under the yoke of an excessive and burdensome war tax. Our industry's sales have fallen off steadily since the end of the war in both unit and dollar volume. Sales in 1949 were almost 5 percent lower than they were at the end of the war, in 1946, and we attribute this in large measure to the burdensome war excise tax on cigars. We cannot adjust our price structure to a peacetime economy if we must continue to pay wartime taxes.

When Secretary Morgenthau appeared before this committee on March 3, 1942, requesting additional wartime revenue, he stated that his proposal would yield to the Government an additional 13.1 million dollars in revenue from the cigar industry. He, in effect, asked for a doubling of the tax rate on cigars, bringing the anticipated total collections to $26,000,000. We willingly consented to this doubling of the tax but pointed out to this committee that the method of taxation whereby additional cigar revenue was sought was not adaptable to the characteristics of the cigar industry. What happened, gentlemen, was that instead of an additional $13,000,000 per year in war revenue, the wartime tax schedule of 1942 has yielded an additional $30,000,000 during each of the peacetime years. Thus, instead of paying approximately $26,000,000 in revenue as Secretary Morgenthau proposed, we have been paying more than $43,000,000 per year since the end of the war. We are not asking to go back to the tax schedule which yielded approximately $13,000,000 in 1941. We ask merely that we be permitted to pay the twenty-million-odd dollars which Secretary Morgenthau requested of this industry as war revenue and which we are still willing to pay as peacetime revenue. This obviously, gentlemen, is an insignificant reduction when compared to the requests made by many industries, some of which are seeking a reduction and others an outright repeal of wartime taxes.

The cigar industry should not be treated as the stepchild of excise taxes. We believe our right to a reduction in the tax load is just as pressing as many of the other claims for reduction of excises on so-called luxury and semiluxury goods. I have no desire to compare our plight with that of other industries. Unfortunately, and I use the word advisedly, certain groups in public releases have suggested that virtually all war excise taxes be repealed, but that tobacco taxes be retained. These statements are probably not made maliciously, but they are apparently made with a complete misunderstanding of the case of the cigar industry. We base our claim for reduction of excise taxes entirely upon the adverse effect which tax collections in excess of those requested by Secretary Morgenthau have had on the cigar industry. While it is true that the cigar industry is part of the tobacco industry and cigarettes constitute the largest segment of the tobacco industry, yet to compare the cigar industry with the cigarette industry is to turn one's back on reality. In 1949 total cigarette sales were 350 billion units, compared with only 5.6 billion cigars. Cigarette sales have doubled in sales since 1939; cigar sales have remained virtually unchanged. Moreover, cigarette sales are up 65 percent since the end of the war; cigar sales are down 5 percent. The cigarette industry, and I speak now of the industry as a whole, is experiencing one of the most prosperous periods in its history, while the cigar industry is in the throes of a depressed period.

I submit on facts proved, that both on the "ability to pay" criterion and the "hardship" criterion, the cigar industry is entitled to a tax reduction. Accordingly, we urge relief from a wartime tax measure which has yielded far more revenue than was anticipated.

We recognized some time ago that the present method of taxation was inflexible and entirely incompatible with a peacetime economy. An examination of the chart which appears on the middle page of our brochure visibly demonstrates the utterly haphazard incidence of the tax. You will note that the tax rate bears practically no relationship to the retail price of the cigar. Under the present schedule, for example, a three for 25-cent cigar, a very popular cigar, is taxed at a rate of 12 percent. A 20-cent cigar is taxed at a rate of 7½ percent. We believe we have devised a more equitable form of taxation; one which imposes a rate of approximately 5 percent on the retail price of the cigar. It is the nearest approach to an ad valorem tax possible, without imposing undue administrative burdens on the Treasury Department.

For the benefit of those members who were not on this committee when I appeared here in 1947, I would like to point out some of the difficulties that cigar manufacturers have encountered as the result of the haphazard incident of the present schedule of cigar taxes. Let us assume that we had a two for 15-cent cigar, which because of increases in material and labor costs, amounting to $4 per 1,000 cigars, must be raised to a higher price. The proper price for that cigar should be three for 25 cents. This would mean an increase in the wholesale list price from $60 to $65 per thousand, that is an increase of $5 per thousand. However, such an increase would shift the cigar from present class D to class E, costing an additional $3 in tax. Now what happens, gentlemen? After trade discounts we would get only $4.40 out of that $5, but we would have to pay to the Treasury $3 out of it, leaving only $1.40. Since the $1.40 does not cover the $4 cost increase the retail price would have to be set at 9 cents, instead of three for 25 cents.

Under the more equitable schedule of taxes proposed by our association and embodied in the Ribicoff bill (H. R. 4665) the public could have obtained these cigars at three for 25 cents (8⅓ cents), a more popular price and a more equitable price from the point of view of both consumer and industry. This example shows how the cigar industry was compelled through the inappropriate and artless method of taxation, now in force, to impose upon the consumer an additional charge of almost 1 cent per cigar. Moreover, when the two for 15-cent cigar was forced into the 9-cent category, it was taken out of its normal competitive price grouping.

I have tried to point out how the existing tax schedule has caused artificial increases in costs to the consumer. We must now look to the immediate future. Strong resistance to high retail prices is now in greater evidence. The schedule embodied in H. R. 4665, the adoption of which we are urging, would enable the cigar industry to adjust its price structure to a changing peacetime economy. It provides a natural grouping of prices in each tax bracket. The two for 5-cent and three for 10-cent cigars are taxed alike. They are naturally competitive. The 5- and 6-cent cigars included in a single tax class, etc.

Our industry is steeped in the tradition of our national economy. The cigar industry though small in comparison with the volume of the great industries of this Nation, nevertheless is important to the hundreds of thousands who are directly or indirectly dependent on its continued welfare for their livelihood. It is therefore within your province, gentlemen, to determine whether the thousands of cigar-tobacco farmers, in the States of New York, Connecticut, Pennsylvania, Massachusetts, Florida, Georgia, Wisconsin, Ohio, and Minnesota, and their hundred-thousand-odd acres of tillable land with investments of upward of $75,000,000, the forty-odd-thousand workers in cigar factories, the thousands of distributors and the hundreds of thousands of independent retail tobacco merchants, not to mention the thousands of cigar manufacturers, are to be maintained or whether they shall continue to be burdened with a wartime tax load improvidently enacted in the stress of a national emergency. I believe, gentlemen, that it is the sense of this committee that a fairer and more equitable tax burden will be applied so that our industry may again return to a normal peacetime operation.

Statement of J. Hardin Peterson, Representative from the State of Florida, First Congressional District

Mr. Chairman, gentlemen of the committee, the district which I represent is one of the districts which produces a substantial amount of the cigars of the Nation. Other areas in our State also manufacture them but the problem which I call to the attention of the committee is Nation-wide. The industry throughout the Nation is feeling seriously the impact of high wartime taxes. This is a tax which is bringing to the Treasury more than was originally estimated. It is difficult to meet and offset consumer resistance through an adjustment of its price structure unless it obtains a lessening of the tax load. It affects the pocketbooks of millions of cigar smokers and revenue tax for 1948 increased 253 percent over 1939.

I would like to urge a substantial reduction and am placing in the record the suggestions proposed by the Cigar Manufacturers Association of America, which association is acutely aware of the problem.

I sincerely hope that the committee will give special attention to the cigar problem when it is considering the other problems, and reduce these wartime excise taxes.

For more than 7 years the cigar industry and cigar smokers in the United States have been paying for a governmental mathematical error.

Through the Government's reluctance to revise its heavy excise tax formula on cigars, the industry is paying many millions of dollars more than the Government originally intended to reap, with a corresponding burden upon the consumer.

The cigar industry believes that a reduction of such taxes will spur business to such an extent that it may point the way to a rejuvenation of the industry and make it possible to translate the downward decline in cigar consumption to an expanded market. The industry points out that it has been suffering from the impact of these high wartime excise taxes and contends that unless there is prompt relief the damage to the economic stability of the industry as well as to its future will be irreparable.

The industry's current situation, with respect to the error in calculations, is explained in this way:

Before the present excise tax schedules on cigars were enacted in 1942 as a wartime measure, the cigar industry paid to the Government approximately $13,000,000. In that year (1942) when the Secretary of the Treasury appeared before the Finance Committees of the Congress, he submitted proposals for increasing cigar taxes in order to give to the Government thereafter what he expected would be an additional $13,000,000 in revenue, making $26,000,000 in all.

What actually happened is this: In 1943 the excise taxes collected were $27,500,000. But in 1944, the excise taxes jumped to $33,500,000 and in 1945, they jumped to $38,000,000—and since 1946 they have been in excess of $47,000,000.

It should be remembered that while the cigar industry did not oppose the additional revenue of $13,000,000 which the Secretary of the Treasury stated was necessary as war revenue, nevertheless, the industry recommended a change in the tax schedules to avoid the very difficulty under which the industry is now laboring—namely that instead of the increase being only $13,000,000, it has turned out to be almost $35,000,000 additional revenue.

Excise taxes on cigars are now prohibitive and the industry is feeling keenly the impact of these excessively high war excise taxes. There is a downward trend today in the total consumption of cigars; sales for the first 6 months of 1949 were more than 3 percent below sales for the first 6 months of 1948. And this fact is disheartening because the total sales for the first 6 months of 1948 were more than 2 percent lower than for the corresponding period in 1947. The cigar industry can do very little, if anything, to offset consumer resistance through an adjustment of its price structure unless it obtains a lessening of the tax load because excise taxes on cigars represents by far the largest increase in the cost element of a cigar.

Revenue taxes for 1948 increased 253 percent over 1939—and this in the face of tobacco costs increases in 1948 of 180 percent over 1939 levels and wage rates of 105 percent in 1948 over 1939 levels.

Whatever justification there may be for a repeal of other wartime excise taxes the cigar industry makes out a very strong case.

In the light of present economic conditions, the conclusion is inescapable that speedy action by Congress is necessary to save an important industry. In 1942, when the Secretary of the Treasury requested his increase in excise taxes on cigars, he said:

"The increase in consumer incomes will keep up the demand for those commodities despite the higher taxes. Needed revenue will thus be obtained. Consumer purchasing power will be tapped. The producers will not be injured and the consumers will not be taxed on necessaries of life."

If the theory upon which the increase in excise taxes was based was sound, present economic conditions require immediate relief. Producers of cigars are injured; cigar smokers are unable to obtain their needs at prices they can afford to pay and the Government has been profiting through a mathematical error made at the expense of an industry fighting for its very existence.

The CHAIRMAN. I also offer for the record two statements from the Retail Tobacco Dealers of America, Inc., relating to taxes on cigars and matches.

(The statements referred to follow:)

BRIEF OF ERIC CALAMIA, MANAGING DIRECTOR OF RETAIL TOBACCO DEALERS OF AMERICA, INC., NEW YORK, N. Y., ON BEHALF OF THOUSANDS OF RETAILERS OF THE COUNTRY, URGING THE IMMEDIATE ADOPTION OF BILL H. R. 8920

I am managing director of Retail Tobacco Dealers of America, Inc., a national trade association which represents thousands of independent retailers throughout the country, both through direct membership and also through our local affiliates in all large cities from Boston to San Francisco. I am also an independent retail tobacco merchant myself, having been engaged in this business in the city of New York for some 35 years under the firm name of Reinhard Bros.

We strongly urge a revision of the existing excise tax rates on cigars, as provided for in H. R. 8920 In 1942, excise taxes amounted to $14,377,000. The then Secretary of the Treasury estimated the proposed revision would yield $13,000,000 more or a total of approximately $27,000,000, which was the additional amount the Government sought, so that our industry bore its proportionate share of the war tax burden.

At that time, we attempted to prove that the rates going into effect would produce far in excess of the amount estimated, but yielded the point in the interests of the country during the war emergency. The resultant Treasury figures over the years have substantiated our claims: Calendar year 1947, cigar tax produced $47,000,000, approximately; calendar year 1948, cigar tax produced $46,000,000, approximately; calendar year 1949, cigar tax produced $43,500,000, approximately.

Although these figures show that the revenue produced by cigars is greater than the amount originally sought, they also prove another point—a steady decline in cigar volume. The law of diminishing returns certainly applies to the cigar business under the present rate of taxation, for as volume diminishes so will the revenues received from this source decrease.

On these two points alone, we feel our request for some relief under today's onerous tax burden is justified. It is unfair to discriminate against anyone industry and if any reduction of Federal excise taxes are made, certainly, the cigar industry has earned consideration.

From the retail standpoint, our concern with this problem is purely one of consumer resistance to the present high prices. Some modification of the tax is essential to stimulate a declining business. Cigar sales constitute a most important part of the volume of business of the average retail tobacco dealer, upon which he depends for a profit. His cigar volume, in many cases, represents the difference between the profitable continuance of his business and failure.

Thus, we endorse, most emphatically the rates of taxation embodied in the Ribicoff bill, H. R. 4665, and in any event not greater than proposed in H. R. 8920.

We urge, with all the force at our command, that the Federal excise tax on cigars be revised immediately so that the retailers of the Nation may have the quick relief they are deserving of.

BRIEF OF ERIC CALAMIA, MANAGING DIRECTOR OF RETAIL TOBACCO DEALERS OF AMERICA, INC., NEW YORK, N. Y., ON BEHALF OF THOUSANDS OF RETAILERS OF THE COUNTRY, URGING THE REDUCTION OF THE EXCISE TAX ON MATCHES, AS PROVIDED FOR IN H. R. 8920

I am managing director of Retail Tobacco Dealers of America, Inc., a national trade association which represents thousands of independent retailers throughout the country, both through direct membership and also through our local affiliates in all large cities from Boston to San Francisco. I am also an independent retail tobacco merchant myself, having been engaged in this business in the city of New York for some 35 years under the firm name of Reinhard Bros.

Near the bottom of the list of excise tax revenue producers you will find, under section 3409 of the Internal Revenue Code, the item that should be at the top of the taxes to be repealed—matches.

According to our information, only fire arms bring less in revenue. Of the $10,000,000 that this tax produces annually, almost one-half comes from the dispensers of tobacco products, most of them quite small, to whom every dollar, yes, every penny, is important.

The free distribution of book matches on which you have a tax of 2 cents per thousand lights is a custom of many years' standing in our trade. It is something

that the consumer not only takes for granted, but actually demands. It is erroneously believed by many that these matches come to us without cost, merely because they carry an advertisement, but the fact is, that we buy them, although the advertising makes them cost less.

At today's prices, the 2 cents per thousand lights represents a 20-percent tax and puts it in the same category with luxuries.

About $1,000,000 of the tax collected on matches comes from the people who have book matches made to order—they are referred to in the manufacturers' testimony before this committee in 1948 as "special reproduction." These matches are made for and given away by hotels, clubs, thousands of industrial firms and other users.

This type of match is a straight out advertising medium and the matches that we give away are an advertising medium because we use them to cement good will. This is the only advertising medium that we know of that is taxed.

If none of us gave these matches away to the smokers, it would cost the American public between $25,000,000 and $35,000,000 to buy them each year.

Thus far, we have discussed between 5 and 6 of the 10 million dollars of revenue, and the balance comes from the housewives of America, for whom we would say a word in their absence.

Wood matches yield something over $4,000,000 of the revenue and we tobacco sellers contribute some of that because we also handle the small boxes of wooden matches. It will interest you to know that the elimination of the tax on this item would put it back into the penny class. In addition to those that we sell to the folks that prefer a wooden match, many are used in coal mines and other hazardous employment, because they are considered truly safety matches. Many of these too are used for advertising purposes.

The kitchen or strike-anywhere match rounds out the picture. In the main they are used in the home where habit rather than utility frequently precludes the use of the paper match, although there are thousands of the localities in the United States today where the paper match is not used.

Comparisons as a rule are not nice for either side, but gentlemen, you do not tax lighters, so why make an exception and tax the match? Can it be that you do it only because it is easy to collect?

What item among the many that you are considering at these hearings for repeal or reduction is as cheap, as useful at all times, and in all places as the match? Please do not deem them too commonplace for your favorable consideration.

The removal of this tax which we urge on you most strongly, would be a great relief to more than a hundred thousand retailers to many of whom it forms a most unhappy and heavy burden.

The CHAIRMAN. Mr. R. E. Joyce is the first witness this morning. Mr. Joyce, you may be seated.

STATEMENT OF R. E. JOYCE, ON BEHALF OF THE TAX COUNCIL OF THE ALCOHOLIC BEVERAGE INDUSTRIES, NEW YORK, N. Y.

Mr. JOYCE. Mr. Chairman and members of the committee, my name is R. E. Joyce. I am appearing for the Tax Council of the Alcoholic Beverage Industries representing distillers, importers, wholesalers, and retailers, embracing some 187,000 business enterprises employing approximately 800,000 people. We feel the failure of the tax bill as passed by the House to provide any relief from the excise tax on alcoholic beverages is a great injustice to our industries.

The motive for the reduction of excise taxes was to furnish relief for those industries struggling under the burden of wartime excise taxes which were depressing employment and production. The House tax bill proposes relief for some 18 industries, but of the 7 which show the biggest decline in Federal excise revenue from their postwar peak, 3 receive no relief whatsoever. The distilled spirits industry is one of these. It shows a revenue decline of 25.8 percent from 1946 collections. But while the bill proposed no relief for the distilled-spirits industry which shows a loss of over one-fourth

of its business, in sharp contrast it does propose a reduction of 50 percent for industries which show declines in tax revenue of only 8.9 percent, 7.4 percent, 4.2 percent, and 3.5 percent from their peak postwar years. A table showing the industries referred to is submitted for the record.

(The table referred to follows:)

Industry	Peak-post-war year	Peak postwar excise revenue (millions)	1949 excise revenue (millions)	Percentage decline in revenue from peak postwar year	Percentage reduction in tax burden proposed in H. R. 8920
Electric, gas, and oil appliances	1947	$93.8	$39.8	−57.6	
Household (constitutes 75 percent of industry sales and Government revenues)					100
Other					None
Furs	1946	98.5	53.7	−45.5	50
Business and store machines	1948	47.5	27.1	−43.0	50
Radio receiving sets, etc	1947	71.1	40.6	−42.8	None
DISTILLED SPIRITS	1946	1,890.1	1,401.9	−25.8	None
Automotive parts and accessories	1947	131.3	98.3	−25.1	25
Sporting goods	1948	20.9	16.5	−21.2	
Regular sporting goods					None
Items used in schools					100
Musical instruments	1947	11.0	9.0	−17.9	50
Jewelry	1946	240.3	198.6	−17.4	50
Tires and tubes	1947	171.2	146.3	−14.5	25
Photographic apparatus	1948	46.7	41.1	−12.0	
Cameras and equipment, business type					60
Film, business type					33⅓
Other photographic apparatus					None
Luggage	1946	86.6	78.9	−8.9	50
Cigars	1946	47.5	43.5	−8.3	33⅓
Chewing and smoking tobacco	1946	38.0	34.9	−7.9	55½
Admissions (including cabarets)	1946	454.9	421.4	−7.4	
General admissions to theaters, etc					50
Cabarets					25
Refrigerators and air-conditioning apparatus	1948	69.9	65.8	−5.9	
Household					30
Other					None
Transportation of persons	1948	250.7	237.7	−5.2	50
Transportion of property	1948	359.0	340.5	−5.2	50
Matches, ordinary	1948	9.8	9.3	−4.2	50
Toilet preparations	1946	97.6	94.2	−3.5	50
Local telephone service	1949	229.8	229.8	0	22
Telephone and telegraph	1949	305.3	305.3	0	17½

Mr. JOYCE. If the purpose of this bill is to remove a depressing burden from those industries adversely affected in both production and employment, it fails to accomplish its purpose. If Congress has determined that the excise tax relief that can be offered must be confined to $1,000,000,000, then that sum should be apportioned so as to give equitable relief to all industries, especially those—such as the distilled spirits industry—showing the largest declines in revenue.

Although cognizant in the past of the direct effect of high taxes on the production of illicit liquor, the House fails to evaluate the magnitude of present-day moonshining in this country. When the Ways and Means Committee recommended the increase from $6 to $9 a proof gallon for the duration of the war in the Revenue Act of 1943, it expressed its awareness of the fact that during the war manpower would be short and copper and sugar rationed, and said: "Ordinarily such a high tax rate would result in increased moonshining operations." Experience since that time has shown the soundness of this observation.

Last February, we pointed out to the Ways and Means Committee that 8,649 moonshine stills were seized by Federal authorities in 1949,

which represented an increase of 34 percent above such seizures in 1946. Since our testimony before that committee, a survey of seizures of illicit stills by State and local authorities was made. This survey showed that these seizures far exceeded those made by the Federal authorities. The total number of stills confiscated in the fiscal year 1949 by Federal, State, and local officials was 18,884.

Senator MILLIKIN. Is that the number of stills or the number of people having stills?

Mr. JOYCE. That is the number of stills.

Nobody knows what the actual production of these stills was, but their estimated daily production capacity exceeded one-half million gallons.

Senator MILLIKIN. How are they selling that moonshine?

Mr. JOYCE. They sell it two ways, Senator. They sell it as white moonshine. Sometimes they take it and color it and sell it under counterfeit labels and as a substitute for the tax-paid product.

The present high tax has been a stimulant to moonshining which has not only deprived the Government of millions of dollars of revenue but is daily aggravating a serious local problem in breeding disrespect for law. A reduction in liquor taxes would result in a sizable shift in present consumption from the illegal untaxpaid product to the legal revenue-producing product.

Finally, the House bill not only denies us any excise tax relief, but imposes increased corporate taxes for the purpose of making it impossible to reduce excise taxes in other fields. Certainly if we are not to receive relief from an excise burden which is daily depressing sales and employment, we should not be saddled with the additional burden of increased corporate taxes.

The CHAIRMAN. Are there any questions?

Senator MILLIKIN. How many men work in the distilling end of the business?

Mr. JOYCE. I do not have accurate figures on that, Senator. The percentage of people employed in the distilleries themselves is the smaller number of people employed by the industry.

Senator MILLIKIN. In the opening of your statement you pointed out that all these various departments of your business employed approximately 800,000 people.

Mr. JOYCE. Yes, sir; we have made a survey which includes the employment in distilleries, rectifying plants, and then through the distribution facilities such as wholesalers, retailers, and tavern outlets. I am sorry that I do not have the breakdown here. I can furnish it if you like.

Senator MILLIKIN. It is not particularly important.

Senator TAFT. Have you any figures on the sales of liquor? I know your contrast in 1946 is based on revenue collections. Is that an accurate picture of sales or the building up of inventories in 1946? Is there actually 25 percent less liquor sold today than in 1946?

Mr. JOYCE. Yes. That follows very closely the sales because the tax is not collected until the whisky has aged and is withdrawn from bond for sale.

Senator TAFT. You think this revenue figure reflects an actual decrease in the use of liquor or at least in the sale of legitimate liquor?

Mr. JOYCE. I think it corresponds almost exactly to the consumption.

Senator TAFT. What is the cost today to make a gallon of liquor? The tax is $9. What is the actual cost of making the liquor?

Mr. JOYCE. The cost of the production end of the whisky?

Mr. KERR. You mean the cost of production or the sales price?

Senator TAFT. I am talking about the cost of production, including the aging, and so forth.

Mr. JOYCE. That cost, including aging of a 4-year whisky, might approximate $1.75.

Senator TAFT. A gallon?

Mr. JOYCE. Or $2.

Senator TAFT. I wonder after all if there is not just as much incentive to moonshine at $6 a gallon as there is at $9 a gallon where the tax is three times anyway the cost of manufacture. Is not the incentive to moonshine just about as great at $6 a gallon as it is now at $9 a gallon?

Mr. JOYCE. The only way we have to measure that is the result of the seizures of the stills. The seizures of the stills have shown a constant increase over recent years.

Senator TAFT. That is because copper has become available and more people can buy it, but I cannot see very much difference in the effect on moonshine between a $6 tax and a $9 tax. As I say, even $6 is more than three times the value of the liquor itself.

Mr. JOYCE. We think there will always be some moonshine operations. We feel that as the difference between the cost of the moonshine product and the legal product as represented by the tax becomes greater, then there is that increased incentive and we believe there will always be a little more of it where there is a bigger incentive.

Senator CONNALLY. You say that now it costs about $1.75 to make a gallon of whisky?

Mr. JOYCE. Yes.

Senator CONNALLY. Your statement amazes me because some years ago in the House of Representatives a Member of the House who was here from Peoria, Ill., who lived there and who was a representative for many years in the Congress, made a speech in which he said they could make a gallon of whisky for 20 cents, and nobody disputed it. Now you say it costs $1.75. How do you figure that?

Senator BUTLER. That was probably when corn was selling at 10 cents or 15 cents a bushel, Senator, instead of $1.75.

Senator CONNALLY. The price of corn does not affect it a great deal. I am astounded at your statement that it costs $1.75.

Mr. JOYCE. We would be quite interested to see his figures for the production at 20 cents.

Senator CONNALLY. That was some years ago. I will admit that was a good many years ago, and of course it has increased some. But this is eight times as much.

Mr. JOYCE. I do not of course know the condition under which that statement was made.

Senator CONNALLY. He was speaking of this town where a large volume of whisky was manufactured, Peoria. That is the headquarters, is it not, for whisky?

Mr. JOYCE. There is a great deal of whisky made there. You have to qualify the conditions under which those statements were made. There are cost figures which show merely the cost of distillation to

produce a gallon of whisky before it is put into the barrel, before it is aged, and before the carrying charge.

Senator CONNALLY. I recognize that the aging would add to the cost some but I cannot see how it would add as much as that.

Senator TAFT. What is the cost of making alcohol today out of molasses, or whatever it is they use for the cheapest alcohol?

Mr. JOYCE. I am not familiar with the cost of molasses. The cost of producing alcohol would be in the neighborhood of 50 cents a gallon.

The CHAIRMAN. If there are no further questions, we thank you very much for your appearance.

Mr. JOYCE. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Gael Sullivan.

Mr. SULLIVAN. Mr. Chairman, Mr. Myers and I are both spokesmen for the motion-picture industry. Our comments have been coordinated. May I ask your indulgence for him to speak first?

The CHAIRMAN. Mr. Myers.

STATEMENT OF ABRAM F. MYERS, CHAIRMAN, COMMITTEE ON TAXATION, COUNCIL OF MOTION-PICTURE ORGANIZATIONS

Mr. MYERS. Mr. Chairman and gentlemen of the committee, my name is Abram F. Myers. I am chairman of the committee on taxation of the Conference of Motion Picture Organizations. That is an association of the 10 leading trade associations in the motion-picture business and covers all branches of the industry.

Senator CONNALLY. Do you mean the producers and large companies, and so forth?

Mr. MYERS. Yes, sir; but for present purposes Mr. Sullivan and I speak almost altogether for the theaters. They are primarily concerned.

In requesting this opportunity to be heard, we voluntarily informed the committee that it was our purpose to present developments in the motion-picture business occurring since the hearing before the Ways and Means Committee.

Our hearing before the House committee was on February 21, and while we submitted general statements indicating a serious decline in theater attendance, our latest information was for January and that is usually a pretty good month for the theaters.

Since then the bottom has dropped out of the motion-picture industry.

This unprecedented decline in box-office receipts should be a matter of concern to this committee for two reasons:

(1) For its probable effect on current estimates of future revenue to be derived from the admission tax.

(2) Because if, contrary to our hopes and prayers, war is again thrust upon us, the Government will have need of the services and facilities of a strong, active motion-picture industry.

I do not need to remind this committee that at all times motion pictures perform a great service in the dissemination of information and that in time of war the motion-picture industry is an important link in the chain of communication between the Government and the people.

Senator MILLIKIN. Are you following the manuscript that we have?

Mr. MYERS. Not at all. I expect to conclude in less than 5 minutes and that would take considerably longer. In the limited time allotted, and I shall not ask for additional time, I can give only the high lights of the figures contained in our written statement which I hope will be incorporated in the record.

The CHAIRMAN. Yes, sir; it will be incorporated.

Mr. MYERS. Thank you, sir.

(The statement referred to follows:)

REPEAL OF THE FEDERAL TAX ON ADMISSIONS

(Joint statement by Abram F. Myers and Gael Sullivan in behalf of Council of Motion Picture Organizations [1]

INTRODUCTION

In submitting this joint statement we are mindful of the committee's admonition that time will not permit of the duplication of testimony given before the House Committee on Ways and Means.

In our testimony before the Ways and Means Committee we urged that the 20-percent Federal tax on admissions be repealed, at least insofar as it applies to exhibitions of motion pictures (hearings, vol. I, pp. 1794, 1797).

We also submitted a comprehensive written statement containing detailed information and statistics, which the Ways and Means Committee was kind enough to include in the record (hearings, vol. I, p. 1800). That statement was prepared with great care and every argument made and every fact cited has a direct bearing on the question which the Finance Committee is now called upon to resolve.

We earnestly hope that members of the Finance Committee will find time to examine that statement. Our industry as a recognized part of the press [2] performs an important function in the communication of information at all times; in time of war it is a vital link in the chain of communications between the Government and the people.

In our appearance before the Ways and Means Committee we pointed out that for several years there has been a steady decline in movie attendance. The situation then was serious and led to the following passages in the committee report (H. Rept. No. 2319, p. 7):

* * * It is believed that a high proportion of these admissions are paid by persons with modest incomes, which means that this tax is one of the relatively more burdensome excises. * * * Moreover, it is recognized that there has been growing resistance on the part of the general public to the present high admissions which include the general admissions tax.

The present rates on admissions are having a serious effect on small-theater owners and other amusement operators throughout the country. This is particularly true because of the competition they now receive from radio and television. * * *

Since our appearance before the House committee this condition has grown steadily worse. A main purpose of this statement is to submit new figures bearing on theater attendance and to supplement those heretofore presented with later figures. We will confine this feature of our presentation to theater attendance in continental United States. The serious declines in foreign revenue are gravely affecting the producing companies, but that is another story. We are now concerned with the 19,000 American motion-picture theaters, and they come under the head of "Small business."

H. R. 8920, part II, sections 121 and 122, provides for a reduction in the tax on general admissions from 20 percent to 10 percent. Thus the House has provided only for relief from the additional 10-percent tax added during the war. It leaves motion pictures still saddled with the 10-percent tax imposed in 1932 as a "depression tax." The depression has been over much longer than the war and we feel that the time has come to lift this burden from our faltering business.

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[1] This is a recently formed association consisting of the 10 principal organizations in the motion picture industry, representing all elements in the industry. Mr. Myers is chairman and general counsel of Allied States Association of Motion Picture Exhibitors and chairman of COMPO Committee on Taxation. Mr. Mr. Sullivan is executive director of Theater Owners of America, Inc The commitee on taxation consists of one representative of each of the constituent organizations of COMPO, who serve without compensation.

[2] "We have no doubt that moving pictures, like newspapers and radio, are included in the press whose freedom is guaranteed by the first amendment." *United States* v. *Paramount Pictures, Inc. et al.* (334 U. S. 131, 166). Also see Freedom of the Movies (Inglis), subtitle "Report on Self-Regulation from the Commission on Freedom of the Press," University of Chicago, 1947.

MOTION PICTURE BUSINESS NOW BELOW PREWAR LEVEL

Without repeating the figures cited to the Ways and Means Committee, it will be helpful to trace the decline in motion-picture revenues over a period of years in order to emphasize the precipitate drop in recent months.

Pointing to the steady decline in Federal admission tax collections, we warned the Ways and Means Committee that the Treasury's estimates of prospective revenue from that source, so far as the movie houses are concerned, are apt to be very misleading (hearings, vol. I, pp. 1804–1805).

Motion Picture Herald for March 25, 1950 (subsequent to the hearings before the House committee) published a "Dollar History of the Tax" which is annexed hereto marked "Attachment A." It shows the sums collected on admissions to motion picture theaters for all years in which the Federal tax was in force from 1917 to and including the first half of the fiscal year 1950.

These figures apparently were all computed on the theory that 80 percent of all such collections are from movie admissions, a theory which prevailed prior to 1949 (hearings, vol. I, pp. 1795, 1804). In all probability they are, therefore, somewhat higher than the actual collections from movie audiences. Even so, they show a steady decline from $312,839,495 in 1947 to $307,256,923 in 1949.

And the promise held out for the fiscal year 1950 is doomed not merely by application of the 80 percent theory but also by the serious declines during the second half of the year as shown below.

Serious as are the declines in admission tax collections, the handicap of those taxes has contributed to even more serious declines in Federal and State corporate income and excess profits taxes from movie sources.

Attached hereto, marked "Attachment B," are figures from the Department of Commerce's Survey of Current Business, July 1949, showing a decline in such corporate taxes from movie sources of from 136,000,000 in 1946 to 49,000,000 in 1948.[3]

We hesitate to cite the figures of the Bureau of Internal Revenue on admission tax collections because they include taxes on all spectator amusements and movie taxes are not segregated. Nevertheless, to date, general admission tax collections for the fiscal year 1950 have lagged behind the fiscal year 1949 by more than $12,000,000.

July through May 1949	$353, 611, 780. 88
July through May 1950	341, 187, 452. 93

On the modern assumption that motion-picture attendance accounts for 76 percent of all spectator amusements (House hearings, vol. I, p. 1804), there is an apparent drop of over $9,000,000 in the motion picture collections.

Federal admission tax collections for all spectator amusements from November 1949 to May 1950, both inclusive, compared with the collections for the same months a year ago, reflect the unmistakable downward trend:

	1948–49	1949–50
November	$36, 280, 867. 79	$34, 306, 573. 37
December	37, 927, 132. 68	33, 513, 950. 32
January	25, 766, 798. 47	27, 909, 723. 35
February	26, 907, 384. 55	21, 431, 143. 75
March	34, 716, 074. 95	32, 910, 332. 57
April	26, 307, 280. 28	27, 394, 996. 25
May	30, 440, 911. 65	30, 370, 576. 19

The seeming recovery in May of each year, just as the movies are entering their seasonal slump, illustrates the difficulty resulting from the lumping of all admission taxes together. A ready explanation, of course, is that beginning in May baseball, carnival shows, circuses, and other outdoor amusements, dormant during the winter, more than offset the decline in admissions to moving-picture shows.

[3] Standard & Poor's Industry Surveys, Motion Pictures, "Lower Profits Likely from Movie Operations," May 4, 1950 (vol. 118, No. 18, sec. 5): "Movie Stocks Behind Market. Motion picture stocks have lagged behind the industrials in the recent market upswing, probably reflecting uncertainties in the outlook for foreign business and fears that television will seriously affect motion picture attendance. The group as a whole is highly speculative."

"Motion picture attendance is likely to encounter a greater than seasonal slump this summer, in part because of the growing television audiences. A cut in excise taxes from the present 20 percent would bolster attendance."

COLLECTIONS OF LOCAL ADMISSION TAXES SHOW THAT THE MOVIE BUSINESS IS ON THE DOWNGRADE

In addition to the Federal tax on admissions, there are admission taxes in a few States and municipalities. While for the most part the local taxes collected on all amusements are also lumped together, we have been able to secure separate figures for motion pictures in a few instances. These show strikingly the decline in movie patronage in recent months and the urgent need for the elimination of the Federal levy.

The city treasurer for Cincinnati, Ohio, has segregated the collections on movie admissions for the first 3 months of 1949 and the first 3 months of 1950, with the following results:

First 3 months 1949:	
Suburban	$18, 724. 00
Downtown	28, 057. 00
Total	46, 781. 00
First 3 months 1950:	
Suburban	10, 695. 66
Downtown	23, 441. 58
Total	34, 137. 24

Since generally speaking the downtown theaters are the larger, circuit-owned theaters, and the suburban houses are the smaller independent theaters, it is apparent that the small independent exhibitors are suffering most.

Chicago also has a 3 percent gross admissions tax and we are able to give the tax collections from October 1949 to April 1950 inclusive (the last month for which figures are available) for all types of theaters. These figures show a decline of 22 percent during the 7-month period.

October 1949	$139, 279. 31
November 1949	127, 735. 27
December 1949	116, 773. 57
January 1950	127, 102. 09
February 1950	124, 047. 92
March 1950	111, 719. 00
Aprl 1950	108, 562. 54

In order that it may not appear that a few horrible examples have been selected for the purpose of the argument, we invite attention to the following table showing, in terms of percentages, the decline in admission-tax collections from theaters in 27 Ohio cities for the first 4 months of 1950 as compared with the like period in 1949:

	Percent
Akron	16. 0
Alliance	19. 0
Ashland	20. 0
Ashtabula	13. 0
Chillicothe	14. 0
Cincinnati	25. 1
Circleville	25. 0
Cleveland	20. 0
Cleveland Heights	9. 0
Columbus	17. 3
East Cleveland	17. 0
Fostoria	15. 0
Greenville	26. 0
Hamilton	22. 0
Kenton	20. 0
Lancaster	18. 0
Lebanon	16. 0
Lorain	17. 0
Marion	15. 0
Massillon	18. 9
Newark	12. 0
Piqua	16. 0
Ravenna	18. 0
Shaker Heights	22. 0
Springfield	17. 0
Washington Court House	23. 0
Wilmington	20. 0

In our presentation to the Ways and Means Comittee we said: "It is estimated that about 70,000,000 theater admissions are sold each week. This is a decline from a wartime peak of 100,000,000." In view of these later figures showing a startling falling off in movie going, we can no longer stand on that estimate.

REPRESENTATIONS TO WAYS AND MEANS COMMITTEE SUPPORTED BY RECENT SURVEYS

In the statement filed with the Ways and Means Committee we cited reports from exhibitors and exhibitor associations in all parts of the United States showing declines of from 8 percent to 50 percent[4] in gross receipts (hearings, vol. I, pp. 1804–1806). Shortly thereafter Motion Picture Herald conducted a poll among its readers to test the accuracy of the figures cited to the House committee.

The results of that survey are attached hereto, marked "Attachment C." This summary shows in percentages the declines during November and December 1949 and January and February 1950 as compared with the same months in 1948–49, 11 States being included in the survey.

It shows an over-all average decline of 17.18 percent. Even so, it does not reflect the disastrous declines in April.

In May the tax committee of the Council of Motion Picture Organizations requested the film companies to ascertain, through their branch offices, the number of theater closings during the preceding 6 months in the several film delivery territories.[5]

The branch managers reported that 580 motion-picture theaters had closed during that period—December 1949–May 1950. The number of closings in each territory are set forth in attachment D.

Startling as this figure is, it represents only permanent closings and takes no account of temporary closings and reduced operating time, all of which make a bad situation worse and contribute to the growing unemployment in our business.

To illustrate, attachment D shows only nine permanent closings in the Cleveland area. Yet Ernest Schwartz, president of the Cleveland Motion Picture Exhibitors Association writes on June 30 that, "up to the present time, 30 theaters belonging to our organization have been compelled to close, either completely or part time."

Mr. Schwartz continues:

"The necessity for the closing of these theaters has not been due to the summer months but because the amusement business has dropped to such a low that the owners of these theaters were compelled to close until the fall season hoping that by the elimination of the 20 percent Federal tax on admissions business will pick up sufficiently for the theaters to reopen this coming fall.

"We never had such a drop in the show business, even during the old days of the depression, and the closing of these theaters has thrown many employees out of work, has deprived the people in the neighborhoods where these theaters are located from attending these nearby theaters and has put a big loss on the theater owners * * * as many of these theater owners have no other means of livelihood."

THE BURDEN OF THE ADMISSION TAX SHOULD BE LIFTED FROM THE MOTION PICTURE BUSINESS AS A NECESSARY MEASURE OF RELIEF AND A SIMPLE ACT OF JUSTICE

It gives us no pleasure to relate the dismal facts concerning the present state of our business. Showmen are by nature optimistic, they are wont to describe their business and prospects in glowing colors. They believe in their business, are proud of it, and are confident of its future. They have no reason to doubt that motion pictures stand first in the affections of the American people among all forms of entertainment.

A number of circumstances outside the control of the motion-picture industry have combined to bring about its present plight. Chief among them is that the people during the war years were unable to purchase such items as homes, automobiles, refrigerators, washing machines, television sets, etc. With the relaxation of the controls on scarce materials and installment buying, their spending money now is going into durable goods.

The motion-picture industry, relieved of this unfair tax burden, will be able to stand on its own feet. It seeks no Government subsidy or price supports. It merely asks that in common with other members of the press, such as newspapers and magazines, it be relieved of this special form of taxation which it has borne for so many years. The admission tax was revived in 1932 as a depression tax, we now ask that the tax be repealed in order to help it out of its present depression.

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[4] Some of the higher percentages were reported by strikebound areas.

[5] For film distribution purposes the United States is divided into 32 film delivery territories, each taking its name from the city in which the film company branch offices are located.

We have forborne claiming credit for the extraordinary service rendered by our industry during the war. The motion-picture industry is proud of its war record and, should war again descend upon us, it will revive its war activities committee and, to the best of its ability, do it all over again. Our only purpose in mentioning this is to remind the committee that if, despite our prayers, we should again be forced into a full-scale war, the Government will again have need of the services and facilities of a strong, vigorous motion-picture industry.

Respectfully submitted.

ABRAM F. MYERS.
GAEL SULLIVAN.

JULY 6, 1950.

P. S.—Since the foregoing was prepared the following figures on local admission taxes on movie admissions only in Pittsburgh, Pa., have been received:

Admission tax on movies, Pittsburgh, Pa.

November 1949	$74, 067	March 1950	$73, 000
December 1949	77, 331	April 1950	64, 375
January 1950	83, 655	May 1950	48, 742
February 1950	73, 411		

[Attachment A]

DOLLAR HISTORY OF TAX

Following are motion picture admission tax collections by fiscal years since they were first imposed November 1, 1917, as a World War emergency measure:

Nov. 1, 1917	(1)	41 cents and over:	
1918	$13, 178, 669	1933	$8, 781, 234
1919	25, 389, 623	1934	8, 314, 525
1920	32, 983, 083	1935	8, 559, 963
1921	44, 177, 760	1936	9, 348, 328
Jan. 1, 1922	(2)	1937	10, 346, 730
10 cents and over:		1938	11, 399, 557
1922	36, 267, 572	1939	10, 658, 109
1923	34, 670, 293	1940	12, 000, 848
1924	38, 404, 751	July 1, 1940	(2)
June 2, 1924	(2)	21 cents and over: 1941	54, 642, 368
51 cents and over:		Oct. 1, 1941	(2)
1925	9, 997, 271	10 cents and over:	
1926	7, 665, 702	1942	85, 846, 328
Mar. 26, 1926	(2)	1943	110, 166, 060
76 cents and over:		1944	142, 395, 020
1927	3, 413, 607	Apr. 1, 1944	(1)
1928	3, 335, 082	1945	239, 618, 111
June 28, 1928	(2)	1946	273, 200, 265
$3.01 and over:		1947	312, 839, 495
1929	(3)	1948	306, 901, 451
1930	(3)	1949	307, 256, 923
1931	(3)	1950 (first 6 months of the 1950 fiscal year ended Dec. 31, 1949)	160, 936, 543
1932	(3)		
June 21, 1932	(2)	Total	2, 322, 695, 271

[1] Straight 10-percent war tax.
[2] 10-percent tax on admissions.
[3] No tax revenue from admissions to motion-picture theatres.
[4] Straight 20-percent tax on all admissions.

[Attachment B]

[From Survey of Current Business—National income number, U. S. Department of Commerce, July 1949

TABLE 17 (*p. 16*).—*Corporate income before Federal and State income and excess profits taxes, by industry, 1942–48*

Motion pictures:		Motion pictures—Con.	
1942	$156, 000, 000	1946	$322, 000, 000
1943	259, 000, 000	1947	223, 000, 000
1944	258, 000, 000	1948	124, 000, 000
1945	248, 000, 000		

TABLE 18 (*p. 16*).—*Federal and State corporate income and excess profits tax liability, by industry, 1942–48*

Motion pictures:		Motion pictures—Con.	
1942	$79, 000, 000	1946	$136, 000, 000
1943	156, 000, 000	1947	90, 000, 000
1944	156, 000, 000	1948	49, 000, 000
1945	147, 000, 000		

[Attachment C]

EXHIBITORS FIND GROSSES SLIP 17 PERCENT IN 4 MONTHS

Box-office business in the past 4 months has been off 17.18 percent from the same period a year ago.

This is indicated in a spot-check survey by Motion Picture Herald of large and small theaters and circuits throughout the country, which was undertaken at the suggestion of Abram F. Myers, allied general counsel and chairman of the taxation and legislation committee of the Council of Motion Picture Organizations, which is spearheading the industry's fight against the Federal admission tax.

In a letter to the Herald of March 11, Mr. Myers said he questioned the Treasury Department's figures on admission tax collections for all spectator amusements as a barometer for motion picture box-office business—figures which were published in the issue of March 4—since, he said, they appear "to refute the reports of serious box office declines in recent months * * *."

He requested that the Herald ask its subscribers to submit a comparison of their box-office receipts for November, December, January, and February with the corresponding months of a year ago to determine the percentage of decline and thus support before the House Ways and Means Committee the industry's argument that the Federal 20 percent amusement tax was inflicting serious damage at the box office.

In the survey, field reporters found that area box office business was not good. New England exhibitors indicated that business was off 15 to 20 percent, from a year ago, and saw little relief unless the Federal tax is removed.

In Ohio, Willis Vance, a circuit operator, said box-office receipts were down about 12 percent, while F. W. Huss, president of Associated Theatres, said the decrease at local situations was from 12 to 25 percent. Also in that area Louis Wiethe, a suburban circuit operator, found business off 22 to 28 percent and said: "The shooting war is over, but the unjust and discriminatory (Federal admission) tax remains to plague us to the limit."

Reports, reflecting business conditions for the 4-month period, by comparative percentages follow:

Theater or circuit	November 1949	December 1949	January 1950	February 1950	Average
	Percent	*Percent*	*Percent*	*Percent*	*Percent*
Adelphi Theatres, Chicago, Ill.	−20	−20	−18	−30	−22
Anderson Theatre Co., Mullins, S. C. (13 theaters)					−30 5
Avalon Amusement Corp., Chicago (2 theaters)	−20	−35	−20	−25	−25
Bartelstein Circuit, Chicago (8 theaters)	−26	−27	−29	−31	−28 25
Blumenfeld Theatres, San Francisco (neighborhood houses)					−13
B. P. R. Corp., Chicago (4 theaters)	−20	−30	−20	−40	−27 5
California & White Palace Theatres, Chicago (2 theaters)	−15	−20	−26	−28	−22 25
Delft Theatres, Inc., Marquette, Mich. (22 theaters)					−5 5
Esquire Theatre (north coast circuit), San Francisco					−15
Fox Theatre (Fox west coast circuit), San Francisco					−9 8
Golden Gate (RKO), San Francisco					−14. 4
Gollos Bros. Lockwood Theatres, Chicago (11 houses)	−15	−20	−25	−25	−21 25
Grand Theatre, Eldora, Iowa	−4	−5	+2	−21	−7
Harris Amusement Cos , Pittsburgh (17 theaters)					−8
Jackson Park Theatre, Chicago, Ill.	−10	−10	−20	−20	−15
Jones, Linick & Schaeffer, Chicago (3 theaters)	−18 1	−18 3	−16. 9	−27. 5	−20 2
Melbro Amusement Corp., Chicago (1 theater)	−20	−25	−25	−30	−25
Sam Meyers Suburban Theatres, Chicago (6 theaters)	−3	−22	−4	−5	−8 5
Midwestern Booking Agency, Columbus, Ohio (10 theaters)	−24. 78	−24 40	−5 05	−21 92	−19 04
Monroe Theatre, Chicago	−24	−23	−7	−14	−17
Montclare Theatre Co , Chicago (2 theaters)	−15	−30	−35	−35	−28 75
Music Box Theatre Co., Chicago (1 theater)	−25	−30	−35	−35	−31. 25
Neighborhood Theatres, Inc., Richmond, Va. (44 theaters)	−10. 92	−13. 21	−8. 77	−8. 55	−10 36
Charles Niles, Anamosa, Iowa (2 theaters)	+4	−3	+2	+1	+1
Orpheum Theater (North coast circuit) San Francisco					−15
Paramount Theater (Paramount circuit) San Francisco					−15
Park Manor Theater, Chicago	−30	−30	−25	−25	−27 5
Rio & Lee Theaters, Joliet, Ill (2 theaters)	−20	−25	−35	−35	−28 75
San Francisco Theaters, Inc. (neighborhood theaters), San Francisco					−9
Snaper Theaters, New York (5 theaters)	−11	−17	−22	−24	−18 5
States Theater, Chicago	−8	−12	−6	−33	−14 75
Stillwater Auditorium Co , Stillwater, Minn (2 theaters)		−12	−21	−11	−14 67
State Theater (Paramount circuit) San Francisco					−15
St Francis Theater (Paramount circuit), San Francisco					−15
United Artists Theater (north coast circuit), San Francisco					−15
Valos Theaters, Chicago (6 theaters)	−14	−12. 5	−14. 5	−19	−15
Y & W Management Co , Indianapolis (34 theaters)	−7	−12	−10	−6	−8 75
Over-all average					−17 18

[Attachment D]

Albany	10	Milwaukee	8
Atlanta	48	Minneapolis	22
Boston	27	New Haven	1
Buffalo	7	New Orleans	18
Charlotte	5	New York	5
Chicago	21	Oklahoma City	23
Cincinnati	38	Omaha	8
Cleveland	9	Philadelphia	71
Dallas	63	Pittsburgh	13
Denver	0	Portland, Oreg	1
Des Moines	5	St. Louis	12
Detroit	37	Salt Lake City	6
Indianapolis	3	San Francisco	14
Jacksonville-Tampa	14	Seattle	7
Kansas City	16	Washington	13
Los Angeles	28		
Memphis	27	Total	580

Mr. MYERS. First, I want to recite the declining revenue being collected by certain municipalities which have local admission taxes. These figures tell the story of what is happening in our business much more clearly than the Internal Revenue Bureau's figures, because they cover only the taxes collected on admissions to theaters, whereas the Bureau lumps together the admission taxes collected on all spectator amusements.

The city of Pittsburgh, Pa., imposes an admission tax and we include in our statement the collections from movie patrons from November 1949 to May 1950, both inclusive. These collections nose dived from $74,067 in November to $48,742 in May, a decline of 34 percent.

Senator CONNALLY. There was no change in the Federal tax law during that period.

Mr. MYERS. No, sir. I am speaking of local State taxes.

Senator CONNALLY. We cannot control that. It was not the Federal tax that caused that slump, was it?

Mr. MYERS. I think it contributed to it because, as shown in the statement filed before the House and included in that record, the admission taxes have amounted to some 67 percent to 80 percent of the net profits of some theaters.

The CHAIRMAN. Has television affected your industry?

Mr. MYERS. Yes, sir.

The CHAIRMAN. To what extent do you estimate television has affected the motion picture theaters?

Mr. MYERS. I have no basis on which to say, sir. It is one of a number of contributing causes, certainly a very important one as the House committee found in its report. That is free entertainment as against entertainment for which you pay at the box office.

Senator MILLIKIN. Obviously as competition becomes greater, the burden of taxes becomes heavier for you to bear and makes competition more difficult to bear.

Mr. MYERS. That is true.

Senator MILLIKIN. Also you do not have admission taxes on residential television.

Mr. MYERS. That is exactly the point.

Senator TAFT. It is also true that these figures on the reduction of city taxes does not take into account any increase in this tremendous number of outside admissions?

Mr. MYERS. No, sir.

Senator TAFT. The cities are not able to collect on them, I suppose. In other words, has not the movie shifted from the cities to the country to a large extent?

Mr. MYERS. There are perhaps 19,000 indoor theaters as against not more than 1,200 so-called drive-in theaters.

Senator TAFT. Last fall I certainly saw a drive-in theater in every county in Ohio, either being built or being operated. They are all over the place. We cannot very well be responsible for where people go to see their movies. I suggest your city figures are based in part on the fact that city business has shifted to the country.

Mr. MYERS. That could not by any possibility account for more than a small fraction of this decline.

Senator MILLIKIN. I suggest that it is a seasonal business and that would not have any effect on the January figures except for the South. In the North they shut down these outdoor theaters in the wintertime.

Mr. MYERS. I happen to know, Senator Taft, that Ohio probably has more drive-in theaters than any other State. I do not know why they have become so popular there unless the climate in Ohio is to salubrious that people like to stay out of doors instead of indoors.

Senator TAFT. That is a good reason.

The CHAIRMAN. All right, Mr. Myers.

Mr. MYERS. Chicago, Ill., also has a 3 percent gross admissions tax and we are able to give the collections for all types of theaters from October 1949 to April 1950. Here the falling off is from $139,279.31 in October to $108,562.54 in April, a decline of 22 percent.

You gentlemen of the committee will recognize that is a direct reflection of the decline in theater attendance because these are strictly admission taxes and they relate only to theaters and are not encumbered with all of the other spectator amusements as are the Federal figures.

The city treasurer of Cincinnati, Ohio, was kind enough to give us the admission tax collections for the first 3 months of 1949 and the first 3 months of 1950, showing separately the collections from downtown theaters and suburban theaters.

For the first 3 months of 1949 suburban theater taxes amounted to $18,724; downtown, $28,057; or a total of $46,781.

Now for the first 3 months of 1950 suburban theaters dropped to $10,695.66; downtown theaters, $23,441.58; or a total of $34,137.24.

This shows an over-all decline for Cincinnati of 25 percent, but the decline for the suburban theaters—which, generally speaking, are the independent theaters—is much greater.

Included in our written statement is a table, in terms of percentages, showing the decline in the collection of admission taxes in 27 Ohio cities for the first 3 months of 1950 as compared with the like period in 1949. These declines range from 26 percent for Greenville to 9 percent for Cleveland Heights, but the decline for Cleveland proper is 20 percent.

A poll covering 11 States made by the Motion Picture Herald and attached to our written statement shows a comparision, in terms of percentages, of the falling off in business during the past year. It shows an over-all average decline of 17.18 percent. That reaches into 11 States. However, the last month included in the survey was February and so the table does not reflect the disastrous experience of the last few months.

There has been a decline in Federal and State corporate income and excess profits taxes from movie sources from $136,000,000 in 1946 to $49,000,000 in 1948.

Senator MILLIKIN. In what area?

Mr. MYERS. The whole United States, sir. These are taken from Department of Commerce publications.

Even the Federal admission tax collections for all spectator amusements for the first half of fiscal year 1950 have lagged behind the collections for the same period in fiscal year 1949, indicating a minimum drop of $9,000,000 in collections from movie patrons alone. There again I point out that this does not include the last few months which have been particularly bad.

Now for the depressing results of this movie depression—for that is what it amounts to. A survey recently made by the branch offices of the film companies reveals that 580 motion-picture theaters have

closed permanently in the past 6 months. This does not include the temporary closings and reduction of playing time which also are contributing to unemployment in our business.

Senator MILLIKIN. How does that compare with previous periods?

Mr. MYERS. There are no statistics that I can find for previous years.

Senator MILLIKIN. How many picture houses have you altogether?

Mr. MYERS. Nineteen thousand.

Senator MILLIKIN. Five hundred eighty closed in the past 6 months?

Mr. MYERS. Yes. There has been no such experience in the memory of the oldest people in the business apparently.

Senator TAFT. What do you blame it on? What is the reason for it? Consumer purchasing power is higher at the present time than it has ever been. Is it entirely television

Mr. MYERS. No, sir. There are as many theories as there are people concerned with it, but here I think is one of the main ones. With the relaxation of controls on scarce materials and credits, installment buying has taken a tremendous surge and I think the available spending money for the time being is very largely diverted to refrigerators, automobiles, washing machines, television sets, homes, and the so-called durable goods. Then of course television is a tremendous factor. When the budget gets a little skimping and there is free entertainment as against entertainment that requires an admission fee, the choice is pretty easy to make.

Senator TAFT. Of course, as far as the State of Ohio is concerned, the coaxial cable got there in October and it now covers every city and there has been a tremendous boom in television. So, if the decrease in Ohio is greater than in other places, it might indicate that it was television.

Mr. MYERS. I have not used Ohio as a horrible example. It so happens that there are more municipal taxes in Ohio than in any other State and there were more figures available.

Senator MILLIKIN. Is it not true that regardless of the reason, whether it be competition with other products, or competition with television, or whether it be the quality of the pictures, whatever the reason, the greater the competiton the greater the need for getting rid of this tax which impairs your ability to compete?

Mr. MYERS. Yes, we go in the same competitive arena with a millstone about our necks.

Senator TAFT. Is it a permanent decrease or does it come from a temporary condition?

Mr. MYERS. The people in the motion-picture business are proud of their business. They have confidence in it. They believe it stands first in the affections of the American people among all amusements. We have no doubt that if this burden is lifted we can stand on our own feet. We do not ask for any subsidies, we do not ask for any private supports, but we do not think we should be handicapped at a time like this, particularly in view of the fact that the motion picture is a recognized part of the press.

I would be the last to suggest putting the boil on another man's neck. Certainly I would be the last to suggest an excise tax on newspapers and magazines, and yet in principle there is no difference.

That is not only pretty clear to anyone who thinks about it but the Supreme Court has said, and I quote it exactly:

We have no doubt that moving pictures, like newspapers and radio, are included in the press whose freedom is guaranteed by the first amendment.

As I said, if war comes, the Government, the military branch of the Government, will be asking the motion-picture industry to carry its messages in the most graphic of all forms to the people. It seems a little odd that for that purpose the Government should exact an admission tax from those who attend those performances.

I am not speaking now of the morale building and all that sort of thing; I am merely talking of it now as a communications industry. As such I think it is worthy of your consideration.

Senator KERR. Mr. Myers, I note that some pictures run to capacity houses for weeks while other pictures in what seem to be larger, more expensive theaters run for the regular time to much less than a full house. Is it not possible that the quality of the picture or the subject of the picture might have a good deal to do with it?

Mr. MYERS. Senator, if there were someone who could predict with unerring accuracy the public fancy from time to time, I doubt that there would ever be any problem in the business.

Senator KERR. Nobody is more able to verify that than men who are in politics, but I am not speaking about the probable drawing power of future pictures. I am asking just as a matter really of seeking information about something I have been very curious about, if records of present and past pictures would indicate the possibility of such a conclusion.

Mr. MYERS. I doubt it, sir, because no one ever tried to make a bad picture. No one ever tried to make a picture that would not attract patrons to the box office. But with all the brains and genius they are able to assemble, they still cannot hit it all the time.

Senator KERR. I notice a great dearth of good mystery stories. That practically keeps me away from the movies. I just wondered if there was anything that could be done about that.

Mr. MYERS. Senator, I represent here an over-all organization of the motion-picture industry but my connection is with the theaters. About a year ago the Association made a survey among exhibitors to find out, if they could, what the public wants to see. You may be pleased to learn that a great many theater owners share your view; they said there were too darn many "who-dunnits"

Senator KERR. I notice on the radio they have increased their presentation of that kind of entertainment. I notice that the bookstands apparently do an amazing business in that kind of entertainment. I wonder if folks have a different desire with reference to what they see in the theater than they do with reference to what they hear on the radio or read in books.

Mr. MYERS. Well, I cannot find enough on the bookstands to bring home to satisfy my wife. She reads every one that is published.

Mr. Chairman, I think I have occupied as much of the time of this committee as I should.

The CHAIRMAN. We thank you for your appearance, Mr. Myers.

Mr. MYERS. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Sullivan.

STATEMENT OF GAEL SULLIVAN, EXECUTIVE DIRECTOR, THEATER OWNERS OF AMERICA, INC.

Mr. SULLIVAN. Since my appearance before the House Ways and Means Committee, I have been in 25 States of the Union. I have had a first-hand opportunity to analyze the impact of the burdensome taxes on our box office.

While Mr. Myers cited the closing of 580 theaters in our various exchange areas throughout the country, there are approximately 9,000 of our theaters now, of the 19,000 that are what we call marginal, they are close to the red ink.

With respect to your question, Senator, about the impact of television, a survey was made by our national theaters. They own 543 theaters throughout the country and they found that the impact of television saturation areas was 40 percent off in the box office and where there was no television saturation it was 20 percent off in their theaters.

While we do recognize that there is an enormous competition for the amusement dollar today, night racing, night baseball, and many of the various spectator sports, we still take about 76 cents of the amusement dollar.

Also, we have lost our foreign markets, which were always a very lush return for production, and we have had to concentrate on the domestic economy for the return from our films. That, too, has been a serious source of trouble.

Senator MILLIKIN. Do the foreign films coming into this country take up any appreciable amount of the amusement dollar?

Mr. SULLIVAN. No, they do not, Senator, and we welcome most of them. We have always felt that by and large the content of our films is superior to foreign production, and can be and will be.

One of the serious troubles that we have, as I traveled around the country, is the fact that in the teen-age group, that is the 12 years to 20 years, they represent between 40 percent and 45 percent of our patronage. In the group between 20 years and 35 years they represent about 35 percent of our patronage, and the remaining percentage of 25 is in the age bracket of 35 years and over.

I mentioned these 9,000 theaters. They are concentrated in towns of 10,000 population or under, and there most of those theaters have been forced to cancel their matinees and have an operating time only in the evening and in many instances they are operating merely on week ends.

It is in the loss of the teen-age patronage, who become the real habitual theater-goers tomorrow, that we are finding now a very serious blight on our box office.

Senator MILLIKIN. They do not have a lot of money to spend either.

Mr. SULLIVAN. They do not.

As you may remember, in the taxes that now exist the teen-ager or student tax is exactly the same as the adult tax. That was one inequity in the tax bill that the House endeavored to correct by having the tax 1 cent on every 5 or major fraction thereof. The tax as it now exists is 1 cent on 10 cents or major fraction thereof for all groups.

Gentlemen, I think this is causing an organic illness to our business. Our operating force is unlike many other industries because

whether we have 10 people in our theaters or a thousand people, we must employ through municipal regulations or sanitary codes or police or fire regulations the same amount of help. We cannot, like some other industries when they meet curtailment in operations or deficiency, start to lay off personnel. We must retain our janitors, our operators, our ushers, our doormen, ticket takers, our managers in the same complement whether we are running at a reduced rate or at a higher rate.

Senator KERR. What is the average in admission charge today compared with a year ago, 2 years ago, and 5 years ago?

Mr. SULLIVAN. Senator Kerr, the average admission price throughout the country is 40.1 cents. That has not increased by 11 percent over the last 10 years. In many instances our theaters have tried to absorb that tax and not raise them.

I cite an example. Frank Walker, who operates a chain of 67 theaters, has not raised his price since 1932 and he tried in all his houses throughout New England and the eastern coast to keep that price down. But in the over-all throughout the Nation it has not increased 11 percent since 1937.

The CHAIRMAN. The House bill places a tax on the actual price of the ticket, does it not?

Mr. SULLIVAN. It is 1 cent on 10 or major fraction thereof as it exists now, and the House bill is 1 cent on 5 or major fraction thereof.

The CHAIRMAN. In that way it helps the teen-age patronage group.

Mr. SULLIVAN. They have attempted to correct that in the new House bill. In section 1700 of the Revenue Code, as presently amended, the teen-age Wax has been the same as the adult tax.

The CHAIRMAN. The tax is on the actual cost of the ticket?

Mr. SULLIVAN. Yes, sir.

The CHAIRMAN. The actual price paid?

Mr. SULLIVAN. On the established price.

Senator MILLIKIN. Is the matinee price usually less than the evening price?

Mr. SULLIVAN. Yes; Senator, it is. There is generally an increase in the price from 6 o'clock on. For example, in Chicago they will have a 40-cent admission at the matinee and 60 cents in the evening.

In closing, Senator, I have only one thought to pass on, that our industry today presently employing about 250,000 people is regarded, in the influences and the trade velocity that it creates, as about the sixth major industry in this country. Just those 250,000 people and their families represent well over a million. But that just applies to production and distribution; it does not apply to any of the manufacturing houses that create our equipment, projection machines, air conditioning equipment, the carpets, the seats, or any allied industries that help to support it.

We can be a healthy, thriving industry, we can stand on our own legs to meet the coming of any additional spectator competition, we believe, if the burdensome taxation is relieved.

I might add that some of the Congressmen expressed the fear that while the Federal Government needed all possible revenue they might be voting a transfer tax, that if they gave it to us now, knowing that the box-office tills of our theaters provide an economic and speedy way to get revenue the cities and States would reimpose that tax at the local level. We were able to assure the Congressmen that the

public who had sought so vigorously to get the repeal of the admission tax at the Federal level will fight just as vigorously or support our cause just as vigorously to prevent the reimposition at the local level.

I might say, gentlemen, that during the past war we sent millions of dollars to foreign countries in our films for our troops and we did not take one single penny from the Federal Government for those films. Every other industry that supported the war effort was paid, United States Steel, General Motors, for whatever they produced for the Government. But in this great morale uplifting force that we provided for millions of our troops overseas, the motion-picture industry provided those feature films, shorts, and newsreels without cost.

If you would go to our newsreel today or tomorrow and see the developments in the Korean conflict, what General MacArthur is saying, what our troops are doing in the way of being trained, what has happened in the United Nations, the vivid presentation of this, as the old Chinese saying, is better than 10,000 words.

We want to continue to provide that visual education for the Nation. We want to be prepared for any emergency, where the Government may call upon us either to provide adult classrooms within the Nation, if you have some civilian defense need, or to provide in foreign service any visual education that our Nation may require. We can do that if we are organically sound, and presently we are suffering from a tax cancer that can only be helped by its excision.

Senator MILLIKIN. How much of your movie dollar stays in the town where it is spent?

Mr. SULLIVAN. There are two types of rentals for films, Senator. There is what is known as the flat rental where there is a stipulated price for the film, generally employed for small houses. Then there is the percentage film where a charge averages between 30 and 35 percent. The rest remains in the local community.

The CHAIRMAN. Are there any further questions?

Senator BUTLER. Mr. Sullivan, is it you feeling that the relief would have to come in a complete elimination of the tax?

Mr. SULLIVAN. Yes, because of our mounting costs, Senator Butler, and the analysis of how we could pass this saving on. We intend, and we have so stated throughout the industry that any saving that may be granted through tax relief will be passed on to the patron.

While Senator Taft cites the enormous increase in purchasing power and Mr. Myers cited the tremendous volume of deferred payment buying at the present time, there is one factor, Senator, that the amusement budget, the recreation budget, of the average family has shrunken.

My wife went out in New York over the week end to buy some steak and she said it was $1.32 a pound. So she did not get as big a steak as she wanted to buy. I could not begin to comprehend how the average family earning, say, as the Department of Labor reveals, $57 a week, could have very much as a family for their amusement or recreation.

Senator TAFT. I do not think that you will find any increase that will account for this falling off in movies. In other words, the cost of living has not gone up to any extent in the last 5 years. It varies a little but nothing to account for 20-percent falling off in amusements.

Mr. SULLIVAN. We have by analysis and by sampling found that the amusement budgets of average families have shrunk.

Senator TAFT. Have they substituted vacation trips or something of that kind?

Mr. SULLIVAN. Possibly so, or they have sought other channels of recreation.

Senator TAFT. I was interested in seeing whether this falling off was a permanent thing or whether it is just a temporary condition from a sudden growth in television.

Mr. SULLIVAN. I do not think it is, Senator. Along with the tax burden, I think we could have a greater and more even flow of good products in the readjustment from the foreign markets. Many of the large studios and even the minor studios curtailed or lowered their production schedules. For example, this year Fox is producing 26 films. In 1940 they were producing 60. When there is an uninterrupted flow of good product to our theaters, there is an assurance of a continuity of the motion-picture habit of going to it. We feel that as Hollywood adjusts itself to the domestic market more and more, we will have that uninterrupted flow of good product and the assurance of continuity of the motion-picture habit. It is not a question of having one good picture this week and three stinkers in the week to follow; you have to have five or six, an even flow each week to guarantee the motion-picture habit.

Senator BUTLER. Is it not true, Mr. Sullivan, that if a readjustment of the family budget is necessary, it would be only natural that the recreational part of the expense would be the first one they would have to cut?

Mr. SULLIVAN. It is true, Senator. You take in the average family of father and mother and three children, if they were moviegoers twice a week, their admission tax would be between $30 and $36 a year.

If it were channeled into other phases of activity on Main Street—where, if people come to the theater we have always felt we have been stimulators to patronage in the businesses that are an integral part of Main Street, the drug store and drygoods store, and where we have attracted them to the theaters from rural areas or from suburban areas generally they have spent money in those other stores on Main Street—where that amount of tax might be applied to the purchase of soft goods or even hard goods, it would be a definite asset to their own life and perhaps enhance their recreational opportunities.

The CHAIRMAN. If there are no further questions, thank you, Mr. Sullivan.

Mr. SULLIVAN. Thank you, sir.

The CHAIRMAN. Mr. William Manice.

STATEMENT OF WILLIAM DE FOREST MANICE, DIRECTOR, METROPOLITAN OPERA ASSOCIATION, NEW YORK, N. Y.

Mr. MANICE. Mr. Chairman and gentlemen of the committee, my name is William De Forest Manice. I am director of the Metropolitan Opera Association in New York.

The Metropolitan Opera Association appreciates this opportunity to appear and offer additional facts which have come to light since their testimony was given before the House Ways and Means Committee.

As you gentlemen are aware, the Metropolitan Opera is the leading producer of operas in this country and as such is an educational and cultural organization. It produces operas every day of the week for a period of 18 to 20 weeks in New York City. The company then goes on tour for a period of 5 or 6 weeks to the leading cities of the country and in that way reaches an additional audience of perhaps 300,000 people. Its Saturday afternoon performances are broadcast over the radio and it is estimated that they reach some 15,000,000 people.

Senator TAFT. Do I understand that the House exempted symphony orchestras but did not exempt the opera?

Mr. MANICE. The opera has been exempted since 1931.

Senator TAFT. In the present law the House bill exempts symphony orchestras but does not exempt the opera?

Mr. MANICE. It does exempt the opera. It is so intended and if it reads the same as the law read prior to 1941, the opera would be exempt.

Senator TAFT. It reads:

> Exclusively to the benefit of religious, educational, or charitable institutions, societies or organizations, societies for the prevention of cruelty to children or animals, or societies or organizations conducted for the sole purpose of maintaining symphony orchestras and receiving substantial support from voluntary contributions.

The CHAIRMAN. You understand that the opera is exempted under the House bill?

Mr. MANICE We were so advised.

Senator TAFT. You are asking us to retain the House language?

Mr. MANICE. I think that is a restoration of the wording that existed prior to 1941.

Senator TAFT. I am told that the word "educational"' is held to cover operas, to exempt religious, educational, or charitable institutions.

Mr. MANICE. I believe so.

The opera through its auditions encourages musical talent and helps artists to become recognized and established. It offers performances to school children at minimum prices and even free performances where the minimum fee cannot be paid. The Opera News reaches a circulation of between 40,000 and 50,000 readers and helps to educate them in the story and history of the operas and its various performances.

The opera enjoys an exemption from the Federal income tax, from the New York State taxes, in fact every form of taxation except the admissions tax which it was exempted from until 1941. It has never passed that tax on to the ticket purchasers; it has always absorbed the tax itself.

In recent years the increased cost of operation has become so heavy that the opera has operated at a deficit in excess of $100,000 for the past 4 or 5 years. It employs some 800 people.

Senator MILILIKIN. How do you make good the deficit?

Mr. MANICE. The deficit to some extent has been made good by individual contributions but it is felt that there the limit has been reached because the contributions that used to be made in hundreds of dollars now are made in tens of dollars.

Senator MILLIKIN. Does that not stem also from the high taxes in other fields, the income-tax field, for example?

Mr. MANICE. I beg your pardon. I did not hear the question.

Senator MILLIKIN. Is not your difficulty in getting the contributions enhanced by the high income taxes?

Mr. MANICE. Yes, I would say so.

The opera employs some 800 people. Its budget is about $3,000,000 a year of which over $2,300,000 is spent for wages.

When the figures were given before the House Ways and Means Committee it was estimated that the deficit for the 1949–50 season would be approximately $200,000. General Spofford, president of the Metropolitan Opera Association, so testified. Since then the figures for the season have been compiled. They show a deficit of $318,643 or some 50 percent more than the original estimated deficit.

For the next season, 1950–51, due to the necessity of including New York unemployment insurance as a means of making agreements with the various unions involved for next year and to the probable increase in the social-security tax which will amount in total to $75,000, it is estimated that the deficit will be $405,000, or substantially the amount that was paid to the United States Government in admissions taxes during the past season. For the season just passed the Metropolitan Opera Association has paid in excess of $400,000 in Federal admissions taxes.

Senator CONNALLY. You say that you do not pass that on to the purchasers of the tickets?

Mr. MANICE. No, sir.

Senator CONNALLY. Why not? That is what the tax was intended for, that they should pay

Mr. MANICE. We found on a survey that we had reached the point in our ticket prices, due to the cost of maintaining the opera and paying the salaries, where that was the maximum amount that the public would pay and therefore we found that we had to absorb that tax. Our prices range from $1 50 to $7.50 a ticket. On Saturday nights they have popular price performances at a lower rate, but we have been advised that our ticket prices have reached the maximum limit at which public patronage can be counted on to continue.

Senator KERR. In other words, you anticipate the ability of the customer to pay and beat the Government to him?

Mr. MANICE. No. Originally the tax was 10 percent and we absorbed that tax and did not increase our price. Then the war came and we found it was not feasible to increase the price during those periods. In fact, for a short period during the war, because the wartime restrictions prevented our producing as many operas and as elaborate a repertoire, as complete a repertoire, we almost balanced our figures. It is only in the last 3 to 4 years that we have been running a deficit. Our deficit for 1948–49 was $167,000. Last year it was $318,643.

The cost of producing the opera, the wages, the transportation costs on tour, all of those expenses have mounted to the point where we now are facing a deficit that cannot be met except, first, by tax relief and, secondly, to whatever extent possible by public contribution. But as I said before, the public contributions are a rapidly decreasing source of revenue.

Senator KERR. Well, you would not anticipate reducing the price, then, to the customer if the tax were repealed; in view of the fact that you absorbed it when the tax was increased.

Mr. MANICE. I had pointed out that the amount that we pay now is the amount of our deficit. As long as that condition exists, it would be very difficult if not impossible to consider reduction in price.

Senator KERR. What is your situation with reference to the percentage of your facilities that are filled?

Mr. MANICE. During the season in New York we play to a 97 percent capacity audience. On tour, the houses are usually completely filled, because they are booked in advance for a short period in each city.

Senator KERR. How long a season do you have?

Mr. MANICE. Eighteen to twenty weeks in New York City; 5 to 6 weeks on tour.

Senator TAFT. Mr. Manice, in foreign countries are not operas frequently supported by the government?

Mr. MANICE. They are; in every foreign country outside of the United States, so far as we are advised, they are subsidized by the government. We, of course, are not seeking a subsidy. We are only seeking relief from having to pay the Government for the privilege of continuing to do business.

Senator KERR. Well, if we repealed the present tax, that would just put you on a basis of operating in the black, but just barely.

Mr. MANICE. Next year, however, if the tax was repealed, and it was the same kind of a year as this, our figures would be just about in balance.

Senator KERR. Then if the deficit continues to increase, in another 3 or 4 years, what measures would be indicated?

Mr. MANICE. I think the same measures would be indicated that any prudent organization would have to take. They would have to curtail their activities or consider economies.

Senator KERR. Have you considered lengthening the season?

Mr. MANICE. That is not feasible, because the Metropolitan audience will not attend after the weather becomes warm in the spring. We open in November, and then right after Easter we go on tour, and by the time the opera comes back from the tour it is the middle of April or the first of May, and they will not sit in an un-air-conditioned opera house.

The Metropolitan Opera House is not air-conditioned, of course. It would cost several hundred thousand dollars, according to our estimates, to air condition it; and so far we have not been convinced that it would add sufficiently to our revenue by permitting a prolonged season to justify that expense, in addition to which we haven't the money at the present time.

Senator MILLIKIN. Are there not serious questions that have been raised as to whether you should stay in business at all? Have you not given consideration to that question?

Mr. MANICE. Very seriously; and it is a very vital question in connection with what we face next year, because as a result of these recurring deficits we have no further capital funds with which to meet the deficits.

The CHAIRMAN. If there are no further questions, we thank you, Mr. Manice.

Senator CONNALLY. Let me ask you one thing.

You say you are a director. Are you a full-time paid officer of Metropolitan?

Mr. MANICE. No, sir. It is a nonpaid organization. All serve without pay except the managing director. I am not the managing director. I am a lawyer in New York City, and I serve the Metropolitan as a civic institution, without pay.

Senator CONNALLY. I congratulate you.

You are not yourself in the position of being able to make up this deficit?

Mr. MANICE. Not with the present state of the practice of the law in New York City, and the Federal income taxes, no.

The CHAIRMAN. Thank you very much, Mr. Manice.

Mr. MANICE. Thank you, Mr. Chairman.

The CHAIRMAN. Without objection, we will insert, at this point in the record, statements of Mrs. Helen M. Thompson, manager of the Charleston, W. Va., Symphony Orchestra, and Arthur J. Gaines, manager of the Minneapolis Symphony Orchestra.

(The statements follow:)

STATEMENT OF MRS. HELEN M. THOMPSON, MANAGER OF THE CHARLESTON (W. VA.) SYMPHONY ORCHESTRA, AND SECRETARY-TREASURER OF THE AMERICAN SYMPHONY ORCHESTRA LEAGUE, AN ASSOCIATION REPRESENTING MORE THAN 500 COMMUNITY, AMATEUR, AND COLLEGE SYMPHONY ORCHESTRAS

On behalf of more than 500 community and college, nonprofessional, symphony orchestras in the United States, I wish to express appreciation for this opportunity to place before you a statement of our purposes, achievements, and grave financial need for the proposed exemption from the 20 percent Federal excise tax on admission tickets to our concerts.

Within the last few days, you have received a similar statement from Mr. Arthur J. Gaines who represents the association of 25 major or professional symphony orchestras in the United States. The orchestras which I represent are not in competition with the professional symphonies, but rather supplement their work by providing the following:

(1) Opportunities for nonprofessional, amateur, and student musicians throughout this country to play symphonic music.

(2) Opportunities for thousands of people living in small communities throughout the Nation to hear this great music. These are the communities which cannot afford to maintain the more costly professional symphony orchestras.

(3) Opportunities for the young and aspiring instrumentalists, conductors, soloists, and composers of this Nation to gain the experience they need to develop their talents so that some of them may enter professional music careers.

Our orchestras exist in every State in the Union—in towns and cities having populations of less than 10,000, such as the orchestras in La Junta, Colo., Kearney, Nebr.; and Greenville, Pa.; on up to orchestras in the larger cities such as Dayton, Ohio; Springfield, Ill.; Bangor, Maine; and Charlotte, N. C.

These quasi-professional and amateur orchestras exist only because people in their communities hunger for fine music and are willing to work hard in order to have it for themselves and their children. Almost all of the community symphony organizations are managed and operated through the volunteer work of the townspeople. The orchestras are supported through ticket sale, and contributions from individuals and industry, because they offer an opportunity for the community to have and participate in a cultural way of life. Most of them are incorporated nonprofit institutions, set up for the express purpose of doing educational and cultural work in their communities.

Some of the orchestras have written even broader community service obligations into their constitutions. For instance, the Haverhill, Mass., symphony is dedicated to the task of using music to "promote greater unity, to build morale, to prevent juvenile delinquency and to make a finer city."

These orchestras bring living symphonic music to hundreds of small communities which would not otherwise have it. As does the Madison, Wis. Symphony, many of them offer opportunities to young artists in the area to appear as orchestra soloists—an opportunity which often spurs a young musician on to greatness in a musical career. These orchestras play music written by budding young American composers from their own areas. Some of them commission American composers to write new works for the orchestras. The Louisville (Ky.) Symphony

and the Charleston Symphony are two examples of orchestras which caused new American music to be written last year. These community orchestras are the medium whereby great segments of the American public become acquainted with America's own cultural output. Such opportunities for our composers may be the means whereby an American Beethoven will come into his own.

Some of the orchestras such as the Norwalk (Conn.) Symphony play free symphony concerts for thousands of America's school children. As in the case of the Wichita (Kans.) Symphony and Williamsport (Pa.) Symphony some offer free scholarships for advanced music study to the outstanding student musicians of their areas. Some of them develop community choral groups such as has been done by the Birmingham (Ala.) Symphony. Several of them have established youth symphony orchestras, offering free music and orchestral instruction to the grade-school and high-school students as has been done by the Rockford (Ill.), the Wichita (Kans.), the Chattanooga (Tenn.) and the Springfield (Mass.) Symphonies.

Some of them—such as the Flint (Mich.) Symphony put on true community participation concerts in which a local soloists, a local composer, a local guest conductor, and students from a high-school class all have a part in the program so as to widen the music and cultural experiences of the community. Some of them combine with educational institutions in presenting orchestral clinics for 20 or 30 high schools in adjoining areas as was done recently in Mitchell, S. Dak., by the Dakota Wesleyan University, in conjunction with the Sioux City, Iowa, Symphony. The Idaho State Symphony at Pocatello, Idaho, plays benefit concerts for other community music organizations and through one such concert helped to send the Aberdeen High School band to the Tournament of Roses parade.

This work is made possible only through the volunteer efforts of thousands of people. In these nonprofessional orchestras, some of the conductors and a few of the managers are paid living salaries—though that is not generally true. In all of these orchestras, the musicians receive very little if any income from their symphony work. They represent a cross-section of the people in their communities. They are the doctors, the lawyers, the farmers, the secretaries, the housewives, the college and high-school students, the workers in the factories, the merchants, the scientists, the teachers and the professional men of the community. As children, these people learned to play a musical instrument. As adults, many of them dropped their music until the formation of a local symphony again gave them an opportunity to play both for themselves and their friends and townspeople. Our Charleston Symphony recently had a Ph.D. chemist join the orchestra. He had not played his bass fiddle for 13 years, and was grateful for the opportunity to play fine music as a counterbalance to his highly technical scientific work. "It makes me a better chemist," he remarked.

The Welfare Association of the United States Department of Agriculture is sponsoring a community orchestra right here in Washington as a constructive outlet for their employees. The Dow Chemical Co. in Midland, Mich., completely finances a community symphony because the company finds it improves the mental stability and general satisfaction of their workers. After a full day's work, these musicians spend long evenings rehearsing so that they may play several concerts a year. Some of them may belong to the musicians' union—most of them do not—but through special union dispensation all play together in these community orchestras.

Even though many of these orchestras rely on the voluntary work of the musicians, there are many other expenses which they must meet. They must buy or rent music, pay ASCAP fees on the use of that music, rent rehearsal and concert halls, pay for printing of programs, tickets and publicity, pay stage hands fees at the prevailing high rates—and, out of their slim resources, they also must pay a 20 percent Federal excise tax on every ticket sold.

Usually in the middle of each year, representatives of the orchestras must trudge up and down the streets of their communities, soliciting additional contributions from civic-minded citizens and business houses in order to keep going, for sources of additional revenue available to these orchestras are limited. They bend every effort to sell additional tickets. But the population of these towns and relatively small cities is limited in the number of people who can purchase tickets. When the 20 percent tax is added to the cost of the ticket, it cuts still further into potential sales.

Most of the orchestras cannot raise the prices of their tickets—for again the size of the community limits the prices. Take Charleston, W. Va., as an example. We must sell a season ticket for six concerts to students at a price which competes with movie prices—so we cannot charge more than $2.50 for a student season ticket. Out of that $2.50, 50 cents must go to the Federal Government, and 5

cents for State taxes, leaving the orchestra a net of $1.45 for six concerts. We sell adult season tickets at $7.50, but after Federal and State taxes are deducted, the orchestra receives only $5.85. That means we would have to sell over 8,000 tickets in a community of only 80,000 population if the orchestra were to pay for itself from ticket sales.

In Columbus, Ind., a city of 10,000 population, symphony tickets must be priced at 50 cents and 75 cents including taxes. A single concert costs $600. To meet expenses from ticket sales alone, they would have to sell nearly 1,000 tickets, but about 600 is the best that they can do—and that is a high percentage of symphony sales to total population.

These nonprofessional orchestras cannot make commercial recordings as a source of increased revenue because their musicians do not all belong to the musicians' union. Even if they did, the orchestra usually does not play on a sufficiently professional level to make saleable recordings. The same situation holds for possible broadcasting revenue for many of these orchestras.

These nonprofessional orchestras cannot go on extensive tours, because, even if they could sell the concerts at a profit, their musicians must be at their daily jobs in business and industry in order to make a living for themselves and their families. Consequently, the orchestras' only hope of making ends meet is to cut down their expenses—and repeal of the 20 percent excise tax would be of inestimable help in doing just that.

It makes no difference whether the orchestra is operating on a $1,500 annual budget in a city of 5,000 population or on a yearly budget of $35,000 in a city of 100,000 the story is the same. And for the great majority of these orchestras, the amount paid to the Federal Government in excise taxes represents the difference between being able to just break even and going into the red each season.

Once an orchestra contracts a deficit on a year's operation, it is in dire trouble. At best about all it can hope to do is to almost meet the operation expenses of a current year. When deficits begin to accumulate, the orchestras do not own enough collateral to raise money through regular finance channels. Unless some public minded citizen will write off these cumulative deficits—the orchestra eventually is bankrupt, has to go out of business, and a fine educational and cultural asset is lost to the community.

I have here specific reports from community orchestras in cities and towns of different sizes in various parts of the Nation showing exactly what is happening to these nonprofit institutions this year and last.

A community orchestra started up in 1948 in Greenville, S. C., a town of 35,000 population. Last year they spent a total of $1,400 on their orchestra and paid $120 in Federal taxes. They didn't meet expenses, so raised their budget to $3,400 for this year. They must pay $700 in Federal taxes this year. They report that "if we had available right now the $700 we are going to pay in taxes, we could pay off our indebtedness and would be able to undertake our pet project—a symphony concert for the colored children of this community who never in their lives have had a chance to hear a symphony orchestra and won't have unless our orchestra can do it for them."

The Springfield (Ohio) Symphony, whose city has a 70,000 population, operated on a $14,000 budget last year. The orchestra paid out $1,762 in Federal taxes and suffered a deficit of $1,787. This year they raised their budget to $18,000, will pay $2,000 in Federal taxes and will have a deficit of $3,000.

Mr. John A. Wagner, treasurer of the Springfield (Ohio) Symphony states that "the 20 percent admissions tax definitely imposes a serious burden on the operations of the Springfield Symphony Orchestra. The orchestra and the local musical public, which is quite large, are strongly in favor of removal of this tax, the purpose for which it was imposed having ceased to exist. Our deficit can be attributed almost entirely to the admission tax. In the next year or two, the admission tax may prove to be the final insurmountable hurdle which would force our community orchestra to suspend operations."

Our own Charleston Symphony Orchestra, which is the product of 11 years of ceaseless work, effort, and dreams on the part of many people is right now facing possible disintegration. This orchestra has brought needed and valued national publicity to the city and State of West Virginia through articles in Reader's Digest, Time magazine, and network broadcasts. Last year in our city of 80,000 population the orchestra operated on a budget of $42,000, paid $3,400 taxes, and suffered a deficit of $3,500. This season, we shall have to pay $3,500 taxes, will have a deficit of $3,500 plus last year's indebtedness, making a total cumulative deficit of $7,000. We are facing an almost impossible problem in raising the needed money to keep the orchestra in operation. Some individuals and business

69474—50——12

firms have made three contributions this year—and still we must raise an additional $7,000 which represents our tax payments for the past 2 years. If the orchestra goes out of existence, because of the taxes, its whole structure of a youth-training orchestra, solo opportunities of young West Virginia musicians, concert performances of music composed by West Virginia composers also will go out of existence.

The specific cases which I have cited can be multiplied by the hundreds. They exist in practically every community which has labored to establish and maintain a community symphony orchestra of, by and for its own citizens.

Gentlemen, on behalf of over 500 community, nonprofessional orchestras, representing approximately 25,000 citizens playing in these orchestras and an estimated minimum of three-fourths of a million Americans who enjoy the music of their own neighbors and fellow townsmen, I submit to you a sincere appeal to grant full relief from the 20-percent Federal excise tax on nonprofit symphony concert admissions.

By so doing, not only will you be helping these orchestras to achieve financial stability, but also you will—in effect—be saying, "The Federal Government of the United States seeks to encourage the cultural life of this great Nation, and so withdraws a previously necessary tax which served as a deterrent to its development, thereby opening the way for ever widening participation of our people in the learning, listening and playing of the world's great music."

Attached to this statement is the list of the symphony orchestras which our association represents. Thank you.

STATEMENT OF ARTHUR J. GAINES, MANAGER OF THE MINNEAPOLIS SYMPHONY ORCHESTRA AND CHAIRMAN OF COMMITTEE REPRESENTING 25 MAJOR SYMPHONY ORCHESTRAS OF THE UNITED STATES

Our committee has been authorized to present this statement to your honorable committee on behalf of the orchestral associations and symphony societies which maintain major symphony orchestras of the highest quality in 25 cities of the United States. The cities represented are: Baltimore, Boston, Buffalo, Chicago, Cincinnati, Cleveland, Dallas, Denver, Houston, Indianapolis, Kansas City, Los Angeles, Minneapolis, Washington, D. C., New Orleans, Oklahoma City, New York, Philadelphia, Pittsburgh, Rochester, N. Y., St. Louis, San Antonio, San Francisco, Seattle, Salt Lake City.

First of all we wish to make it clear that the organizations here represented are maintained solely for artistic and educational purposes; that no symphony association in America is nor ever has been operated at a financial profit; and that we are all dependent on the contributions of private citizens of the communities in which we operate to bridge the annual gap between our earned income and our operating expense.

In recent years, our operating expenses, consisting very largely of the salaries of orchestra musicians, conductors, and artists, have increased by leaps and bounds. Earned income, on the contrary, has remained almost static, due to limitations both in the seating capacities of our concert halls and in the number of concerts that a symphony orchestra can adequately rehearse and present in the course of a concert season. This situation has, therefore, resulted in greatly increased operating deficits. A study of the operating deficits of the orchestras for the concert season of 1944–45 in comparison with season 1948–49, discloses the alarming fact that operating deficits show an increase of more than 50 percent. Under the pressure of these conditions the Detroit Symphony and the Columbus Philharmonic have already been forced to abandon their activities. There is grave danger that further casualties may be expected unless these trends can be changed. The loss to the musical world through the abandonment of any fine symphony is incalculable.

The difficult problem of symphony orchestra finance must, and will be dealt with by the boards of directors of our supporting associations. We have never had, nor do we now request governmental subsidy such as is almost universally accorded such projects in other countries. There is a way, however, in which our Government can remove a burden from our shoulders, the release of which will be of infinite help in working out a solution of our problems.

Under present regulations 20 percent of every dollar collected from the public from the sale of tickets for symphony concerts, must be paid over to the Government as an excise tax. We are convinced that this excise tax is a great deterrent to symphony concert attendance. We also know that we have little chance of

adjusting our admission prices to conform to greatly increased operating costs as long as this 20-percent excise tax on our admissions remains in effect.

During World War I the Government first levied a war tax on admissions of all kinds. At the conclusion of that war the Internal Revenue Code was amended to read: "No tax shall be levied in respect of societies or organizations conducted for the sole purpose of maintaining symphony orchestras and receiving substantial support from voluntary contributions * * * and no part of the net earnings thereof inures to the benefit of any private stockholder or individual." This specific exemption remained in effect until the beginning of World War II; then in 1941 this exemption was repealed and a tax of 10 percent was imposed. In 1943 this tax was increased to 20 percent as a wartime revenue measure and with the assurance openly given by governmental officials that it "shall continue only until approximately 6 months after the termination of the war."

We appeal to this honorable committee and to the Congress to restore the same exemption that the symphony orchestra associations and societies enjoyed during the period from 1919 to 1941. We believe the Congress should follow the precedent established at the end of World War I and we further believe this procedure is justified for the following reasons:

WHY THIS TAX BURDEN SHOULD BE LIFTED

1. Taxation of the receipts of a symphony orchestra association is inconsistent with the Government's entire attitude toward the institution with respect to all other taxes. Symphony associations are not subject to income or other taxes and the same philosophy which makes them exempt from such taxation justifies their exemption from the admissions tax.
2. There is further inconsistency in the Government's tax position. On the one hand the Government permits contributors to deduct from income and other taxes their contributions to symphonic institutions. On the other hand the Government still is imposing an indirect tax—on admissions—on the operation of the same institution.
3. In practically all other countries, symphony associations not only enjoy tax exemption but they are almost wholly supported by governmental funds. Our symphony associations are not appealing to the Government for a subsidy. Symphony organizations are hard-pressed to meet the annual recurring deficits through solicitations from the public. The public should not be subjected to the additional burden of tax on admissions.
4. The problem of symphony deficits is not limited to a small number of cities nor to the small number of people in the upper income brackets. At least 500 communities of varying size recognize the same acute dilemma in their symphony societies, and the audience which attend their concerts represent a complete cross section, at every income level, of those who enjoy and appreciate the inspiration of symphonic music. Relief from the burden of the admissions tax would be of relatively greater value to the smaller orchestral associations throughout the country, whose maintenance is in delicate balance from year to year because of financial deficits in communities of middle-class incomes.
5. The directors of these musical institutions have not sat back lazily and waited for relief from the Government repeal of the admissions tax. Every effort already has been made to tap sources of additional income. Radio broadcasts, phonograph-record royalties, and other activities. Still the deficits are increasing because symphony payrolls have increased on the same pattern as all other operating costs in industry.
6. The total amount of the annual tax on symphony admissions, while large in terms of orchestra financing, is negligible in terms of the national budget. The total admissions tax collected from the country's leading 25 orchestras in the year 1947–48 amounted to slightly more than $1,000,000. For the same period, the total operating deficits for those 25 orchestras was more than three and one-half million dollars. These figures represent a year of great prosperity when ticket sales reached a high level.

CONCLUSION

Symphony orchestras are the fount and mainspring of all musical life and activity in America. This Nation has taken world leadership in this form of the musical art and no other nation has so many nor such fine symphony orchestras. Millions of Americans across the Nation enjoy the concerts given by our more than 500 symphony orchestras in communities of every size. The symphony concerts given exclusively for children at nominal cost, or often with-

out charge, form an integral part of the musical program of our schools. Symphony orchestra members are the source for the teaching staffs of our schools and colleges.

Therefore, the restoration of the exemption from admissions taxes, as it existed during the years 1919 to 1941, is urged upon Congress as a step to be taken to make possible the continuance of the invaluable cultural and educational benefits flowing from the maintenance of symphony orchestras in the United States, and to insure the continued employment of thousands of the world's finest musicians.

We respectfully request that the foregoing statement be made a part of the record of the public hearings on H. R. 8920 now under consideration by the Finance Committee of the United States Senate, Eighty-first Congress, second session.

Respectfully submitted.

ARTHUR G. GAINES, *Chairman.*
GEORGE E. JUDD, *Boston,*
WILLIAM E. ZALKEN, *St. Louis.*

The CHAIRMAN. The next witness is Mr. Reilly, representing the League of New York Theaters.

You may have a seat, if you wish to, Mr. Reilly. Will you identify yourself, please, for the record?

STATEMENT OF JAMES F. REILLY, REPRESENTING THE LEAGUE OF NEW YORK THEATERS AND THE NATIONAL ASSOCIATION OF THE LEGITIMATE THEATER

Mr. REILLY. My name is James F. Reilly. I represent the League of New York Theaters and also the National Association of the Legitimate Theater, which is next on the list.

Senator TAFT. You represent both?

Mr. REILLY. Yes, sir.

Mr. Chairman and gentlemen, the legitimate theater, as we like to call it, is rather a small institution. Throughout the United States, including the 30 legitimate theaters in New York, there are less than 250 places where plays are presented. The business since 1933–34 has fallen from a national annual income of $80,000,000 to $50,000,000 for 1949–50. We have the same economic problems as the motion-picture people have; in some cases greater, as we are never assured any minimum income, which a picture is once it is released. I am not attempting to make any comparison between the two, but I just want to point out that we will frequently have a situation where there is absolutely no return on a particular play or investment.

However, just as the opera, as the gentleman just preceding me has said, has been subsidized in certain European countries, so has the theater, as well, been subsidized in those countries. We have never had that here in the United States.

We have had this tax since 1918. I think it was one of the two taxes that continued right through from 1918 to the present time.

We are not too dissatisfied with the bill as reported to the House and as passed by the House. We do feel this, however, that if any relief is given to any other form of entertainment, any other segment of the entertainment industry, as has been done in the past, by way of an exemption up to a certain figure, we should have the same relative benefit, either on a percentage basis or through finding some other way to calculate it.

We seek no advantage over others, but we do hope to accomplish and obtain the same advantages as others may get.

That is the extent of my statement, Mr. Chairman.

Senator CONNALLY. What branch of the industry do you represent?

Mr. REILLY. What we call the legitimate industry, the spoken theater. Our association, the League of New York Theaters, represents every legitimate theater in New York City plus most of the producers of plays throughout the United States. There are only two or three that do not belong to it.

Senator CONNALLY. They pay admission taxes now?

Mr. REILLY. Oh, yes.

Senator CONNALLY. All right. I am for the legitimate theater, if you can find it.

Senator KERR. You say your revenue has decreased from $80,000,000 to $50,000,000?

Mr. REILLY. Yes, sir; 37½ percent.

Senator KERR. Is that the revenue received by the theaters, or does that include the revenue received by the speculators?

Mr. REILLY. That does not include the revenue received by the speculators.

Senator KERR. Did the theater operators ever consider the proposition of selling their tickets to the customers?

Mr. REILLY. The majority are sold to the customers direct. There is a relatively small percentage sold by the brokers, Senator.

Senator KERR. Well, our experience is that none of them are sold by the theaters, and mighty few by the speculators.

Mr. REILLY. Well, that is not so. It is a popular conception, because of the fact that for some big hit there is difficulty in obtaining tickets. But if you take the average, all over, for the plays that are less than hits, and the hits, you probably do not find more than 20 percent sold by brokers.

Senator KERR. But if they happen to hit one that is a success, they are sold that way about a hundred percent, are they not?

Mr. REILLY. Oddly enough, there are a tremendous number of mail orders which are filled, which we assume come from the public.

Senator KERR. You do not happen to have a little address up there that a little mail could go to with some degree of hope?

Mr. REILLY. Well, I venture that you can write to the Majestic Theater and get tickets for South Pacific, if you are not too impatient.

Senator KERR. I am just 54 years old. I think maybe I could.

The CHAIRMAN. If there are no further questions, we thank you for your appearance, Mr. Reilly.

Mr. REILLY. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Charles Sands? Will you identify yourself, please, for the record, Mr. Sands?

STATEMENT OF CHARLES E. SANDS, REPRESENTING HOTEL AND RESTAURANT EMPLOYEES INTERNATIONAL ALLIANCE AND BARTENDERS INTERNATIONAL UNION, WASHINGTON, D. C.

Mr. SANDS. Charles E. Sands, representing the Hotel and Restaurant Employees International Alliance and the Bartenders International Union, affiliated with the American Federation of Labor and with the Railway Labor Executives Association.

The CHAIRMAN. You may be seated, if you wish to, Mr. Sands.

Mr. SANDS. I want to talk to you, Mr. Chairman and Senators, this morning, on the cabaret tax and refresh your memory on this. The cabaret tax is, in my opinion, misnamed, because the majority of the public and even some members of Congress imagine that it is just a tax put on some swanky night club where the people go to eat and dance and drink. Of course, that is not a fact. The cabaret tax goes on where there is dancing permitted, or entertainment.

Senator MILLIKIN. It is a tax which goes on Republican box dinners for a dollar a throw.

Mr. SANDS. Well, maybe they didn't have any cabaret, but they had some good vaudeville there.

Senator MILLIKIN. We got taxed for it just the same.

Mr. SANDS. Now, according to Webster's dictionary, a cabaret is defined as "a restaurant where customers are entertained with dancing or vaudeville acts." Well, this tax goes on every restaurant which permits dancing or singing or any form of entertainment. According to Webster, the cabaret is put in the category of places furnishing entertainment. If that is so, we cannot see why we are to be discriminated against in the bill as passed by the House.

Now, the House has reduced the tax, as I understand it, on motion pictures to 10 cents. They likewise reduced the cabaret tax and then juggled it around, and finally they have reduced it 5 cents. What I can't figure and what my people can't figure is where we, the so-called cabarets, are concerned, that are in practically the amusement field, why the tax should be 15 cents on us and 10 cents on the moving pictures.

Now, when this tax was first placed on, the tax was 20 cents on theaters and 30 cents on cabarets. We came to the Congress, and my good friend, the late Senator David I. Walsh, introduced a bill reducing the cabaret tax from 30 down to 20, and he had no trouble in convincing the Congress of the justification of our claim that our tax should be no higher or no lower than that of the other people who furnish entertainment.

That is our view. We hope that this committee, the Finance Committee, will give us the same tax in the amusement field affecting cabarets as applies to any other part of the amusement field. We hold that is is discriminatory and unfair to say that a patron should be taxed 15 cents when he goes in where there is a song or a dance. It is all entertainment. And yet other forms of entertainment are let off with a 10-cent tax.

We leave that thought with the committee and pray for relief in the same category or in the same field.

The Seventy-ninth Congress gave us that relief and placed us with the 20-cent tax, reducing it from 30. We hope the committee will report 10 cents for the so-called cabaret tax.

Thank you.

The CHAIRMAN. Thank you, sir.

Are there any questions?

Mr. SANDS. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Bomze? Will you be seated and identify yourself for the record?

STATEMENT OF NORMAN BOMZE, WASHINGTON, D. C., CHAIRMAN, LEGISLATIVE COMMITTEE, NATIONAL LICENSED BEVERAGE ASSOCIATION

Mr. BOMZE. Yes, sir.

Mr. Chairman and gentlemen of the committee, my name is Norman Bomze. My business address is 1423 F Street NW., in Washington. I am chairman of the legislative committee of the National Licensed Beverage Association, which is a trade association of 30,000 tavern and restaurant owners like myself.

Membership in this association is held through 25 State and local associations, which are listed by name at the close of this prepared statement, which I would like to submit to the committee for the record and then speak on just a few of the points, with the chairman's permission.

The CHAIRMAN. You wish to submit the statement for the record?

Mr. BOMZE. Yes, Mr. Chairman. And I would just like to speak briefly on a few points.

The CHAIRMAN. It will be entered in the record.

(The statement referred to follows:)

STATEMENT OF THE NATIONAL LICENSED BEVERAGE ASSOCIATION

My name is Norman Bomze. My business address is 1423 F Street NW., Washington, D. C. I am chairman of the legislative committee of the National Licensed Beverage Association—a trade association composed of 30,000 tavern and restaurant owners like myself. Membership in this association is held through 25 State and local associations which are listed by name at the close of this statement.

The members of this association are within that segment of the alcoholic beverage industry containing the greatest number of individuals, there being some 160,000 licensed outlets where alcoholic beverages are sold for consumption on the premises. Each of these licensees is a small businessman. His proprietary interest is more than an investment—it is his livelihood. He is, therefore, vitally interested in the present excise tax structure, because the present rates have a direct effect upon his gross revenue and net income.

While the interest of these Americans for whom I speak today is directed toward tax relief, their greater interest is in the general welfare of the country. I, therefore, wish to state clearly that our desire for tax reduction is conditioned upon the absence of a national emergency. Should the present world situation deteriorate, we ask that our request for tax reductiou be considered as withdrawn. There have been several occasions during the past 10 years when the retail alcoholic beverage industry has been subjected to increased taxes. In none of these instances did the National Tavern Associated or the Associated Tavern Owners, which were merged this year to form the present association, appear in opposition to such increases.

The two excises in which our members have the greatest interest is the present 20 percent so-called cabaret tax, and the gallonage tax on alcoholic beverages. In discussing the first of these taxes, I hesitate to use the name "cabaret tax" because it has a tendency to bring to mind dine and dance establishments with name bands, society patrons and gross revenues in large figures. Actually, most of the establishments subject to this tax are modest taverns and restaurants, operated by men who work in the business themselves and use live music and entertainment in an effort to keep up what is now lagging public patronage.

Beginning in 1946, there has been an accelerating downward trend in the gross revenues of licensed establishments authorized to sell alcoholic beverages for on-premise consumption. Surveys among our membership have indicated that the greatest loss has been in establishments which pay the 20 percent cabaret tax, which would indicate that this tax is, to a great extent, responsible for the loss of patronage which we are now realizing.

This loss of income to the operator of the tavern or restaurant is reflected in loss of revenues to the Government. The revenue from this source, as reported by

the Treasury Department, shows beyond any question of a doubt that the law of diminishing returns has this particular tax well within its grasp. Collections from this source have declined steadily from a high point of $72,000,000 for the fiscal year ending June 30, 1946. By June 30, 1949, collections had fallen an average of one-half million dollars a month. Collections for that year were a little over 48,000,000. Comparing the first 9 months of the fiscal year just ended and 1949, there is a continuing fall but one that has increased to three-quarter million dollars each month.

The Ways and Means Committee of the House of Representatives first decided to cut this 20 percent tax in half, but ultimately recommended only a one-quarter reduction to 15 percent. We ask that the tax be reduced to the 1942 rate of 5 percent. We believe that, with the removal of this business depressant, the increase in gross revenues to the operators of taverns and restaurants will not only broaden the base upon which the other types of taxes are levied, but will also increase the amount against which the new 5-percent rate can be levied. The cabaret tax is one of the excises that is brought directly to the attention of the consumer at the time he pays it, because it is put on his bill. The accelerating decline in revenues from this source is a clear indication of the resentment of the consuming public against this high rate. Unfortunately for our industry of small-business men, the customer expresses his resentment by staying away from our establishments.

The second excise with which our membership is concerned is the gallonage excise on alcoholic beverages.

Our association has been alarmed by discussion in the press and in the Congress which makes it appear that the only segment of the alcoholic beverage industry concerned with this tax is the producers. We are concerned because the fact is that the incidence of this tax is on the consumer and being closest to him, we feel the greatest effect. The difference in price to the retailer resulting from a tax reduction would be an important factor in maintaining the small margin of profit under which we now operate.

Restaurants and taverns depend upon serving large numbers of customers (some 60,000,000 daily) at a small profit rather than small numbers at a high profit. Surveys show that the average net profit of the Nation's restaurants range between 2 and 2½ percent and also that the present trend is downward. There is at this time a high rate of business mortality in this industry.

To stay in business, restaurateurs must now watch their costs very closely in order to survive, and even minor increases in expense may throw many operations from the black side of the ledger to the red. The average restaurant with a high efficiency rating and an effective cost-control system has a 50 to 55 percent food cost and the average salary in such operation is 30 to 35 percent, which leaves only 15 to 20 percent for rent, repairs, replacement, laundry, maintenance, insurance, taxes, advertising and other operating costs. What is left is the 2 to 2½ percent profit I mentioned before.

In considering the gallonage excise rates from the standpoint of their revenue-raising effectiveness, it is to be noted that the reduction in the amount of distilled spirits purchased does not necessarily mean a similar reduction in the amount of distilled spirits consumed. Our membership is now experiencing, as a result of that fact, a kind of competition which no fair-trade law will cure. As a tax collector for the Government, the tavern operator is now trying to compete with his unfair competitors, the bootleggers, who pay no excise. The increasing rate of still seizures indicates clearly that this type of unfair competition is real and present.

As in the case of the cabaret tax, the gallonage tax is not only a depressant to the business of taverns and restaurants, but its present rate is defeating the purpose of revenue raising. Although the tax is still a tremendous revenue raiser, it has declined from its high in 1946. There is a striking similarity between the present situation and that the country faced just after the War Between the States. During that period, we had an increasing rate of excise taxation on spirits and a corresponding increase in revenues during a great war; and decreasing revenues from the same tax after the war, until the tax rate was lowered. At the beginning of the Civil War, the tax on distilled spirits was 20 cents per gallon. During the course of that war, the tax was raised successively from 20 cents to 60 cents, then to $1.50, and finally to $2. Accompanying this increasing curve in the tax rate were increasing revenues which, at the time of the 20-cent rate, were slightly over $3,000,000 for the fiscal year 1863, but under the $2 rate for the fiscal year 1866 had risen to slightly over $29,000,000. The next year, 1867, the revenue fell a million dollars and the following year, 1868, revenues fell to $13,000,000. In

1868, the tax per gallon was reduced from $2 to 50 cents per gallon, with the result that for the fiscal year 1869, revenues increased to over $45,000,000 and the following year, 1870, to over $55,500,000. We do not now maintain that a reduction in the excise rate at the present time from $9 to $6 would result in the fabulous increase in revenue that was experienced in 1868. We do, however, believe that the same principle applies and that this $3 reduction will result in the effective blocking of the law of diminishing returns and that the Federal Government will collect the tax on a broader base than it does now.

The demand for the product exists and illegal production will fill that demand unless the legal industry is allowed to compete.

We are asking that the present rate of $9 be reduced to $6. This is not, as in the case of some other excises, a return to the pre-war level. This is, instead, a return to what we call "the preparedness rate."

Assuming that the world situation will not deteriorate, we ask for the return of these excises to the 1942 level.

MEMBERS OF NATIONAL LICENSED BEVERAGE ASSOCIATION

Arizona Retail Liquor Dealers' Association
Associated Tavern Owners of Brooklyn, Inc.
Buckeye Retail Liquor Dealers' Association
Cass County Liquor Dealers of Fargo, N. Dak.
Central & Northern California Tavern Association
Chicago Tavern Owners' Association
Hawkeye National Beverage Association
Illinois State Retail Liquor Dealers' Association
Illinois Tavern Owners' Association
Indiana Retail Alcoholic Beverage Association, Inc.
Kansas City Tavern Association
Maryland State Licensed Beverage Association, Inc.
Massachusetts Retail Liquor Dealers' Board of Trade
Michigan Table-Top Licensees' Congress
Minnesota Retail Liquor Dealers' Association
Montana Retail Liquor Dealers' Association
Nebraska Beer & Liquor Retailers' Association
New York State Restaurant & Liquor Dealers' Association
Philadelphia Retail Liquor Dealers' Association
Philadelphia Tavern Association
Restaurant Beverage Retailers of Washington, D. C.
Rhode Island Retail Liquor Dealers' Board of Trade
South Dakota Liquor Dealers' Association
Tavern League of Wisconsin, Inc.
United Licensed Beverage Association of New Jersey
Utah Retail Beverage Association
West Virginia Tavern Institute
Wisconsin Tavern Keepers' Association

Mr. BOMZE. Our group is concerned with two forms of tax which the committee is considering. One is the cabaret tax or the 20 percent amusement tax. We are affected by it, as small taverns and small restaurants, who offer some form of amusement or entertainment in order to induce patronage. We do not operate the lush night club or large diningroom, usually, and in many of the small towns and hamlets throughout the country, the small tavern merely uses a local form of entertainer or local musician in order to encourage patronage. Yet he is subject to the same tax percentage as the large operation with large revenue.

The tax has been felt sorely by our group due to the fact that this particular tax is placed right on the check, and the customer feels it when paying the bill. We also feel that in a survey we made recently the largest loss of income to our membership was in those groups who offered entertainment, taxable type entertainment.

The loss of income to the operator of the tavern or the restaurant was also reflected in loss of income to the Government. The revenue from this source as reported by the Treasury Department shows beyond any question of a doubt that the law of diminishing returns has this

particular tax well within its grasp. Collections from the source have declined steadily, from a high point of $72,000,000 for the fiscal year ending June 30, 1946, until by June 30, 1949, collections had fallen an average of one-half million dollars a month. Collections for that year were a little over $48,000,000.

Comparing the first 9 months of the fiscal year just ended and 1949, there is a continuing fall, but one that has increased three-quarters of a million dollars each month.

Senator TAFT. This is the tax which the House reduced from 20 percent to 15? And you are asking for more of a reduction?

Mr. BOMZE. We are asking to go to the prewar figure, sir, of 5 percent.

We place emphasis on this particular tax, Mr. Chairman, because of the fact that our membership is made up of a group of small-business men. Their revenue is obtained by selling food and drink at a small profit. We thrive on the fact that we attempt to serve many at a lower profit rather than a few at a larger profit.

Restaurants and taverns serve some 60 million-odd people daily, and surveys show that the average net profit of restaurants ranges from 2 to 2½ percent. That is in a good operation with efficient food-cost control and liquor-cost control.

Also we are interested in the gallonage tax on liquor, on alcoholic beverages. In considering the gallonage excise rates from the standpoint of their revenue raising effectiveness, it is to be noted that the reduction in the amount of distilled spirits purchased does not necessarily mean a similar reduction in the amount of distilled spirits consumed. Our membership is now experiencing the result of a type of competition to which no fair trade law could ever offer any cure. As a tax collector for the Government, our member is now trying to compete with an unfair competitor, the bootlegger or illicit still operator, who pays no excise at all, and the increasing rate of still seizures indicates clearly that this type of unfair competition is real and present.

We also feel that the gallonage tax, the same as the cabaret tax, is a business depressant, and its present rate is defeating the purpose of revenue raising.

We ask for the reduction of $3 a gallon on the alcoholic beverage tax, and we feel that this is actually not a return to the prewar level but is rather a return to what we would like to call the preparedness rate. We feel that the $3 reduction would result in an effective blocking of the law of diminishing returns, and that the Federal Government would have an opportunity to collect a tax on a much broader base than it does at present. The demand for the product exists, and if a legal method of production does not meet it, then illegal production methods will meet it.

In view of all of this, sir, there is one point we would like to make, however, and that is that our group, although businessmen, are still primarily Americans, and although they seek tax relief in this picture their greater interest is, of course, the country, and I have been told to state clearly to this committee that our desire for tax reduction is conditioned upon the absence of a national emergency, and should the present world situation deteriorate we ask that our request for any tax reduction be considered as withdrawn.

The CHAIRMAN. Any questions?

If not, thank you, sir.

Mr. BOMZE. Thank you.

The CHAIRMAN. Mr. Tunick? You may be seated, please, sir, and identify yourself for the record.

STATEMENT OF ABRAHAM TUNICK, WASHINGTON COUNSEL, WINE AND SPIRITS WHOLESALERS OF AMERICA, INC., WASHINGTON, D. C.

Mr. TUNICK. Mr. Chairman and gentlemen, my name is Abraham Tunick and my office address is 917 Fifteenth Street NW., Washington, D. C. I am Washington counsel for Wine and Spirits Wholesalers of America, Inc., the only national trade association of wholesalers in this industry, representing over 400 member firms located in every open-license State and the District of Columbia.

This statement is also presented on behalf of our advisory council, which is comprised of representatives of State wholesalers' associations in each of such States and the District of Columbia.

Earlier this year a spokesman for our association appeared before the House Ways and Means Committee to petition for relief from the war-tax rate imposed in 1944 which increased the tax on distilled spirits from $6 to $9 per gallon.

At this time, Mr. Chairman, with your permission, I should like to incorporate in the record of this hearing the statement presented by Mr. Fred M. Switzer before the Ways and Means Committee last February. I can file adequate copies with the clerk.

The CHAIRMAN. That is available to us already, but you may put it in this record if you desire.

Is it a lengthy statement?

Mr. TUNICK. It is not a lengthy statement.

The CHAIRMAN. You may put it in.

Furnish it to the reporter.

Mr. TUNICK. Thank you, sir.

(The statement referred to follows:)

STATEMENT OF FRED M. SWITZER, GENERAL COUNSEL AND EXECUTIVE VICE PRESIDENT, WINE AND SPIRITS WHOLESALERS OF AMERICA, INC.

My name is Fred M. Switzer. I reside and practice law in St. Louis, Mo. I am general counsel and executive vice president of Wine and Spirits Wholesalers of America, Inc., which, as its name implies, is the national trade association of wholesalers of distilled spirits and wine. It is the only national trade association of wholesalers in the industry. It is composed of over 400 member firms located in every wet State and the District of Columbia, except those 17 States having the so-called monopoly system of liquor control. I am filing a roster of our membership with the clerk of the committee.

In each open-license State there is a State association of wholesalers which is represented on the advisory council of our national association. In speaking for Wine and Spirits Wholesalers of America, I am also speaking for each of these State associations.

These organizations and their members feel very strongly that the alcoholic beverage industry and its more than 60,000,000 customers should receive fair and equal treatment in any program to reduce wartime excise taxes on various commodity and service industries. Certainly, when the Congress provided, in the Revenue Act of 1943, that the wartime excise taxes then imposed should end 6 months after termination of hostilities, there was no thought of discriminatory selection, as between the industries on which these taxes were imposed, when

the time came to reduce these burdensome taxes. The suggestion that this may be done now, at the expense of our industry, strikes us as extremely unfair and unrealistic and ignores some very compelling factors.

Actually ours is the most heavily taxed industry. As a matter of fact, the $3-a-gallon wartime excise tax, which the industry is recommending should be reduced, is really the second wartime excise tax imposed on our products. The first wartime excise tax on distilled spirits was in 1942, when the tax was raised from $4 to $6 per gallon. We are recommending only that the last wartime excise of $3 (which increased the total excise to $9 per gallon) be reduced at this time.

Revenue from the excise tax on distilled spirits is declining. Consumer resistance to high prices resulting from the combined excise taxes of the States and the Federal Government is increasing, as is the illegal activity of bootleggers in the production and sale of tax-free spirits. Last week we made a telephone survey, among some of our members throughout the country, to check business conditions. We learned that prewar competitive conditions and consumer habits are back again. We feel very strongly that a reduction of the excise tax on alcoholic beverages is essential to the stability of our industry, which is in turn so inportant to the security of the Federal revenue.

I believe it is proper to point out that the excise tax on our products differs in one important feature from other excise taxes being considered, in that the tax is paid by the manufacturer of alcoholic beverages in the first instance and not by the consumer at the point of sale. This has an important effect on the industry. It means that the wholesaler finances the tax, as well as the cost of the merchandise, from the time it leaves the manufacturer until it has been in the hands of the retailer for approximately 30 days, and the retailer finances it till it is paid for by the consumer. This means two things. The ultimate burden of the tax on the consumer is actually greater than the exact amount of the tax itself, for the consumer ultimately pays the cost of this financing, and the repercussion on the industry is heavier when consumer resistance results in slowing up of demand, increasing the burden of this financing process. Strong consumer resistance can even make it very difficult for a merchant to recover the tax along with his investment in the merchandise.

However, to avoid repetition of statements made by other representatives of the industry and to conserve the valuable time of this committee, I am not going to dwell on the arguments supporting our position that the wartime excise taxes on alcoholic beverages should be reduced. I do wish to record our concurrence in these arguments and our strong belief that we should receive equal and favorable treatment along with other industries accorded tax reduction. The final responsibility for determining what the over-all tax reduction shall be is, of course, on the Congress. This question involves many serious problems of revenue requirements, and national commitments, including the problem whether, and to what extent, such revenue reduction should be offset by new revenue provisions. We do not presume to suggest to you gentlemen what this over-all tax reduction should be. But we believe it is appropriate, and only fair, once the over-all amount of the reduction is determined, to request that our heavily burdened industry share proportionately in the excise tax reductions, whether they be large or small.

The President of the United States has reported to the Congress that he favors reduction of excise taxes only to the extent that such reductions are offset by new revenue, and I believe that this committee has under consideration legislative proposals to accomplish this end. I would like to call your attention to a source of revenue that is already provided for by existing legislation, but is simply not being collected from a large segment of the alcoholic beverage industry. I believe this is a subject worthy of the attention of this committee, the Congress and of the highest administrative officials. Since repeal, the Federal Government has failed to collect from this source well over a billion dollars, and the revenue loss runs about $75,000,000 per year at the present time.

I am referring to the failure of the Bureau of Internal Revenue to collect income taxes on the business profits derived from the purchase and sale of alcoholic beverages by the 17 States that have adopted the monopoly system of liquor distribution and have gone directly into the liquor business, particularly at the wholesale level.

The size of the State monopoly business is illustrated by the following figures:

Statistics reported by the Distilled Spirits Institute show that the monopoly States (excluding the county store system of North Carolina) enjoyed a total net revenue, derived directly from alcoholic beverages, during the years 1940 to 1948, inclusive, of more than $1,706,175,350.

During the 3 years 1946–48, the monopoly States (again excluding North Carolina) sold alcoholic beverages for a total sum of $2,598,479,460 with a net profit of $511,595,287.

In 1948, the last full calendar year for which we have figures, these States sold alcoholic beverages in the sum of $869,273,149 with net operating profit therefrom of $178,196,128. None of these figures include local revenues or sales taxes.

Failure to collect Federal income taxes on these tremendous profits is a subject worthy of the fullest consideration of the Congress and of administration authorities, particularly at this time when Federal international commitments are so heavy and the need of revenue is an important factor in the consideration of the reduction of burdensome wartime excise taxes.

Continued failure to collect these taxes will inevitably result in further loss of income taxes now received from wholesalers and retailers engaged in business in the other 29 wet States. There is constant pressure on these States to adopt the monopoly system for revenue reasons made particularly convincing because of the favorable practical exemption from the Federal income tax. Legislation to accomplish this purpose was introduced in 11 State legislatures (Massachusetts, Minnesota, North Dakota, South Dakota, Nebraska, Texas, Arkansas, South Carolina, Delaware, Georgia, and Colorado) in 1947 and in approximately the same number in 1949. Once such a movement starts, there is no telling where it will end, since the exemption practically amounts to subsidization of the State monopoly system of the Federal Government.

The various internal revenue acts since repeal of prohibition clearly imposed, and the Internal Revenue Code clearly imposes, the income tax on the net income of States derived from the business of buying and selling distilled spirits and wine. This tax has not been collected however because of an administrative interpretation (G. C. M. 14407) issued in 1935 by the Bureau of Internal Revenue. This interpretation was and is wrong and should be reversed.

It is not my intention to argue here the legal question involved. We are filing with this statement copies of a brief that we previously filed with the Bureau and with the Treasury Department. This brief goes into the question fully. The Bureau has declined to change its position, but I understand that the matter is presently being considered by the appropriate Treasury officials. However, I would like to outline briefly the history of this administrative interpretation.

Originally, in 1934, the Bureau ruled that the profits of the Oregon Liquor Control Commission were subject to the Federal income tax. This was a well-reasoned opinion in the form of an income-tax ruling (I. T. 2797 C. B. XIII-2, p. 74).

The ink was hardly dry on this ruling, and certainly no considerable additional study could have been given the subject, before it was reversed by a ruling in the form of a General Counsel Memorandum (G. C. M. 13745 C. B. XIII-2, p. 76). Apparently, the premise of this latter ruling was that the State was constitutionally immune from Federal tax on profits from a State proprietary activity when the income was used for essential governmental purposes.

This ruling was unsound, and no such position has ever been sustained by the Supreme Court. Actually, there was and is no question of the constitutional power to levy taxes on the income of States from the sale of alcoholic beverages. As early as 1905, in the case of *South Carolina* v. *U. S.* (199 US 437), and again in 1939, in the case of *Ohio* v. *Helvering* (292 US 360), the Supreme Court held that a State was subject to the Federal excise tax for a license to engage in the liquor business, on the ground that, when a State engages in a business of a private character, that business is not withdrawn from the taxing power of the Nation. This proposition has been reaffirmed in the recent case of *Wilmette Park District* v. *Campbell* decided by the Supreme Court December 12, 1949.

The leading case of *New York* v. *U. S.* (326 U. S. 572) involving a tax on mineral waters sold by the State, decided in 1946, makes it clear that "so long as Congress generally taps a source of revenue by whomsoever earned and not uniquely capable of being earned only by a State, the Constitution of the United States does not forbid it merely because its incidence falls on a State."

The decisions as they have developed the law of State immunity make it abundantly clear that the right to tax the profits of States from the sale of alcoholic beverages will be upheld.

The constitutionality of the tax and the impropriety of the eagerness of the Bureau in asserting the lack of power in the Congress to impose such a tax were evidently apparent to the Bureau.

Before its second ruling was a year old, the Bureau ruled that the profits of the State of Montana were not subject to the Federal income tax (G. C. M. 14407) XIV–1, C. B., page 103 (1935). This time, however, the Bureau asserted that

the basis of its interpretation was that the income was not taxable "under existing legislation" and specifically stated that the prior ruling (G. C. M. 13745) should not be taken as a determination of the constitutional question involved. This cleared the decks of the constitutional problem and raised the question of interpretation of section 116 (d) of the Internal Revenue Code.

Section 116 (d) excludes from gross income "income derived from any public utility or the exercise of any essential governmental function and accruing to any State." The liquor business is obviously not a public utility, and the Supreme Court in both the South Carolina case in 1905 and the Ohio case in 1934 held it was not an essential governmental function when engaged in by a State but is, on the contrary, a proprietary function. It follows, therefore, very simply that such income is subject to the tax. This question, and the administrator's interpretation, are discussed at length in our brief, but the legislative history of section 116 (d), the relevant cases and applicable principles only serve to sustain the validity of the simple propositions stated above. Nor are we alone in our position on this question. We are supported by such eminent authority as Dean Griswold, of Harvard Law School, in an article in the American Bar Association Journal in 1936 (Griswold, Income Taxes of State Liquor Monopoly 22 ABAJ 619 (1936)).

Our brief goes to some length also to establish the proposition that the Treasury is not estopped nor precluded in any way from changing its ruling at this time to conform to the clear meaning of the statute. Needless to say, Congress has the power to reaffirm its enactment and reverse the Treasury, if necessary.

Not only is the Federal income tax actually imposed on State profits from the liquor business by existing legislation, but failure to collect it is unfair to the Federal Government, the nonmonopoly States and the wholesalers and retailers in those States. Such monopoly State tax exemption imposes an unfair burden on taxpayers in other States. It also puts monetary pressure on other States to adopt a particular regulatory system for reasons not pertinent to the merits of the system. This was also the conclusion of the Joint Committee of the American Bar Association, the National Tax Association and the National Association of Tax Administrators on the Coordination of Federal, State, and local taxation in 1947.

After pointing out these inequities, they concluded the State liquor stores should be subject to Federal taxation upon their profits, as determined by the customary accounting methods applied in private enterprise, in the same manner as private concerns.

It is respectfully submitted that to terminate the inequities mentioned and to secure to the Federal Government revenue already provided by law that the de facto exemption of monopoly State stores from the sale of alcoholic beverages should be promptly terminated. This obvious source of new revenue from the liquor industry itself should surely be considered in determining the excise tax relief to be afforded this industry. It is further submitted that, in any case, this industry is entitled to proportionate relief along with other industries bearing wartime excise taxes.

Mr. TUNICK. While denying any relief whatsoever to the distilled spirits industry from this one wartime tax increase, the House Ways and Means Committee, in making its recommendation for tax reduction to other industries, did not restrict its consideration to rates imposed under the Revenue Act of 1943. The committee recognized that earlier tax increases directly related to the war emergency were "equally deserving of consideration." In its report on the bill the committee stated:

> Tax increases were also made during 1941 and 1942, which are equally deserving of consideration since they were made under wartime conditions.

If this consideration were extended to our industry, it becomes even more apparent that we are entitled to some relief from the excessive burden borne by our product. The tax on distilled spirits was actually trebled between 1941 and 1944 when three successive emergency measures raised excise-tax rates on distilled spirits. In 1941 they were increased from $3 to $4 per gallon. In 1942 they were

increased from $4 to $6, and finally under the Revenue Act of 1943 they were increased from $6 to $9 per gallon.

Distilled spirits bear the heaviest burden of all commodities and services affected by wartime excise taxes. At the current rate of $9 per gallon, 42 cents of every consumer dollar spent on distilled spirits is taken up by Federal excise tax, whereas on the other commodities and services affected by this bill, the excise burden ranges from a maximum of 20 cents to as little as 3 cents per dollar expended.

The burden thus imposed is manifestly unfair and discriminatory to 65,000,000 consumers of our product, 85 percent of whom are persons in the lower income brackets, that is, with incomes of less than $5,000 a year.

As national income has leveled off, consumer resistance to war-tax-inflated prices for legal distilled spirits has mounted to a point where the percentage of disposable consumer income expended for our product amounts to less than 1.9 percent of the total. By contrast the percentage of disposable income expended on our product in the prewar years, 1939, 1940, and 1941, was 2.2 percent. In other words, relative consumer expenditures on our product declined by 15 percent between 1939 and 1949, despite an increase in disposable consumer income of over 170 percent during that period and despite an increase of 12.6 percent in population.

I would also point out that the resulting effect on employment in this industry has been more adverse than on any other industry affected by excise taxes, with the single exception of the fur industry. Current Bureau of Labor statistics data show that production employment alone in our industry has fallen off by over 26 percent from the 1947 level, while employment at retail and wholesale levels, as estimated by trade and labor-union sources, has declined substantially.

We submit that the war-tax rates under the Revenue Act of 1943 were not imposed on a selective basis and the act expressly provides for their simultaneous termination. The House has departed from this principle and has granted relief on a selective basis. Our industry has been denied any relief whatsoever.

We ask only for fair and equal treatment on a proportionate basis with that accorded to other industries affected by war-tax rates, and respectfully urge your favorable consideration.

The CHAIRMAN. Is there any question?

Senator KERR. You heard the statements here about the increase in seizures of stills?

Mr. TUNICK. Yes, Senator.

Senator KERR. I believe one man said that the number had increased to where it was now about 18,000 a year.

Mr. TUNICK. That is correct.

Senator KERR. Do you have any information as to how many of them there are?

Mr. TUNICK. No, we have not. We can only guess.

Senator KERR. Are they represented here?

Mr. TUNICK. I beg pardon, sir?

Senator KERR. Have they been heard about their views?

Mr. TUNICK. So far as I know, not up to this point.

Senator KERR. Do you think that the decrease in employment that you have referred to here has been in anywise offset by an increase in the number which they employ?

Mr. TUNICK. We, of course, have no reliable data to establish that fact.

Senator KERR. I was just wondering whether the over-all economy of the country had suffered to the extent that your employees had declined, or whether it had been offset by increases in others engaged in similar enterprise but not affiliated with your association.

Senator TAFT. Do you think that if we took off the $3, a good many of the States might put on $3 for themselves?

Mr. TUNICK. We have no definite knowledge, Senator Taft, as to that. We would hope that the States would be content with their present excise tax rates, which have doubled in most cases since repeal.

Senator TAFT. I remember that Governor Driscoll, of New Jersey, was down here urging that we reduce this from 9 to 6, in order that New Jersey might put on the $3 for New Jersey, which would leave you just where you started.

Mr. TUNICK. That is right.

The CHAIRMAN. If there are no further questions, we thank you, sir.

Mr. TUNICK. Thank you very much, Mr. Chairman.

The CHAIRMAN. The next witness is Mr. Barta, representing the Ethanol Committee.

STATEMENT OF A. K. BARTA, SECRETARY, THE ETHANOL COMMITTEE, WASHINGTON, D. C.

Mr. BARTA. Mr. Chairman and members of the committee, my name is A. K. Barta, and I am secretary of the Ethanol Committee, which was especially created to bring to the attention of Congress the perplexing tax problem we have with relation to the use of alcohol in medicinal products.

To save the time of the committee, I have prepared several exhibits and would like to call your attention to them.

The first is a copy of an invoice, which indicated that when you buy a carload of alcohol the cost of the alcohol is $1,334, but at the time of withdrawal we pay about $75,000 tax to the Government.

The second exhibit indicates what happens to the industry when a dollar is spent for alcohol to be used for medicinal purposes. For each dollar's worth of alcohol, we pay the Treasury $57 tax at the time of withdrawal, and then after a period of 5 or 6 months the net tax is $19, and under the provisions of the House bill, the net tax would be $12.66. The 10- and 20-percent excises are indicated on that second exhibit, compared with the $1, and you can see that we still pay a very high tax.

The third exhibit I have, Mr. Chairman, indicates what would happen in the production of a simple medicinal like aromatic spirits of ammonia. The cost today is $5.78. If we had tax-free alcohol the cost would be $1.93.

For more than 150 years, Congress has recognized the policy and has never had a tax on alcohol that was used in medicines. The Ways and Means Committee recognized that in part, and in the report accompanying the bill they state:

> Using these medicines and medicinal preparations as a source of revenue, however, appears to be in contradiction of the policy generally followed in not imposing excise taxes on medicines.

In the about 4 minutes I had before the Ways and Means Committee, I made a slight impression, and they recommended some increase in the rate of draw-back. We should like to have the entire $9 per gallon we pay returned to us under a draw-back system. It would not change any of the existing procedures within the Treasury Department. The loss in revenue would be approximately four and a half million dollars. But it would eliminate the discrimination as to the use of alcohol. No other industrial-alcohol use pays any tax on alcohol, and why it should be levied on these medicines is a little difficult to understand.

The CHAIRMAN. Is it on any food products?

Mr. BARTA. Excuse me, Senator. I did speak for them at one time. The flavoring-extract industry still has to pay a tax. Apparently the tax is not too burdensome with them. Their use is in the nature of a luxury use, whereas in medicines it is an essential chemical, the only chemical that can be used in many medicines, and we have to carry it along in there.

The CHAIRMAN. And what did the House give you? They increased the rate?

Mr. BARTA. They increased the rate of draw-back from $6 to $7 a gallon. And we should like to be placed on a tax-free basis and have a $9 draw-back. We still would not have tax-free alcohol, because under the draw-back system the industry polices itself to a certain extent. The inspectors from the Alcohol Tax Unit go into the plants to see that the alcohol is used honestly. Then we make a claim. It takes about 6 months from the time you use the alcohol until your money is returned The result is that we have more than $5,000,000 in the treasury at all times as a revolving tax fund. There is no interest paid on that. The Government gets their money first, and then we prove it was used honestly, and then we get the draw-back.

Senator TAFT. It is a question of enforcement. Is the net tax put on as a question of enforcement in the beginning? It was not the direct intention to tax medicines, was it?

Mr. BARTA. Senator Taft, our problem goes back to the days of prohibition, when the Treasury said that anything that went below the Adam's apple had to be ethyl alcohol or we paid a tax on it. We have been struggling since that time to get the tax off. The way it used to be handled was under a permit-and-bond system, where you put up a bond and withdrew alcohol tax-free. During prohibition, when the possibility of diversion was so great, the Treasury refused to carry on any further, and when we started getting some relief the only way they wanted to do it was to have us pay the full tax and then, after the expiration of each quarter, make a claim for draw-back. It helps them in their enforcement problem, because they have the beverage money, or that tax rate, already in the Treasury. Then we have to prove that we used it for a nonbeverage medicinal purpose and then get our money back. It is partly enforcement that the draw-back system is in existence for.

Senator MILLIKIN. There was a time when a line was drawn between beverage medicines and medicines. You perhaps recall the Peruna which was sold so widely.

Mr. BARTA. Under the draw-back, all our formulas are on file in the Alcohol Tax Unit, and they know what is in each.

Senator BUTLER. There is no draw-back on alcohols used in flavoring extracts?

Mr. BARTA. Yes; a $6 draw-back now. We were both in the same category, and then we appeared before the House and made our statement and showed them what the tax load is, and they went along and increased our rate $1.

Senator BUTLER. How about the extracts?

Mr. BARTA. They left that alone.

Senator MILLIKIN. How long is your money tied up?

Mr. BARTA. Between 5 and 6 months. You buy in January, Febfuary, and March, and then you make the claim by the 30th of April, and it is June before you get the January, February, and March money back. That money comes out of working capital. You can't get any money on a claim against the Government.

Senator MILLIKIN. May I ask the Treasury representative: Has the Treasury ever estimated how much is the minimum amount of draw-back necessary to properly police this?

Mr. KIRBY. We can give that estimate to the committee. We have made a study in this field. I don't have it with me, but we will be glad to present that.

The CHAIRMAN. Suppose you give us that information for the record.

(The information referred to follows:)

An examination of draw-back claims for the fiscal years 1948, 1949, and 1950, indicates that the cost of administering the present draw-back provisions with respect to distilled spirits used in the manufacture of both medicines and food products is approximately $500,000 per year, and involves processing 4,400 claims for draw-back on 5,000,000 gallons of distilled spirits. Thus, the cost of administering the draw-back system amounts to approximately 10 cents per proof gallon of distilled spirits subject to draw-back. An examination of the claims also discloses that of the distilled spirits represented by draw-back claims approximately 45 percent were used in the manufacture of medicines and medicinal preparations, and 55 percent in the manufacture of food products.

It should be observed that under present law, in order to be eligible for draw-back on distilled spirits used in the manufacture of medicines and food products, the claimant must have paid an annual occupational or license tax which is graduated in amounts from $25 to $100 depending upon the number of gallons of distilled spirits used. H. R. 8920 would add another bracket to the graduated license system by providing that in the case of persons withdrawing 10 proof gallons or less the license tax shall be $5. A lower license tax bracket together with an increase in the rate of draw-back would increase the number of claims by users of small amounts of distilled spirits. While it is impracticable to estimate the number of additional small claims that would be made, and their effect on administrative costs, it is possible that the processing of these additional small claims would somewhat increase the per-gallon cost of administering the draw-back system.

The CHAIRMAN. Any further questions?

Senator CONNALLY. I want to ask: You speak of "medicinal purposes." That has a wide range, has it not?

Mr. BARTA. Not all medicines need alcohol, but alcohol is used in the production of a great many of them.

Senator CONNALLY. That is what I am talking about.

Mr. BARTA. And it may not be in the finished product when you get through. For example, we extract the medicinal properties of many herbs and things. They go into the still and are soaked in alcohol, and that is run off. Of course, alcohol is the only chemical that you can use in many of these products to keep them in suspension or solution.

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Senator CONNALLY. Does your industry carefully restrict itself to real medicines? Or a lot of fake medicines?

Mr. BARTA. Pretty much to real medicines now. The food and drug law covers that. Everything that goes now in interstate commerce is subject to the Federal Food and Drug Act.

Senator KERR. Their test is as to the purity of the product, and not as to its value as a medicinal element, is it not?

Mr. BARTA. That is right.

Senator CONNALLY. Senator Millikin expressed grief over the disappearance of Peruna. What has become of Peruna?

Mr. BARTA. I don't know. That is a little before my time.

Senator KERR. Has your profession ever had as high a regard for the medicinal value of alcohol as the patient?

Mr. BARTA. I don't know. That is a tough one to answer. It does have a tonic effect on many patients. We know that.

Senator KERR. I thought, if they really did, they would consume more of it themselves and sell less of it.

Senator MILLIKIN. How much does it cost you for a gallon of the kind of alcohol you use? I mean, tax-free.

Mr. BARTA. We have no tax-free alcohol.

Senator MILLIKIN. None at all?

Mr. BARTA. No. But it costs 30 cents if you buy it in carload lots. That is 190-proof alcohol, which means we pay $17.10 tax at the time of withdrawal as compared with $9 on beverage alcohol.

Senator MILLIKIN. But if you had no tax at all you could buy the alcohol for how much a gallon?

Mr. BARTA. Thirty cents.

Senator MILLIKIN. I think that goes to the question the Senator was asking.

Senator KERR. You say you can buy alcohol for 30 cents a gallon?

Mr. BARTA Yes, sir.

Senator KERR. Well, there was evidence here that it cost $1.75 a gallon to make whisky.

Mr. BARTA. As I understood that question, which I heard, Senator, that was also bonded whisky.

Senator TAFT. Four years.

Mr. BARTA. Yes. And Senator Connally referred to Mr. Hull, of Peoria. I recall one time when he said he could make a lot of money if he could sell all the alcohol he could make at 25 cents a gallon. And apparently that is about the price now, that is, the cost of producing it. Of course, most of the alcohol we buy is made from blackstrap molasses. It is cheaper than grain alcohol. But the witness this morning, I think, forgot to explain that it might cost about 25 cents a gallon per year to hold that in storage while it is aging, which would bring your cost up perhaps to a dollar and a quarter for your 4-year-old whisky.

Senator KERR. You mean taking blackstrap molasses, it is worth 50 cents a gallon, and they can make alcohol out of it and sell it for 25 cents a gallon?

Senator BUTLER. You buy it at about a cent or 3 cents a gallon, or else the Cuban Government gives it to you.

Mr. BARTA. It is a byproduct. There is a lot of it imported from Cuba.

The CHAIRMAN. The alcohol that the proprietary medicine people use is from the blackstrap molasses?

Mr. BARTA. They use both kinds, but blackstrap is what you can get most readily in tank-car lots, because the storers of grain are diverting most of theirs to alcoholic beverages, whisky. Most of ours is from blackstrap molasses, except in times of emergency, when it is made from everything.

Senator BUTLER. Do you have any estimate on the cost of alcohol made from grain, at the present time?

Mr. BARTA. No, sir; I do not. We get the quotations on alcohol as such, but they don't specify always whether it is from grain or cane.

The CHAIRMAN. If there are no further questions, the committee thanks you for your appearance.

Mr. BARTA. Thank you, Mr. Chairman.

(The prepared statement of Mr. Barta follows:)

STATEMENT OF A. K. BARTA, SECRETARY OF THE ETHANOL COMMITTEE, WASHINGTON, D. C.

Mr. Chairman and members of the Senate Finance Committee, my name is A. K. Barta and I am secretary of the Ethanol Committee, which was created primarily to bring to the attention of Congress a most difficult tax situation insofar as it relates to distilled spirits on ethyl alcohol used in the production of drugs, pharmaceuticals, and medicines.

I have prepared several exhibits, copies of which have been made available to each member of the committee, and a brief explanation of each will tell our story completely.

First is a copy of an invoice which shows that in the purchase of a carload of alcohol, the cost per wine gallon is approximately 30 cents, or a total of $1,334. But you will note that at the time of withdrawal a tax of $74,795 must be paid the Government. We submit this initial tax outlay on an essential chemical ingredient of medicines is extraordinarily high. It is a tax of 5,700 percent. (The exhibit has been placed in the committee files.)

The next exhibit shows the tax problem in relation to the expenditure of $1 for alcohol for medicinal use. At the time of withdrawal we pay a tax 57 times the cost of the commodity. Then under the draw-back system in the course of 5 to 6 months we obtain a refund, leaving a net tax 19 times the cost of the alcohol. In a mighty brief hearing before the Ways and Means Committee we made a little impression, and section 141 of the bill before you recognizes our plight and provides that after draw-back we pay a net tax 12⅔ times the cost of the commodity. A comparison of this tax with 10- and 20-percent excise levies generally is made easy by this second exhibit.

The third exhibit has been prepared to show on a simple item like aromatic spirits of ammonia just what a manufacturer's costs are, and please note the present cost of $5.78 per gallon compared with a cost of $1.94 if the alcohol used were tax-free.

Virtually all industrial use of alcohol is tax-free. Thus we believe the industrial use of this essential chemical in medicines should also be tax-free. This was the policy of Congress for more than 150 years of our national existence, and it is in part still recognized by the Ways and Means Committee, for the report accompanying this tax bill states in part:

"Using these medicines and medicinal preparations as a source of revenue, however, appears to be in contradiction of the policy generally followed in not imposing excise taxes on medicines."

If the age-old policy of Congress is to be restored, and we hope it will, then the existing discrimination among users of alcohol for industrial purposes will in large measure be eliminated. Under the draw-back system we will still be penalized by keeping on deposit in the Treasury at all times a revolving tax fund of approximately $5,000,000.

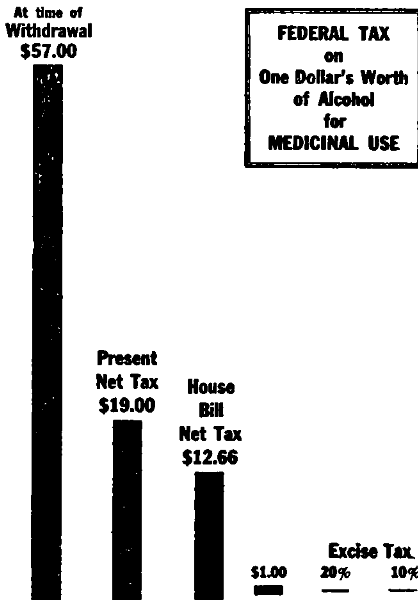
But this penalty we accept as a necessary evil when dealing with a commodity which may be misused. The draw-back system compels self-policing within the industry, and if relief is granted us, existing procedures within the Treasury Department will not be disturbed.

To place all industrial use of alcohol on almost an equal basis, this committee can eliminate an unjust and inequitable discrimination on medicines and medicinal products, and restore an old policy of Congress by amending section 141 of the bill by striking out the figures "$7" in line 17, on page 23, and inserting in lieu thereof the figure "$9."

We hope you will see the equity of our plea.

A manufacturer's active ingredient cost, 1 gallon aromatic spirits of ammonia U. S. P. XIII

Materials:	Cost per gallon
Ammonium carbonate	$0.05389
Stronger ammonia water	1.37061
Oil of lemon	.26448
Oil of lavender	.02653
Oil of myristica	.02938
Alcohol (95 percent, or 190 proof)	4.04081
Present total cost	5.78570
Cost of alcohol (tax free)	.19140
Cost of other ingredients	1.74489
Total cost would be	1.93629



The CHAIRMAN. Mr. Haddock? Is Mr. Haddock in the room? Mr. Irving J. Balaban?

You may identify yourself, please, for the record.

STATEMENT OF IRVING J. BALABAN, NEW YORK, N. Y. RESTAURANT OPERATOR

Mr. BALABAN. My name is Irving J. Balaban. I live at 8512 Chelsea Street, Jamaica, N. Y.

Senator CONNALLY. Whom do you represent?

Mr. BALABAN. Myself.

Senator CONNALLY. Yourself? What business are you in?

Mr. BALABAN. The cabaret business, the restaurant cabaret business.

Mr. Chairman and gentlemen, I am in business at 163 West Forty-sixth Street, New York City, at which location I was operating a restaurant with dancing and a modest show under the name of Zimmerman's Hungaria. I have been at this location for 12 years, operating under the same policy, successfully for the first 10 years. A week ago I was compelled to eliminate the show and dancing, which resulted in the laying off of 30 people, most of whom have been employed here for 12 years, because of the patrons' resistance to the cabaret tax. I am uncertain now whether I can continue to operate under my new policy. Operating under the old one, being subject to the 20-percent tax, had become impossible.

I appear before your committee for the purpose of urging a further reduction in the tax and also to point out to you the folly of the meaningless, inconsistent, and ill-advised reduction to 15 percent adopted by the House. I am not a lobbyist, nor do I represent any organization, nor am I being paid by anyone for appearing here. I and others appeared before the House Ways and Means Committee on February 21, 1950, and presented arguments in favor of a reduction to 5 percent. The reduction was then tentatively made to 10 percent. Subsequently, and before final adoption of the bill, it was increased to 15 percent.

It is my opinion, and one which is shared by many others, that this increase was capricious and punitive and does not serve the best interests of the Government, and undoubtedly will cost the Treasury untold millions of dollars, as well as bankrupt operators who have held on only in the hope that a substantial reduction would soon be forthcoming. After all, the reason for the reduction in excise taxes was to ease the burden on hard-pressed businesses. The token reduction made by the House cannot help a business which is as equally hard pressed, if not more, than those receiving more equitable reductions, such as race tracks, amusement and ball parks, and so forth. Rather than be the dubious beneficiary of a meaningless reduction, it is far better that the tax remain at the present 20 percent.

Senator MILLIKIN. How do you figure that? Is not any reduction better than none?

Mr. BALABAN. Not in this case, sir. I doubt very much whether this reduction will help us in any way, and certain it is that the Government will at least lose the 5 percent. I will try and develop that argument, Senator, in a little while.

What is a cabaret? It is a restaurant with dance music, and sometimes a floor show. Very few throughout the country present such lavish floor shows as to warrant the addition of 20 percent on a patron's check. Most of them have only dancing and very modest shows.

Senator KERR. Do they attend the very modest shows much now?

Mr. BALABAN. They attended my shows, which were very modest. They attended my shows to the extent where I used to pay $15,000 per month to the Government in excise taxes.

Senator KERR. Is that the resaon that you are now closing down? Because of the modesty of the shows?

Mr. BALABAN. Because they will not pay the 20 percent cabaret tax now.

Senator KERR. All right.

Senator CONNALLY. Are you still in business?

Mr. BALABAN. Yes, sir, I am.

The CHAIRMAN. All right.

Mr. BALABAN. Before qualifying for a cabaret and liquor license, an operator must first show that he will operate a restaurant on his premises. Seventy-five percent of my establishment's gross income is derived from the sale of food, full course dinners ranging in price from $1.50 to $3. When I say "full course dinner," I mean an appetizer, soup, roast, potatoe, and vegetable, dessert, coffee, and salad. The rest of the income is derived from the sale of wines and liquors. A 15-percent tax on this food eaten in an establishment that furnishes dance music is unwarranted and punitive, especially in the face of reductions on general admissions to 10 percent. Bear in mind that the liquor served in these establishments is subject to a double excise tax. That is the excise tax that my predecessor spoke about, of $9 per gallon, plus 20 percent on the cost of the drink in the cabaret establishment.

Now let us see how retention of the tax as passed by the House is seriously affecting the revenue of the Government. Already, thousands of places throughout the country have eliminated features in their operation which subject their patrons to the 20-percent tax. If the tax remains at 15 percent, those few that are left will follow the example of the others, as I have been compelled to do. Now, the feature in the operation that I refer to is this. It may not be understood. That is that there has been an interpretation that if you provide music without dancing and without live talent you are not subject to the 20-percent excise tax. You are not subject to any excise tax. Of course, if you have a singer and a dancer, then the tax becomes operative, but not if you have concert music; and thousands and thousands of hotels throughout the country have eliminated their dance music and substituted concert music. You can imagine the effect this has had on the revenue of the Government, alone.

I recently have been compelled to do that. I did it just a week ago. I present to you gentlemen the picture of a sign that I had made.

Senator KERR. This sign says, "No cabaret tax."

Mr. BALABAN. That is right, sir. This is the policy I have been compelled to pursue.

Senator KERR. Was that what caused you to lose your business? Because you did not charge the tax?

Mr. BALABAN. No, I just started that this last Sunday night; not in anticipation of coming here, I assure you.

Senator KERR. Then you do not know how this will work out.

Mr. BALABAN. No. I know it couldn't operate the other way.

Senator JOHNSON. You say it is "sensational."

Mr. BALABAN. Well, allow for advertising exaggeration, please.

Senator KERR. What is the percentage of exaggeration in the statement you have given us here? How much should we allow for that?

Mr. BALABAN. You can hardly base that on percentages. It is an advertising man's way of having them read your ad. Anything that is sensational, they will read; as evidenced by some of our newspapers, you know.

Senator TAFT. Just what did you eliminate?

Mr. BALABAN. I eliminated the dance band.

Senator TAFT. And other entertainers, too?

Mr. BALABAN. I eliminated a dancer, a dance team, a duet consisting of a boy and girl, singers, and several other acts that created live entertainment.

Senator TAFT. So that you no longer classify as a cabaret. You are just a restaurant.

Mr. BALABAN. A restaurant with music.

Senator BUTLER. That is the artificial music?

Mr. BALABAN. No, sir, live music; concert music.

Senator MILLIKIN. It says "Gypsy music." It also says that you have some "table strolling Romany rollers."

Mr. BALABAN. That is to make them curious.

Senator MILLIKIN. Do they do a little wiggling while they are roaming?

Mr. BALABAN. No, it is just very fine concert music, very lilting; beautiful gypsy music of six pieces.

Senator JOHNSON. You say in your statement that:

> A week ago I was compelled to eliminate the show and dancing, which resulted in the laying off of 30 people.

Mr. BALABAN. That is right, sir.

Senator JOHNSON. You laid off 30 people, did you?

Mr. BALABAN. Yes, sir. The dance band and show alone affected all those people. And incidental to that, I was compelled to lay off, because of the drop in business, and because of the new operating policy on shorter hours, bus boys and about 12 waiters. I had a staff of about a hundred people. I now have a staff of about 65 people, and several cooks.

Senator TAFT. You do not know whether people will come now or not?

Mr. BALABAN. Well, we started on Sunday, and I can tell you, Senator, that they have been very receptive to it.

Senator JOHNSON. Maybe you will have to put on some more waiters.

Mr. BALABAN. It is possible I will. I hope I will. Then my argument before you gentlemen will become academic as far as I am concerned.

But we have had this tax now for 6 years. Under the law, it should have been removed 6 months after the declaration of peace. The removal of it was mandatory, as I understand it, 6 months after the declaration of peace. We have been hanging on and looking forward to some reduction, and my own personal experience has been that I have invested in my business during these last 3 or 4 years of the drop in business my entire personal fortune, to keep the thing alive, never losing the hope that some relief would be forthcoming on the cabaret

tax. Because in my opinion that is the greatest reason for the drop in our business.

And I believe, with all due respect to the Congress, that their actions in regard to this cabaret tax have been shortsighted even insofar as the revenue of the Government is concerned. The policy has hurt the revenues of the Government.

Senator TAFT. If this tax were reduced from 15 percent to 10 percent, would you open up again?

Mr. BALABAN. I certainly would; and many others would, too, Senator.

As I have said, already thousands of places throughout the country have eliminated features in their operation which subject their patrons to the 20-percent tax. If the tax remains at 15 percent, those few that are left will follow the example of the others as I have been compelled to do. The cabaret tax collections will dwindle to a point of nonexistence. It will cost more to collect and administer than will be received in revenues. Unemployment among performers, musicians, waiters, cooks, bus boys, et cetera, will mount greatly. The incidence of unemployment in these fields is very high now. In addition to losing revenue from direct cabaret tax collections, the receipts from income tax on wages and earnings of operators will diminish.

A consistent reduction to 10 percent, however, which I am urging now—and I say "consistent"; to make it consistent with the other amusement tax reductions—will most certainly have the reverse effect. I speak from knowledge and long experience. Operators who have eliminated taxable features, and from whose establishments no tax is being earned, will again reestablish them and become subject to tax. Competition with tax free establishments will make it advisable and compelling for them to do so. The number of tax units from which collections can be made will increase by the tens of thousands throughout the country. Employment in all categories will surge. Withholding taxes and taxes on operators' income will mount. These arguments in favor of a reduction consistent with other admission taxes make sound common sense and are coldly logical. The greater the reduction in the tax the more productive it becomes. This reasoning applies more so to the cabaret tax than to any other excise tax in the law, because people can take it or leave it, and dine in tax free establishments if the tax is too high. Now, this is an important point that applies more to the cabaret tax than to any other excise tax in the law, because it is so set up that people can take it or leave it and dine in tax-free establishments if the tax is too high, and even be entertained with music.

It is for these reasons that I urged a reduction to 5 percent before the House Ways and Means Committee. Great benefits to the Government revenue, to the workers engaged in this business and to the operators can and will be gained by making the reduction consistent with the other reductions. The retention of a 15-percent tax on cabarets glaringly distinguishes them from other types of amusements, thus creating the impression that they are a super luxury, will seriously hurt the Government's revenue and the livelihood of its citizens employed in this industry. A 5-percent or 10-percent tax can hurt no one and benefit everybody concerned, including the Treasury.

The CHAIRMAN. Any further questions?

If not, we thank you, sir, for your appearance.

Mr. BALABAN. Thank you, gentlemen.

May I have just one more word?

The CHAIRMAN. Yes, sir.

Mr. BALABAN. I would like to point out, here, a living example. In Canada the tax was taken off entirely, and from reports that I get from people who have been employed by me, particularly entertainers who travel back and forth and work in Canadian cabarets, their business is booming. Of course, their tax has been reduced entirely. Nobody is urging that here. I never have urged that. But I say that the tax should be reduced to a sensible figure, consistent with the other admission taxes, and nobody will be hurt.

The CHAIRMAN. Canada reduced a great many other taxes also.

Mr. BALABAN. Yes, sir.

Thank you, gentlemen.

The CHAIRMAN. Mr. Ragland? You may be seated, sir, and identify yourself, please, for the record.

STATEMENTS OF EDWARD F. RAGLAND, EXECUTIVE SECRETARY, ASSOCIATED TOBACCO MANUFACTURERS, AND JOSEPH E. CASEY, COUNSEL, ASSOCIATED TOBACCO MANUFACTURERS

Mr. RAGLAND. Thank you, sir.

My name is Edward F. Ragland and I appear in support of a change in the method of Federal excise taxation of cigarettes from the present inequitable flat-rate basis to an equitable ad valorem basis.

The Associated Tobacco Manufacturers, of which I am executive secretary, is a trade association comprising practically all of the manufacturers of cigarette, smoking, and chewing tobacco in the United States except the five largest cigarette manufacturers which were defendants in the recent antitrust suit successfully prosecuted by the Department of Justice at Lexington, Ky.

Gentlemen, I might interpose here the suggestion that what I am reading is not what you have before you. That is a lengthy statement. I am trying to conform with your instructions, sir, to limit my testimony to 5 minutes.

The CHAIRMAN. You appeared before the House committee?

Mr. RAGLAND. Yes, sir.

The CHAIRMAN. You had quite an extended hearing there. Is that not correct?

Mr. RAGLAND. Yes, sir. We were there for 2 days, as I recall. But if I may, I would like to continue with this very brief statement.

The CHAIRMAN. Yes, sir. Do you wish to put this other statement in the record?

Mr. RAGLAND. Yes, I would like to, Mr. Chairman.

The CHAIRMAN. It will be inserted in the record.

(The statement referred to follows:)

STATEMENT OF EDWARD F. RAGLAND

My name is Edward F. Ragland. I appear in support of a change in the method of Federal excise taxation of cigarettes from the present inequitable flat rate basis to an equitable ad valorem basis.

I appear on behalf of Associated Tobacco Manufacturers as its executive secretary, speaking on behalf of our 18 members which constitute practically all of the manufacturers of cigarettes, smoking and chewing tobacco in the United States except the five largest cigarette manufacturers which were defendants in

the recent antitrust suit successfully prosecuted by the Department of Justice at Lexington, Ky. This statement is a documented story in support of a proposal to tax the lower-priced economy brand cigarettes at the same rate at which the higher-priced so-called standard brand cigarettes are now taxed.

We come to you now with a case of extreme hardship and serious public as well as private injury. The hardship to us lies in the fact that the three dominant standard-price cigarettes, manufactured by companies that stand convicted of price fixing and monopolization in the cigarette industry, have practically put our members out of business and have reduced the business of the three of our members which manufacture economy brand cigarettes from a substantial volume of business in the 1930's to a present volume of less than one-half of 1 percent of the total market.

Unless prompt action is taken to change the Federal cigarette tax structure, these independent manufacturing companies which have survived against increasing odds will soon be obliged at last to give up their struggle and go to the wall.

The present Federal cigarette tax is a flat $3.50 per thousand, or 7 cents on a package of 20 cigarettes, regardless of the value or selling price of these cigarettes. This means that the three dominant standard-price cigarette brands, Lucky Strikes, Camels and Chesterfields, retail generally before State taxes at 17 cents a package. Economy price cigarettes like Marvels, Dominos, and Wings retail generally before State taxes at 14 cents per package. In terms of the net price to the manufacturer after trade discounts and after the Federal tax, the existing flat tax is at the rate of 163 percent on the economy brand cigarette and 104 percent on the dominant brand cigarette.

This is a regressive, inequitable, discriminatory tax, because the cigarette tax is strictly a consumer tax, paid by the manufacturer but passed on in full to the smoker. It taxes the lower income group at a higher rate than those better able to pay and is thus discriminatory not only against the smaller manufacturers who seek to provide price competition, but also discriminatory against the consumer of low purchasing power. A study by the United States Department of Labor ("Family Income, Expenditures, and Savings in 1945"—Bulletin No. 956) shows (1) that expenditure for cigarettes is an important cost-of-living item and (2) that expenditure for cigarettes rises in almost direct relation to family income at the lower income levels. The flat tax, by denying cigarettes in a lower price range to the consumer of low income, thus denies him satisfaction of his smoking needs, whereas an ad volorem tax, by making a lower-priced cigarette available to him, would permit him to satisfy his desire for cigarettes without inflating his expenditure therefor; or it would permit him, while continuing his present rate of consumption of cigarettes, to do so at reduced expense.

In respect of the manufacturing segment of the tobacco industry, the flat tax has built up and sustains an extreme monopoly condition in the cigarette industry, which according to a survey recently made by the Secretary of Commerce, has the highest degree of concentration of business in the hands of a few of any industry in the United States; it restricts the competitive market for the farmers' tobacco; and it has worked to the harm of consumers, tobacco growers, tobacco distributors, independent manufacturers, and, in fact, of every segment of the tobacco economy except those dominant large manufacturers which have twice been branded by the Supreme Court of the United States as flagrant violators of the Sherman Antitrust Act.

We propose that Federal taxes on cigarettes shall be brought in line with the usual ad valorem excise tax principle. By so doing the Federal tax would continue at $3.50 per thousand on cigarettes manufactured to retail at more than 12 cents per package of 20 cigarettes and would be $2.45 per thousand on cigarettes manufactured to retail at not more than 12 cents per package. This would mean that the rate of tax which smokers would pay would be the same, approximately 41 percent of the retail price, whether they bought a dominant brand of cigarettes or any economy brand. This tax reduction for economy brand cigarettes would be passed on to the consumer and would result in the introduction of price competition to an industry from which price competition has been wholly lacking for many, many years.

There is, of course, plenty of successful precedent for ad valorem taxes on cigarettes, since even in the tobacco industry it is the system on which cigars are taxed, and almost all other excise taxes are not flat, but proportionate to the price of the product taxed.

Our members recognize the historical role of tobacco products in sypplying large amounts of Federal revenue; we welcome the responsibility so placed on us, and we assure the members of this committee that it is our considered judgement

that if our economy brands are give a chance under this proposal to compete in price with the standard brands—something we cannot do under the existing tax set-up—Federal income from excise taxes on tobacco products will continue to increase. Our economy brands on the basis of the record of past experience will unquestionably get most of their following from those low-income-group smokers to whom a few pennies mean something, who now roll their own cigarettes and who, if they shift from roll-your-own to economy-brand cigarettes, would be paying the Treasury approximately 98 cents per pound on the tobacco used in their cigarettes, instead of the 18 cents rate they are now paying on manufactured tobacco. Furthermore, the economy brands would get increased business from even lower-income groups who are now not able to satisfy their desire for cigarettes because all the cigarettes now on the market are too high priced for them.

The economy class of cigarettes can be made available to the smoker under this tax plan only through lower manufacturing costs, lower costs of selling and advertising, and most of all, through a conception of possible net profit far below the rates of profit to which the entrenched brands have become accustomed. Indeed, for their present dividend purposes and considering their capital and debt structure, net profit after taxes of the companies making the dominant entrenched brands must be larger than the entire gross operating profit available to the makers of the economy class. No saving on the costs of making the economy brands would be at the expense of the leaf grower or of labor.

Our membership, although representing the great majority of all the independent cigarette manufacturing companies in the United States, represents but a small segment of total cigarette manufacturing in the United States—necessarily so because the companies which have been convicted of monopolizing the industry themselves manufacture over 95 percent of domestic cigarette production. However small and few in number though we may be, our case for cigarette-tax revision is sufficiently strong that it commands and has received the endorsement of every agency of the United States Government which is concerned with the tobacco industry except the Congress of the United States to which we are now appealing. It did receive the approval of the House Select Committee on Small Business of the Eightieth Congress, second session, House Report No. 2466 of December 1948.

About 2 years ago inquiry was made of the various agencies of the Federal Government concerned with this subject as to their attitude about this principle of changing cigarette taxes to an ad valorem basis. The reaction and response was uniformly favorable.

The Department of Commerce took a position with the Committee on Ways and Means of the House of Representatives as follows:

"In general, we are opposed to restraints on free competitive enterprise, particularly when their effects is to discriminate against smaller enterprise. The vitality of American industry and business in large measure stems from the preservation, in this country, of the ideal of free economic opportunity, which, in turn, depends upon maintaining in full vigor the competitive position of smaller enterprise. The present regressive tax on cigarettes plainly discriminates against the smaller manufacturers by artificially narrowing the price ratio between their products and those of the 'Big Three.' Its effect is therefore to support the present high degree of concentration in the industry. For these reasons we are hopeful that considerations of tax and fiscal policy will not preclude a modification of the tax." (Letter of November 24, 1947.)

Again on March 13, 1950, the Department of Commerce restated its position in a letter to the Chairman of the Committee on Ways and Means of the House of Representatives by saying:

"The Department of Commerce favors enactment of H. R. 2016 because it will place the tax on cigarettes on what is essentially an ad valorem basis in which the 'economy brands' will have a lower tax rate to the extent of 2.1 cents per pack of 20 cigarettes. Inasmuch as the standard brands of cigarettes in single pack sales retail for approximately 17 cents per pack while the 'economy brands,' in order to obtain the benefit of this tax, will have to sell for not more than 12 cents per pack of 20 cigarettes, the rate for the two types of cigarettes will be proportionate to their retail prices."

The Federal Trade Commission, in a letter from its Acting Chairman dated June 30, 1947, concluded, on premises which cannot be seriously questioned, that "the proposal for a graduated cigarette tax based upon the manufacturer's net selling price deserves the Commission's endorsement." The Federal Trade Commission noted that it had previously "recommended that Congress consider the advisability of levying, in place of the present uniform tax, a graduated tax on cigarettes" which, said the Acting Chairman, "would not only afford a strong

incentive for manufacturers to keep their brands within reasonable price limitations and curb any tendency to increase cigarette prices without regard to the economic soundness of the change, but through the medium of increased competition in the cigarette industry would also result in increased competition in the purchase of cigarette types of leaf tobacco and thus afford to the grower and to the public generally such benefits as flow from greater competition."

On February 27, 1950, Mr. Robert B. Dawkins, Associate General Counsel, Federal Trade Commission, testified before the Committee on Ways and Means of the House of Representatives, and said:

"The history of the 10-cent cigarettes made it clear that if a reasonably substantial differential in price below the major brands can be maintained, there is ground for believing that economy brands of cigarettes made by smaller manufacturers can effectively compete with the major brands. A graduated tax would facilitate the maintenance of such a price differential. This should promote increased competition in the cigarette industry and result in benefits to consumers and to growers of tobacco. * * * It appears reasonably certain, however, that the uniform tax on cigarettes continues to handicap the growth of effective competition in the cigarette industry."

The Secretary of Agriculture, in a letter of July 16, 1947, stated as the opinion of his Department "that the effect of stimulating the manufacture of cheaper cigarettes by affording a lower tax rate would not only increase the number of buyers and competition for many of the presently recognized cigarette brands but would bring other grades (of leaf tobacco) into the cigarette field." The Secretary of Agriculture concluded his letter as follows:

"It is a matter of knowledge in this Department that the smaller manufacturers of standard and economy brands are having extremely difficult going and many of them may be forced out of the field entirely.

"I believe that a graduation of excise tax according to the intended retail price, precedent for which exists in the tax rate on cigars, would go far in maintaining the competitive position of the manufacturers of economy brands and would work to the benefit of the tobacco growers."

The specious argument that permitting more competition to enter the leaf-tobacco markets will hurt the growers of leaf tobacco seems to be conclusively refuted by this statement from the Secretary of Agriculture who, after mature consideration, expressed the view of his Department that an ad valorem cigarette tax not only would not harm the growers of leaf tobacco, whose interests it is his duty to safeguard, but would affirmatively benefit those growers by increasing the competition for their produce.

The Treasury Department strongly endorsed ad valorem cigarette taxes when a bill of this kind was first introduced in the Congress of the United States. Later, in a letter to the chairman of this committee from the Secretary of the Treasury, dated October 17, 1947, the Secretary stated that "the Department agrees in principle with this proposal."

Again on February 25, 1950, the Treasury Department, in a letter addressed to the chairman of the Ways and Means Committee, endorsed the principle of an ad valorem tax in these words:

"The Department has consistently favored in principle the application of a lower rate of tax to 'economy brand' cigarettes. The present cigarette tax, which is a flat rate per thousand cigarettes, represents a larger proportion of the retail price of 'economy brand' cigarettes than of 'standard brand' cigarettes, and in this respect discriminates against the 'economy brands.' It also appears that the present cigarette tax on 'economy brands,' which are consumed largely by low-income groups, tends to be regressive in nature."

The Secretary of the Treasury has said that the principle of this proposition is sound. The Department of Agriculture says that it will not harm, but will benefit, the growers of leaf tobacco. The Federal Trade Commission, speaking from the standpoint of competitive conditions in the industry, strongly urges the passage of this kind of legislation. The Secretary of Commerce, speaking from the standpoint of business, urges that such a law be passed. The House Small Business Committee has pointed to the necessity of it. The National Association of Tobacco Distributors, representing the distribution end of the tobacco business, has warmly endorsed it. And my association, representing practically all of the independent small-business men who are left in the industry, tells you today that we cannot survive without this legislation.

The Department of Justice, as the accredited spokesman for the Government on the antimonopoly aspect of the legislation, has repeatedly endorsed the proposal. The latest such endorsement came during the hearings before the House Ways and Means Committee recently when John C. Stedman, Chief of the

Legislation and Clearance Section of the Antitrust Division, read a statement which included the following comment:

"It is the view of the Department of Justice that the enactment into law of the principle of a graduated cigarette tax is an objective both desirable and necessary as a means of giving the smaller manufacturers of cigarettes, and particularly of economy-price cigarettes, an opportunity to compete with the strongly entrenched major brands of the so-called Big-Three tobacco companies, which were convicted of monopolizing and restraining trade in the tobacco case tried before a Federal court and jury in Lexington, Ky., in 1941, which convictions were subsequently affirmed by the Supreme Court of the United States."

The Department of Justice, on March 30, 1948, endorsed a bill providing for an ad valorem tax on cigarettes which then was pending before the House Ways and Means Committee. Because the implications of this proposed tax change go so far beyond tax rates and strictly revenue considerations, I should like to quote in full the Justice Department letter to the chairman of the House committee:

MY DEAR MR. CHAIRMAN: In a letter of October 16, 1947, in response to a letter from Representative Woodruff of your committee, the Department indicated that it had no suggestion to make at this time about a proposal to amend section 2000 (c) (2) of the Internal Revenue Code to provide for a graduated rather than a flat-rate excise tax on cigarettes. Since that time, as the result of further careful study of the tobacco industry, and of data not previously available, I have come to the conclusion that the enactment into law of the principle of a graduated cigarette tax is an objective both desirable and necessary as a means of giving the smaller manufacturers of cigarettes, and particularly of economy-price cigarettes, an opportunity to compete with the strongly entrenched major brands of the so-called Big Three tobacco companies, which were convicted of mopolizing and restraining trade in the tobacco case tried before a Federal court and jury in Lexington, Ky., in 1941, which convictions were subsequently affirmed by the Supreme Court of the United States.

The charges of the Government in that prosecution centered on the deliberate elimination by the Big Three of price competition from the cigarette industry. Since the convictions of the Big Three in 1941, price competition has not been restored in any substantial degree in the cigarette field, and the Big Three, which in 1939 has 67.6 percent of the cigarette market of the United States, have increased their monopoly position to a point where they now have approximately 86 percent of a market which has doubled in volume. The smaller cigarette manufacturers are passing out of the picture, and, being unable to compete under the existing Federal tax law on a price basis, these smaller manufacturers are facing extinction.

The Department of Justice has under consideration the correction of the various abuses and restraints of trade charged by the Government in the Lexington case, and condemned in the opinion of the courts in that case. These proposed corrective measures are expected to enjoin, by court decree, the abuses known to exist. I believe, however, that if the smaller manufacturers are to be given affirmative relief, legislation is necessary which would assist them to compete on a price basis with the major cigarette brands. The proposed legislation would tend to create price competition and would give the consuming public an opportunity to realize the benefits of such competition on the basis of its graduated purchasing power.

Furthermore, the proposed bill could result in the restoration of competitive factors which have been eliminated from the markets in recent years. Smaller manufacturers who have been forced to withdraw from the cigarette industry since 1941 would be afforded an opportunity to return to the industry and compete with the Big Three on a price basis.

Because of these factors, I strongly recommend the enactment of a graduated Federal excise tax on cigarettes. Whether the rates proposed in Representative Woodruff's House bill No. 3912 would be the most satisfactory rates, from the standpoint of our Government's fiscal policies, is a matter on which the Congress will look for advice to the Treasury Department rather than the Department of Justice. My recommendation is based entirely on the relationship of this bill to the removal of monopoly conditions and restraints of trade in the tobacco industry, which is a recognized obligation and objective of the Department of Justice in its duty to enforce the Sherman Antitrust Act.

With kind personal regards,

Sincrely yours,

PEYTON FORD,
The Assistant to the Attorney General.

The monopoly aspects of the tobacco industry have long been recognized. The industry was highly competitive prior to 1890, when a group headed by James B. Duke promoted a merger of the five more successful units and started a combine which has steadily increased its monopolistic control of the entire industry.

The principal reason, apart from monopoly practices by the Big Three companies, why the economy brands have not survived has been the rigid and discriminatory flat Federal tax rate, which has helped to keep the price structure frozen in the cigarette field, and has been the major factor in keeping price competition, and its benefits to the American public, completely out of the cigarette industry. If Congress should see fit to enact the ad valorem cigarette tax, a long step will have been taken toward bringing competitive conditions back to the industry. At last the smaller manufacturer would have a chance to compete on a price basis. He cannot compete successfully in the same price bracket that the three leading cigarette brands are in, because the power of their advertising is such that most business experts agree that it would take an investment of literally hundreds of millions of dollars to undertake an effective campaign to launch a cigarette brand in the standard-brand price field. The three major companies each keep well over $200,000,000 in leaf tobacco inventories, and they spend tens of millions of dollars a year in advertising. The Federal tax must be paid before the cigarettes leave the factory. Even if a new enterprise were willing to invest the necessary capital, it is highly doubtful that this field could be successfully invaded without a price differential, because outstanding efforts have been made in the past without succeeding, such as with the Raleigh and Old Gold brands.

The obvious fair solution for this difficulty would seem to be a cigarette tax representing a fair rate or percentage of the selling price of the cigarette. There seems to be no sound reason in principle or in logic for a tax which requires a man of modest means, who is obliged to look for the least expensive good cigarette on the market, to pay a higher rate of tax than is paid by a man of unlimited means who can afford to pay 50 cents a package for luxury Egyptian or Turkish-type cigarettes, and that is the situation today. Practically all other Federal excise taxes are on the basis of a percentage of the selling price. Thus a man who smokes stogies does not pay a higher rate of Federal tax than the man who smokes Corona Coronas. These two types of smokers choose their price field, and pay a tax based on a percentage of the price they are willing and able to pay for their cigars. The woman who buys a $200 fur coat pays 20 percent as a Federal tax, or $40, and is not subjected to the same amount of tax as the woman who pays $5,000 for a mink coat, on which the Federal tax is $1,000. The same principle applies to cosmetics, to theater tickets, and to a long list of other items subject to Federal excise taxes, and the discriminatory feature of the cigarette tax is made even worse by the fact that the tax itself bears such a high ratio to the retail price of the cigarettes sold in the United States. This is what the experts call a regressive tax, and it needs no demonstration to show how discriminatory it is against a man of modest means who wants to buy and needs to buy an economy-priced cigarette.

Associated Tobacco Manufacturers, representing about all there is left of the independent manufacturing interests in this country, are completely and unanimously convinced that unless such a tax is enacted, we few remaining smaller businessmen in the cigarette industry are doomed to early and complete extinction. We look to Congress for this help, and hope that our plight will make itself felt in time to keep us in business.

Senator CONNALLY. You are interested in the cheaper cigarettes, and so forth?

Mr. RAGLAND. Yes, sir, what we call the economy brands.

Senator CONNALLY. You want to cut the tax on that, and differentiate that from the other?

Mr. RAGLAND. We want to have the tax rate applied equally to the economy brands, as it is now applied to the higher priced cigarettes.

Senator KERR. What you are asking for is a tax on the amount of the sale price of the cigarette, rather than a flat tax on the cigarette regardless of its sale price?

Mr. RAGLAND. Precisely, sir.

Senator TAFT. And the House rejected that, did they, finally, in their final bill?

Mr. RAGLAND. They voted on that three times, Senator Taft. We won twice; we lost the last time.

The CHAIRMAN. You would not hold out much confidence that the House conferees would recede if we adopted your views, would you?

Mr. RAGLAND. Well, Mr. Chairman, my answer to that is this: I think that education is a long process, and we hope to keep everlastingly at it, until we have convinced the folks of the fairness of our proposition.

The CHAIRMAN. How long have you been educating us here in this committee on this same subject?

Mr. RAGLAND. Well, I understand that in 1942 some folks came before you.

The CHAIRMAN. Quite a number of them. You are opening up a field now where we would not be justified in excluding the producers of tobacco, because they appeared before this committee, quite a number of them, in 1942 or even prior to that time.

Senator BYRD. You only lost by one vote?

Mr. RAGLAND. We only lost by one vote.

Senator CONNALLY. You lost, though?

Mr. RAGLAND. A temporary set-back, Senator Connally.

Senator BYRD. On the third vote that was taken, one vote changed, and you lost by one.

Senator BUTLER. In your prepared statement, there, Mr. Ragland, do you bring out the facts as to prices on different kinds?

Mr. RAGLAND. Yes, sir. I think that I have covered this as briefly as I could and as thoroughly.

The CHAIRMAN. You may proceed, Mr. Ragland, and your full statement will go on the record.

Mr. RAGLAND. Thank you, sir.

In February of this year members of this association appeared before the Committee on Ways and Means of the House of Representatives in the hope of demonstrating the need for a change in the method of taxing cigarettes by the Federal Government. The present basis of excise taxation of cigarettes is unfair and discriminatory because all small cigarettes are taxed at the same dollar rate without regard to the intended retail selling price. For example, the dominant brands of cigarettes retail generally before State and local taxes at 17 cents a package. The Federal tax of 7 cents per package of 20 cigarettes thus represents approximately 41 percent of the retail selling price.

In the case of economy brands of cigarettes such as Avalons, Dominos, Marvels, and Wings, they carry the same tax burden of 7 cents a package.

Senator MILLIKIN. May I ask you: Are they all the same size?

Mr. RAGLAND. Yes, sir. That is, they all conform to the Internal Revenue Bureau's restriction on small cigarettes. They all contain not more than 3 pounds of tobacco per thousand.

Senator MILLIKIN. Are not all cigarettes made with the same licensed machinery?

Mr. RAGLAND. Yes, sir, so far as I know they are.

Senator MILLIKIN. So that they are all "round, firm, and fully packed"?

Mr. RAGLAND. Yes, sir.

As I was saying, in the case of these economy brands which I mentioned, they carry the same tap burden of 7 cents a package, although their average retail price before State or local taxes averages 14 cents a package. This means that the economy brands are taxed at the rate of 50 percent of the retail selling price.

We are asking your committee to restore to H. R. 8920 a provision to tax economy brands of cigarettes at the same percentage rate as the dominant brands. This provision was approved by the House Ways and Means Committee by two separate votes. At the last minute, however, it was knocked out by the narrow margin of one vote. Thus, the House had no opportunity to express itself on this issue so vital to the smaller manufacturer and to the 60,000,000 cigarette consumers.

The change from a flat excise tax to an ad valorem tax could be made with resultant benefits to all factors in the tobacco industry by establishing a tax of $2.45 per thousand or 4.9 cents per package of 20 cigarettes applicable to cigarettes having an intended retail selling price of not more than 12 cents per package of 20 cigarettes. On all other cigarettes the tax would remain at its present level. For all practical purposes, there are but two price classes of cigarettes, the dominant or so-called standard brands and the economy brands. The application of the same rate of tax to both of these classes of cigarettes would provide equity in Federal excise taxation of cigarettes.

During the hearings of the Committee on Ways and Means of the House of Representatives in February of this year, a spokesman for the Treasury Department quite unexpectedly estimated that the enactment of the proposed advalorem cigartete tax would result in a loss to the Federal revenue of approximately $90,000,000 a year. On cross-examination the Treasury expert stated that this estimate was based on economic conditions prevailing in November 1932, which you will recall was at the depth of the worst depression in the Nation's history. The Treasury expert also stated that the estimated loss of $90,000,000 a year was predicated on the assumption that there would be a shift of 25 percent of the cigarette smokers in this country from the dominant brands to the economy brands of cigarettes.

Senator CONNALLY. Let me ask you, right there: Is there any substantial difference in the make-up, the content, the quality of tobacco, in your cigarettes and what you call the dominant brands?

They must have a little better cigarette? Have they not? Or have they?

Mr. RAGLAND. Senator, quality in tobacco is sort of an abstract thing. I mean, it is a matter of judgment. Of course, the soundness of a leaf and the color of the leaf and the texture of it are apparent to anybody, but some people have different ideas about the blend. I imagine the same thing is true as to this whisky that you were hearing about a little while ago.

Senator CONNALLY. Well, let us stay on tobacco and get off of whisky.

Senator BYRD. Mr. Ragland, on the question of the loss, did not the Treasury reverse its position?

Mr. RAGLAND. Yes, sir; they did. I would like to have Mr. Joseph E. Casey, our counsel, talk about that. I think he knows more about that than I do.

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Senator BYRD. I would like to have an explanation of that. I have read the hearings, and I am somewhat confused on what basis they estimate this loss.

Mr. RAGLAND. Well, shall I proceed with the rest of this, which is just a page and a half? Then Mr. Casey could answer that, Mr. Chairman.

The CHAIRMAN. Yes, sir.

Mr. RAGLAND. I was talking about this $90,000,000 loss. Members of the Associated Tobacco Manufacturers took violent exception to this estimate because of their experience during the thirties, when the largest share of the cigarette market ever garnered by the economy brands amounted to slightly less than 15 percent. This, incidentally, was in 1939.

It was suggested that we obtain independent expert opinion on the validity of the basis used by the Treasury Department expert in arriving at his fantastic estimate, and for this independent analysis two of the Nation's outstanding economists specializing in finance were invited to comment on this matter. Dr. Harley L. Lutz, professor emeritus of public finance, Princeton University, said:

> It is well-nigh incredible that cigarette users would today more than double the proportion of the purchases of lower priced cigarettes which they bought in the depression years.

Dr. Lutz also said:

> It is wholly indefensible to take a single month out of that long depression and make it the basis of a projection into present conditions.

Dr. Lewis H. Kimmel, staff specialist in tax and fiscal matters of the Brookings Institution, said:

> In my judgment the underlying assumptions for the estimate of $90,000,000 are completely untenable.

Dr. Kimmel said, moreover, that:

> Independent estimates indicate that an increase in sales of economy brands from present figures to 2 to 5 percent of the total would mean a negligible revenue loss in the range of 2 to 6 millions * * *. If prosperous conditions continue, as is assumed by the Treasury in preparing its estimates, there appears to be no possibility of a revenue loss so large that it would materially influence the estimates for the tobacco excises in the budget for the year ending June 30, 1951.

Irrespective of the trifling loss which conceivably could result from the adoption of an ad valorem cigarette tax, we respectfully submit that the Senate Finance Committee should give favorable consideration to this proposal on the basis of the merits involved. Practically every department of the Federal Government has given its endorsement to this proposal for an ad valorem tax on cigarettes. Ample precedence exists even in the excise taxation of another tobacco product, cigars. The members of the Associated Tobacco Manufacturers, therefore, urge your support so that price competition may again be restored to the cigarette industry and an injustice to the small manufacturer of cigarettes may be corrected.

And lastly, gentlemen, we believe that the low-income consumer in this country should have the opportunity to purchase a lower priced cigarette.

That concludes my 5-minute statement, sir, and now would you like Mr. Casey to answer that question of Senator Byrd's?

The CHAIRMAN. Yes, sir.

Mr. CASEY. Mr. Chairman and members of the committee, my name is Joseph E. Casey. I am an attorney here in Washington at 1025 Connecticut Avenue. I represent the tobacco association of which Mr. Ragland is secretary.

There were two Treasury reports on this bill now under discussion. One was true and one was false. One is true, and one is false. I think it is very important to determine which is the true report and which is the false report, because there is no way of estimating whether you are going to have a loss or not or how much the loss is going to be unless you know the true report and the one that is based upon fact and not upon fancy.

This bill was introduced in the first session of this Congress. The Treasury Department has had it under consideration during the entire year, almost, of 1949. They studied it. They sent it to Internal Revenue. And this report, which I claim is the true report, was sent to every department of the Government having any connection with this problem. It went to Commerce, Federal Trade Commission, the Department of Justice, and the Council of Economic Advisers. It went to the budget. And that report, which I have before me, has initials which I think come from Internal Rvenue. It is in the form of a letter addressed to the chairman of the Ways and Means Committee.

Now, we knew of its existence, after a long, long time, because you can't keep things like this quiet, and we were trying to get it out of the Treasury Department. The sponsor of the bill, Congressman Boggs, endeavored to get the report from Treasury. And last February 14, on a Friday, we had our hearing, and it was a hot hearing. This is a very ticklish subject, particularly with one member of the Ways and Means Committee.

The CHAIRMAN. Well, it is more than that. You are just badly off if you do not think this is an important question with all the producers of tobacco, of bright leaf tobacco particularly. And that is the tobacco that goes into your cigarettes. I happen to grow a little tobacco.

Go ahead with your statement.

Mr. CASEY. I still think that I have underplayed the situation with respect to what I have said.

The CHAIRMAN. I think it is hardly a fair statement to say that it was a very ticklish subject with one member of the Ways and Means Committee. I think it is hardly a fair statement. That is what I am calling your attention to.

Mr. CASEY. I have had a lot of experience with this, Senator, and I still think it is an accurate statement. However, I do not want to comment upon something that is displeasing to the chairman.

The CHAIRMAN. Very well. Go ahead.

Mr. CASEY. Well, we had our hearing before the Committee on Ways and Means on February 14, 1950, and still there was no report from Treasury, although the sponsor of this bill was trying to get a report from Treasury. And 1 week thereafter, the opponents of this measure appear, on Friday the 23d of February, and still there is no report. So we come to a Monday, which is the last day there is going to be a hearing. And up until that day this report which I hold in my hands, and which I would like the Senators to see, with the symbols of Internal Revenue, which I claim is the true report and represents the

true attitude of Treasury after a well-considered study of the subject, was the only report down in Treasury on this subject.

Senator MILLIKIN. What is the guts of it?

Mr. CASEY. The report says that the enactment of this measure will cost the Government practically nothing, because of the increased consumption of cigarettes. It says it favors it in policy and it has no objection to its enactment. That is the studied and serious report of the Treasury Department, which was sent around to every other department.

The CHAIRMAN. They do not claim it will produce any new revenue, do they?

Mr. CASEY. They do not claim it will produce any new revenue, Senator.

Senator MILLIKIN. Would it bother your presentation too much if I were to ask you: Where do you buy your tobacco for the so-called economy cigarettes? Do you buy your tobacco in any different places than where the predominant makers, if that is what you call them, buy their tobacco?

Mr. CASEY. I think Mr. Ragland can answer that.

Mr. RAGLAND. No, sir, there are certain markets set up and so designated by the Department of Agriculture.

Senator MILLIKIN. You buy in all the markets?

Mr. RAGLAND. Yes, sir, in competition with anyone else who wants tobacco.

The CHAIRMAN. Do you buy the high-grade tobacco, or the low?

Mr. RAGLAND. Senator, I would say that there are high grades of tobacco in every economy brand cigarette. The exact proportion I am not in position to say, sir.

The CHAIRMAN. All right.

Any further questions?

Is there any further statement you wish to make?

Mr. CASEY. Yes, Mr. Chairman. I call your attention to the fact that we are now coming to the last day of the hearing, and still there is no report from the Treasury, although this report is in existence and has been sent around to every department.

Senator CONNALLY. You said there was a false report. What about that?

Mr. CASEY. I am now coming to the false report, which I say does not accurately portray Treasury's real considered judgment.

Senator BYRD. This is not dated?

Mr. CASEY. That is an undated report.

Senator BYRD. Was it signed by the Secretary of the Treasury?

Mr. CASEY. It was never signed.

Senator KERR. It has not been signed?

Mr. CASEY. It was never signed.

Senator KERR. It had been prepared by the staff for the signature of the Secretary, and, of course, was to be dated when signed, if signed?

Mr. CASEY. I presume that is so; and sent to the Budget and around to all these other departments, who approved it in policy and technically and in every way. It was approved. And yet there was no signature.

Senator HOEY. Which do you say was the correct one? The one that was not signed?

Mr. CASEY. That is correct.

Senator JOHNSON. By whom was it received, and when?

Mr. CASEY. It was received by every department of the Government.

Senator JOHNSON. But where did you get this?

Mr. CASEY. Well, I do not recall just now. But you cannot keep those reports secret. We have been in this for a long, long time. We had appeared at Treasury.

Senator HOEY. This report is undated and unsigned?

Mr. CASEY. Yes.

Senator HOEY. And this, you say, is the correct report?

Mr. CASEY. The correct report.

Senator HOEY. There was a report which was signed, was there not?

Mr. CASEY. There was a report which was signed. But I now want to call your attention to the second report, which is dated February 25, which is before your committee as the full report and as reflecting Treasury's studied conclusions on this bill. That was dated February 25, 1950. I call your attention to the fact that that date is a Saturday, when Government employees do not work. I think it is a correct date that is on there. But a date becomes very important. February 25, 1950, on a Saturday preceding the Monday which is the last day of the hearing. So it is the last possible chance of changing what has been down there, and what has been under study for almost a year.

So you come up to this last chance on a Monday, February 27. And so, on a Saturday, when the Treasury usually does not work, you have a report. That date becomes significant. Then, on Monday, a Treasury representative appeared before the Ways and Means Committee, and, when asked for copies of that report, had no copies. There was just this original on February 25 of a report that had never been sent to the budget. True, it said it had the approval of the budget, but I think that was a quick telephone call on Monday morning. But it had never been sent to any of these departments concerned with it, as the original report had been. No serious consideration could have been given to that report. And it was a recent invention in order to get before the committees, the Committee on Ways and Means and this committee, the idea that this cigarette tax would cost $90,000,000 if enacted into law. And that explains why, I believe, these specialists in the field of economy, Professor Lutz and this gentleman from Brookings Institution, call it an incredible report. It is not a difference of honest opinion between Treasury and these estimable economists, who call it fantastic and incredible. It is the fact that I think their purpose was to try and show, in this recently invented report, as high a figure as they could.

Just see what they did to get that high figure. They went back 18 years, for something to base this figure on. They went back to 1932 and took 1 month, when, for a brief period, the economy cigarette had reached something like 20 percent, I think, of the total of the cigarette business, and then receded. They took that 1 month, ignoring all the other months and all the other years since 1932, and upon that month, at the depth of the depression, they projected that it would cost $90,000,000; although we are not facing a depression this year.

Senator MILLIKIN. What percentage of the whole business are you doing now?

Mr. CASEY. One percent. And, of course, while we are on that, Senator, it is a simple proposition——

Senator MILLIKIN. Is that in terms of money, or number of cigarettes?

Mr. CASEY. Percentage of volume of business done.

Mr. RAGLAND. Unit sales.

Mr. CASEY. The simple proposition is this: That the well-established big cigarette companies have advertised millions and millions of dollars every year for a great many years. And so there is a public acceptance of their cigarettes, by virtue of the radio and the newspaper and every means of advertising. I am not compl uining about that. But there is a public acceptance. So if you have a cigarette like the Lucky Strike, that is well advertised, and you have a Marvel in the same case, which is an economy cigarette, the public has never heard or scarcely heard of Marvel, and if there is no difference in price they are going to buy the Lucky Strike. So you have that acceptance of these well-advertised brands by the big companies.

What this bill seeks to do is to put price competition in there, to let in the fresh air of free enterprise.

The CHAIRMAN. You mean to say there is no difference in price?

Mr. CASEY. There is a difference, but long experience, Senator, has taught us that the nickel break the coin break——

The CHAIRMAN. Oh, well, but you are getting away from my question. There is an actual difference in price now.

Mr. CASEY. There is a difference in price.

The CHAIRMAN. And always has been?

Mr. CASEY. But do not think I am getting away from your question, Senator.

The CHAIRMAN. Yes. You are.

Mr. CASEY. Because you can take a great many companies, including a big company from your State, Coca-Cola that repeatedly talk about the importance of that coin in machines, and so forth.

The CHAIRMAN. That is because they have stayed by one price, regardless of the cost of making it.

Mr. CASEY. I think they have done a remarkable job.

The CHAIRMAN. They have maintained a 5-cent price.

Mr. CASEY. I think they have done a remarkable job. But I merely wish to emphasize the importance of the coin; that the difference, as to the breakage, is not enough to get a customer to buy an unknown cigarette as against one that has been publicly accepted.

The CHAIRMAN. Well, what I am getting at is that there is today a difference in the so-called economy-brand price and the standard-brand price.

Mr. CASEY. That is correct.

Senator JOHNSON. Where would the ad valorem tax be assessed? At the retail level?

Mr. CASEY. It is the same method as would now be employed in the cigarette business, and the Treasury has said, in both reports, that there is no difficulty in the method of collection.

Senator JOHNSON. It would seem to me it would be a terrific difficulty to assess an ad valorem tax with the millions of retail outlets that we have, and it would look to me like it would be extremely complicated to assess that tax. And who would collect the tax?

Mr. RAGLAND. Senator, may I answer that, sir?

This tax is levied, as you know, sir, in the form of revenue stamps purchased by the manufacturers prior to the production of the cigarette. The same method of taxing cigars is used. That is, they use a stamp tax. However, unlike the flat cigarette tax, cigars are taxed according to their intended retail selling price. The 5-cent cigar does not pay the same tax that the 10-cent cigar pays, nor the 20-cent cigar. It is the manufacturer's responsibility, as to cigars, to first determine the market he is trying to reach with his product. He then buys a tax stamp in anticipation of a certain price of that product. It is just as simple as that. There would be no difficulty. We have been assured of that by the technicians at the Bureau of Internal Revenue.

Senator JOHNSON. Then the answer to the question is that the ad valorem tax would be levied at the source, at the manufacture?

Mr. RAGLAND. Yes, sir, that is it.

Senator JOHNSON. And not at the retail outlet.

Mr. RAGLAND. No, indeed, sir.

The CHAIRMAN. Any further questions?

Let me make an inquiry, since you have drawn into question one report from Treasury and one, here, that is unsigned.

There is a representative from the Treasury here.

What is the report of the Treasury? Has the Treasury made a report on this matter?

Mr. KIRBY. Yes, we have made a report, Mr. Chairman, and I am very surprised that Mr. Ragland and Mr. Casey would make any charges that this $90,000,000 estimate was a recent estimate. I had these gentlemen in my office months before any report came out, and we went over with them the tentative estimates that we had made, and I indicated to them that I thought that our figures were somewhat in the vicinity of $100,000,000. They must recall that.

Senator BYRD. What was the reason for going back 18 years to 1932?

Mr. KIRBY. I may say that, of course, I do not make the estimates. We have a special office that is just devoted to that, to making all revenue estimates.

Senator BYRD. You do not go back 18 years, do you?

Mr. KIRBY. They went back to 1932 to get the most comparable history. It was at that time that they had a differential between the cheaper cigarettes and the standard brands that was comparable to the differential that would result from the proposal before you.

Senator BYRD. Was that the latest time they had a differential?

Mr. KIRBY. That was the latest time they had that large differential, which, as I recall, I think, is still some smaller than the differential that would result from this graduated tax.

Now, it was during 1 month of that year 1932 that the standard brands, I think, had something like about 24 percent of the business. The reason why that did not continue is that the standard brands immediately dropped their prices, and that large segment of the business disappeared. But I wanted to stress particularly to the committee that the estimate was made sometime previously in connection with the study of this subject and was not a new development as they suggest and charge.

Now, the report was presented to the Ways and Means Committee indicating that in general we are in favor of this graduated type of

tax. It was indicated, however, that there was a $90,000,000 estimated loss on a full effective basis.

The CHAIRMAN. We just wanted to get that straight about this report.

Mr. KIRBY. This report that we talk about as being the true report never was approved by the Department and never was approved, of course, by the Bureau of the Budget.

Senator BYRD. Was it approved by anyone? What is the history of it?

Mr. KIRBY. That is merely a tentative report that was prepared within the Department.

Senator BYRD. I see. Who prepared it? Do you know who got it up?

Mr. KIRBY. As I recall, it was started in the Bureau of Internal Revenue.

Senator BYRD. Then it went to the Secretary of the Treasury?

Mr. KIRBY. Well, it goes through numerous offices.

Senator BYRD. It had the approval of these offices that it went through, before it went to the Secretary?

Mr. KIRBY. No, I wouldn't say that, Senator.

Senator JOHNSON. Did it go to the Federal Trade Commission?

Mr. KIRBY. I don't know where it went.

Senator JOHNSON. Did it go to the Department of Justice?

Mr. KIRBY. I do not know where it went. I assume that it was transferred by the Bureau of the Budget. We did not send any report out to any of the other offices.

Senator JOHNSON. It originated with the Department of Internal Revenue, did it?

Mr. KIRBY. Yes.

Senator HOEY. But it never was approved?

Mr. KIRBY. It never received the approval of the Department. It does not represent the approval of the Department.

Senator JOHNSON. Does the Department approve documents of this kind before they are approved by the Bureau of the Budget?

Mr. KIRBY. No.

Senator BYRD. It was approved as far as it went, I imagine. The Bureau of Internal Revenue would not have submitted it to the Secretary of the Treasury if they had not approved it, would they?

Mr. KIRBY. There are a lot of tentative reports——

Senator BYRD. I understand it has not been finally approved.

Mr. KIRBY. As long as it has been within the Department, it has not received the approval of the Department.

Senator BYRD. I understand that. But it must have received the approval of those who prepared it. They certainly would not have prepared a report like this if they had not approved it.

Mr. KIRBY. That may be. I don't know.

Senator BYRD. They would not have prepared a report for submission to the Bureau of Internal Revenue unless they approved it. At some level it must have been approved, or this letter would not have been written.

Mr. KIRBY. And that letter never was sent out by the Department.

Senator BYRD. I understand that. But I want to get my question clear. You have a number of subordinate agencies that pass on these before they get to the Secretary of the Treasury.

Mr. KIRBY. That is right. A number of employees that may well have prepared that report or approved it.

Senator BYRD. Well, it was prepared by Internal Revenue to begin with, was it not?

Mr. KIRBY. I think that is true.

Senator BYRD. Then it was approved by Internal Revenue so far as their authority went?

Mr. KIRBY. No. The Commissioner of Internal Revenue has the——

Senator BYRD. What are these initials up here, "MT:T–CST:–CWS"?

Mr. KIRBY. I can give you a few. "MT" means "Miscellaneous Tax Unit."

Senator BYRD. They approved it? That unit approved it?

Mr. KIRBY. Those initials do not indicate that the head of that unit approved the report.

Senator BYRD. Why would they prepare a report and put their initials on it if they did not approve it?

Mr. KIRBY. Those are not the initials of the official that might have approved it, at all.

Senator BYRD. Give an explanation of these different initials. 'MT" is what?

Mr. KIRBY. That just indicates the office out of which this report emanated. That is the Miscellaneous Tax Unit.

Senator BYRD. You think that was prepared by that office without the approval of that office?

Mr. KIRBY. Without the final approval.

Senator BYRD. I understand about the final approval. I am not talking about that. I mean the approval of the agency that prepared this report. There is a three-page letter here. They certainly would not have prepared it if they did not approve it, would they?

Is that a department?

Mr. KIRBY. It is a unit in the Department.

Senator BYRD. I understand that was not official, because it was not signed by the Secretary of the Treasury.

Mr. KIRBY. That is right. And I do not know who has approved that report.

Senator BYRD. Well, "MT" is what? Let us get that in the record. 'MT" means what?

Mr. KIRBY. Miscellaneous Tax Unit.

Senator BYRD. What does "T" mean?

Mr. KIRBY. "Tobacco."

Senator BYRD. All right. "CWS"?

Mr. KIRBY. I do not know what that means.

Mr. RAGLAND. Would that mean "Tobacco and Capital Stock Tax Section"?

Senator BYRD. You do not know what "CST" means?

Mr. KIRBY. No.

Senator BYRD. "CWS"? Is that the initials of the person that wrote it?

Mr. KIRBY. It may be. It may be the initials of the particular employee that wrote the report.

Senator JOHNSON. We might want to have the party who prepared this report come up here and testify, if we could identify him.

Mr. KIRBY. We can find that out for you. We would be glad to.

Senator BYRD. I think that would be interesting, Mr. Chairman, to find out who prepared the report.

The CHAIRMAN. It is not a report, Senator Byrd. It never did come here as an official report.

Senator BYRD. But it was an official report as far as it went.

The CHAIRMAN. I would not be able to state to you who signed the report, but it is very easy to get a report started at some level in some department of the Government.

Senator BYRD. I think the first paragraph is indicative of what it is:

> Further reference is made to the request of your committee for the views and recommendations of this Department on H. R. 2016, a bill to amend section 2000 (c) (2) of the Internal Revenue Code relating to taxes on cigarettes.

Somebody asked for the report.

Mr. KIRBY. Yes, we were requested for a report on this bill by the Ways and Means Committee.

Senator BYRD. It was not just a voluntary operation on the part of the Department. It was requested by the Ways and Means Committee.

Mr. KIRBY. It was. And we did give the Ways and Means Committee a report, a final report.

Senator HOEY. As a matter of fact, is it not frequent that these committees request a report, and it is given to some unit, and they make an investigation, and they make it up, and then finally it is not approved by those in charge?

Mr. KIRBY. That is entirely correct.

Senator HOEY. This was submitted by someone on some level, and it went around and was not approved, and therefore did not become the letter, or the authority, of the Treasury Department.

Mr. KIRBY. That is entirely correct. The reports that we send to the committees are not unchanged from the initial level.

Senator BYRD. Well, some unit approved it, or the letter would not have been written.

Mr. KIRBY. I think that may be so.

Senator CONNALLY. The "some unit" is not the Secretary of the Treasury.

Senator BYRD. That is fully understood.

Senator KERR. It represents the views of somebody in the Department, does it not?

Mr. KIRBY. Somebody; yes.

Senator BYRD. I think the committee is entitled to know, because this is at such complete variance, how far it was approved by the officials of the Department.

The CHAIRMAN. We will have to refer that to some investigating committee. If we do not have one, we will set one up, if it is a matter of public interest.

Senator BYRD. I do not think we will have to set up a committee for that. I think just a mere inquiry would ascertain that.

Mr. KIRBY. I would be glad to have the estimating staff appear before your committee and indicate exactly the reasons why they came up with this figure that was approved by the Secretary and appeared in the final report.

The CHAIRMAN. You can have them up in the morning? Tomorrow is Saturday, but we are going on tomorrow.

Mr. KIRBY. I would like to say that the Treasury does work on Saturday, and that is not unusual.

We did give a full statement to the Ways and Means Committee.

The CHAIRMAN. Is that in the record?

Mr. KIRBY. It is in the record.

Senator MYERS. Might I ask a question of the gentleman?

Do you know when the request was made by the Ways and Means Committee for opinion by the Department on this particular matter?

Mr. KIRBY. I think our report indicates. It probably refers to the exact date when we were requested.

Senator MYERS. I just wanted to know how long a period of time it took to reply to that.

Mr. KIRBY. It took, really, a considerable period of time. But this Monday that we did report, I appeared before the committee and orally gave the report. The time for our appearance was set a number of days ahead of time by the clerk of that committee. It was not a suddenly called meeting at all.

Mr. CASEY. Could I ask one question?

The CHAIRMAN. You may make a statement if you wish to make a statement, but there will be no point in having a debate here.

Mr. CASEY. I would like to call the committee's attention to the fact that although during the entire year of 1949 this was under consideration by the Treasury, no other report except the one which bears those symbols which the Senator from Virginia has been talking about was in the Treasury, up until February 25, the Saturday before the Monday of the conclusion of the hearing; and the February 25 report was a recent invention, just the Saturday before the Monday of the hearing; and that report was not the result of action by Internal Revenue or anybody else but just a single author who got it together; and it was never sent around to the various departments, as the report which I say is the true report was sent around, for their consideration, over a period of 4 or 5 months.

Senator HOEY. That must be conjecture on your part, because you do not belong to the Treasury Department, and you would not know about that.

Mr. CASEY. I hope the Senator will inquire of the Treasury Department as to those questions.

Senator CONNALLY. Regardless of that, the action of the Secretary in signing this report precludes any other reports. And so what difference does it make how long this supposed report remained there or whether it was ever presented or not? You want to override the Secretary of the Treasury by some subordinate, who you say should have acted sooner.

Mr. CASEY. No, we think that there was pressure on the Treasury to bring in a different report.

Senator CONNALLY. Maybe there was, but they brought it in, whether there was pressure or was not. You were putting on all the pressure you knew how to put on, were you not?

Mr. CASEY. I still think this is a Government of laws rather than a Government of persons, Senator.

Senator CONNALLY. That is something that everybody agrees with.

Mr. CASEY. Persons who don't think that this has merit, but who vote against their convictions sometimes by virtue of other influences.

Senator CONNALLY. You are impugning the motives of the Members of the Congress, and yet you people have been up here with your tongues hanging out asking for things.

Senator MILLIKIN. I would like to ask: Where are these economy cigarettes made? In what States?

Mr. CASEY. In Philadelphia, in Richmond, Va., and in Louisville, Ky.

The CHAIRMAN. Have you a full list of the stockholders of all the manufacturers of these cigarettes?

Mr. CASEY. I think so.

The CHAIRMAN. Available? And their residences? Will you put them in the record?

Mr. RAGLAND. Yes, sir, we will do that.

The CHAIRMAN. A complete list of all the stockholders?

Mr. RAGLAND. Mr. Chairman, in that respect, all except one of these companies are privately owned. Firms like Larus & Brother Co. of Richmond, Va., and Stephano Brothers in Philadelphia, are family owned concerns. Right now there are only three manufacturers of economy brands. There were five. Two of those have gone out of business. And the Brown and Willamson Tobacco Corp. in Louisville is a subsidiary of the British American Tobacco Co., and I I presume they would have a record of their stockholders. I understand that 50 percent of their stockholders or perhaps more than that are citizens of this country, but I shall certainly try to get that information for you.

The CHAIRMAN. Yes; if you have it.

Mr. RAGLAND. I do not have it in my possession, but I will try to get it.

The CHAIRMAN. Try to get it and furnish it to us by sometime before the conclusion of the hearings.

Mr. RAGLAND. Yes, sir.

(The information referred to follows:)

ASSOCIATED TOBACCO MANUFACTURERS,
Washington, D. C., July 12, 1950.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
The United States Senate, Washington, D. C.

MY DEAR MR. CHAIRMAN: On Friday, July 7, you asked me to furnish the committee with a list of stockholders of the manufacturers of economy cigarettes in whose behalf I appeared before your committee.

There are only three manufacturers of economy-brand cigarettes left in business today, two of which—Larus & Bros. Co., Inc., Richmond, Va., and Stephano Bros., Philadelphia, Pa.—are family-owned concerns with the voting stock held by members of the families. The third manufacturer of economy-brand cigarettes is the Brown & Williamson Tobacco Corp. of Louisville, Ky., and I enclose their reply to my request for the information in question. I trust that this will suffice for your purposes.

May I thank you in behalf of the members of the Associated Tobacco Manufacturers for the courteous hearing accorded me last Friday.

Respectfully,

EDWARD F. RAGLAND,
Executive Secretary.

BROWN & WILLIAMSON TOBACCO CORP.,
Louisville, Ky., July 12, 1950.

Mr. E. F. RAGLAND,
Associated Tobacco Manufacturers, Washington, D. C.

DEAR ED: This will confirm the information which I have previously given you in person and by telephone to the effect that all of the outstanding stock, both common and preferred, of Brown & Williamson Tobacco Corp. is owned by British-American Tobacco Co., Ltd., a British corporation, having its principal office at Egham, Surrey, England.

I trust this gives you the information which you have been asked to file with the Senate Finance Committee but if there is other or further information you or the committee require please let me know.

Very truly yours,

ADDESON YEAMAN.

The CHAIRMAN. Very well. We thank you very much.

Mr. RAGLAND. Thank you.

The CHAIRMAN. Mr. Boyd? Will you identify yourself for the record, Mr. Boyd? You may have a seat, if you will.

STATEMENT OF ROBERT LEE BOYD, VICE PRESIDENT, THE BLOCH BROS. TOBACCO CO., WHEELING, W. VA.

Mr. BOYD. Thank you.

Mr. Chairman and gentlemen: My name is Robert Lee Boyd.

I am vice president of the Bloch Bros. Tobacco Co., Wheeling, W. Va.

Our company manufactures Mail Pouch and other brands of scrap chewing tobacco; Eight Brothers and other brands of fine-cut chewing tobacco; Kentucky Club and other brands of smoking tobacco, and Melo-Crown and Crown Stogies.

Senator CONNALLY. What do you mean by scrap chewing tobacco?

Mr. BOYD. Scrap chewing tobacco, Senator, is tobacco that is cut up in narrow ribbons, I should say a half-inch wide, possibly, running up to perhaps an inch and a half or 2 inches long. It comes in small pieces and has acquired the name of "scrap."

The CHAIRMAN. It is ready for use.

Mr. BOYD. Yes, it is ready for use.

Senator MILLIKIN. You used to have photographs of Jim Corbett and bicycle riders, and so forth, with your product. Do you do that now?

Mr. BOYD. No, Senator. Now all our customers get is tobacco; no pictures.

You have all seen Mail Pouch on barns. That is where we are most publicized at the moment.

Our principal interest in the bill you are considering is with respect to the tax on scrap and fine-cut chewing tobacco. Senator, I might say fine-cut chewing tobacco is a type where the pieces of tobacco are cut in smaller, narrower shreds, more like the tobacco used to roll your own cigarettes.

Senator CONNALLY. It is fine. What kind of cut is that?

Mr. BOYD. Long cut, narrow cut, and there are a lot of names for it, but it comes out in very thin shreds.

All of these chewing tobaccos are made from grades of cigar leaf tobacco that are not suitable for cigar manufacturing, because of the

color, size, or the characteristics of the leaf. Unless the chewing tobacco manufacturers took what are known as "stemming grades," the price of cigar leaf tobacco would have to be greatly increased to produce any substantial return to the growers.

Chewing tobaccos are used principally by workers in industry, mining, oil production, and other wage earners, and could not be considered a luxury item by any definition.

The pending bill proposes to reduce the rate from 18 cents to 8 cents per pound on each of plug, twist, and snuff, but has omitted any adjustment on the scrap chewing and fine-cut chewing tobacco.

All of these tobacco products are in competition with each other to a substantial extent, as they are all used primarily for chewing.

My comments will be principally directed to the scrap chewing tobacco situation, as that is much the largest and most productive branch of our business, but what is said in connection with the scrap chewing will also apply to the fine-cut.

We are very greatly concerned about the competitive effect of reducing the tax and thereby making it possible for plug, twist, and snuff to be manufactured at a cost of 10 cents per pound less than the present cost of manufacturing if we have no corresponding relief for scrap.

A comparison of the reports of the Commissioner of Internal Revenue for the last 10 years shows the production of each of these types of tobacco, as follows:

Plug:
- 1940 production .... 48, 758, 919 pounds.
- 1949 production .... 41, 902, 503 pounds.
- This is a reduction from 1940 of about 14 percent.

Snuff:
- 1940 production .... 37, 871, 629 pounds.
- 1949 production .... 40, 908, 291 pounds.
- This is an increase from 1940 of about 7½ percent.

Twist:
- 1940 production .... 5, 605, 287 pounds.
- 1949 production .... 5, 586, 111 pounds.
- This is a reduction from 1940 of about three-tenths of 1 percent.

Fine-cut:
- 1940 production .... 4, 176, 364 pounds.
- 1949 production .... 2, 756, 414 pounds.
- This is a reduction from 1940 of about 33$\frac{9}{10}$ percent.

Scrap chewing:
- 1940 production .... 42, 909, 979 pounds.
- 1949 production .... 39, 673, 645 pounds.
- This is a reduction from 1940 of about 7½ percent.

Combined plug, snuff, twist:
- 1940 production .... 92, 235, 834 pounds.
- 1949 production .... 88, 297, 566 pounds.
- This is a reduction from 1940 of about 4$\frac{2}{10}$ percent.

Senator MILLIKIN. May I ask what the cause is of the increase in snuff?

Mr. BOYD. We don't manufacture snuff, Senator, and I don't know, except that they must be awfully good merchandisers.

From these figures, it is apparent that even without a competitive cost advantage, snuff, plug, and twist are either actually gaining markets or are more slowly losing their customers at the expense of scrap and fine-cut.

If we assume the same production of scrap and fine-cut chewing tobacco as in 1949, equalizing the tax on all these products, the annual reduction in revenue would be only about $4,000,000.

We believe if the tax is reduced on all types of chewing tobacco, that the production and sales will be increased, thereby offsetting at least a part of the revenue change occasioned by the reduction in the rate per pound.

It is not possible to project that increased production and sale nor to apportion it to the different categories of chewing tobacco, but our experience in the past when the tax rate has been changed is that after a reduction, the production and sales increase.

We have no doubt whatever that if we are at a competitive disadvantage of 10 cents per pound in the production of scrap and fine-cut chewing tobaccos, we will lose a lot of business to the other types of chewing tobacco.

Senator MILLIKIN. What is the retail price of a package of Mail Pouch?

Mr. BOYD. Fifteen cents.

We do not ask the committee to recommend any change to give us an advantage over our competitors, but we do ask that whatever relief is granted to them should be granted to us.

Senator MILLIKIN. May I ask what is the weight of the tobacco in a package of Mail Pouch?

Mr. BOYD. One and three-quarter ounces.

Over a long period of time, these five types of chewing tobacco have been in vigorous competition with each other, and as a result of that competition, prices have become pretty well established among the different types of chewing tobacco. If there is a change of 10 cents a pound in favor some types of chewing tobacco, it will disrupt the entire price structure of the industry.

The price per pound received for each of the categories of chewing tobacco is different. Within each of the classes, there are differences between the manufacturers, either in the price at which the packages are sold or the weight of the packages.

A 10-cent differential in cost would upset this relationship, and it cannot result in anything but a very great disadvantage to the scrap and fine-cut chewing manufacturers.

From our own experience, it is probably safe to say that the net profit to any manufacturers of any kind of chewing tobacco will not be as much as 10 cents per pound.

We, therefore, ask that the committee add to the pending bill a provision for taxation for scrap and fine-cut chewing tobaccos at the same rate as our competitive members of the chewing tobacco family. That is at 8 cents per pound.

The CHAIRMAN. Any questions?

Senator CONNALLY. I want to say that I think it is a very fair statement.

Mr. BOYD. Thank you, Senator.

The CHAIRMAN. Thank you very much, Mr. Boyd.

Mr. BOYD. Thank you, gentlemen.

The CHAIRMAN. Mr. Ela?

STATEMENT OF EMERSON ELA, ELA, CHRISTIANSON & ELA, MADISON, WIS.

Mr. ELA. Mr. Chairman and gentlemen of the committee, my name is Emerson Ela from Madison, Wis. I am here appearing in support of the suggestion just made by Mr. Boyd of the Bloch Bros. Tobacco Co. I am here speaking in behalf of about 6,000 Wisconsin producers of tobacco. I speak officially for the members of the Northern Wisconsin Cooperative Tobacco Pool, which was organized in 1922, and which has operated continuously and successfully ever since that time. I have been identified with it as counsel and part of the time as business director.

Senator CONNALLY. Is that chewing or smoking?

Mr. ELA. That is classified as a cigar type of tobacco, but I will develop later the situation in regard to our interest in this measure of reducing the tax on scrap chewing tobacco.

I also appear by the approval of the vice president and manager of the Southern Wisconsin Tobacco Growers Association, who have a membership of some 1,700. Through these two organized groups I assume responsibility for being in a position to speak for all of the Wisconsin growers, who number about 6,000 members.

This matter of leaving scrap chewing tobacco at its present level of 18 cents and reducing two competitive products is of grave concern to our producers. Wisconsin tobacco in 1948, the crop year for which I have definite statistics, amounted to 29,000,000 pounds of tobacco; and of that tobacco which is classified as cigar-type tobacco, fully 70 percent is used solely and only for scrap chewing tobacco purposes. In other words, some 21,000,000 pounds of that year's crop. And that is a proportion that will apply year in and year out without much deviation 21,000,000 pounds of that one year's crop, and that amount, 21,000,000 pounds, out of 29,000,000 pounds, was used for the purposes Mr. Boyd has described, as scrap chewing tobacco, and for no other purpose, because it does not have the quality necessary for the cigar-type usage.

So practically we are supplying, according to my estimate, about 50 percent of all of the tobacco that goes into scrap chewing tobacco packages.

To other States which supply it, I understand, are Ohio, Pennsylvania, and Connecticut. So we are supplying more than one-half of the raw material that is used in the manufacture of the end product which goes into this small package of a few ounces and is retailed, as I understand it, at 15 cents.

The result is that 70 percent of our entire crop is discriminated against by this difference in tax, and we feel that it is definitely unfair to the growers of Wisconsin tobacco to permit this kind of discrimination.

Thirteen million pounds of our tobacco is in the end product.

Senator MILLIKIN. What do you get a pound for your tobacco?

Mr. ELA. We get a pound, Senator, for the stemming end of our tobacco. I have here an accumulation of prices.

Senator MILLIKIN. Just give me a rough figure.

Mr. ELA. Yes, sir. I will give you the exact figure on the 1948 crop. The farmers, through the tobacco pool, which is the organization I speak for, the Northern Wisconsin Cooperative Tobacco Pool,

received 19⅛ cents per pound for their product from the farm. That, however, has ranged all the way from 8 or 9 cents a pound to that price, during the last 10 years of time, depending upon the season and depending upon the demand for the product.

We suggest about $1,300,000 of the tax produced by scrap chewing tobacco is borne by our Wisconsin tobacco.

I noticed in the report of the House committee this statement:

> Your committee's bill provides for reduction of tax in the case of plug and twist tobacco and snuff, since these are used primarily by the lower-income groups, and therefore any tax upon them can be expected to be highly regressive.

I am not too well informed on what "regressive" is, but at any rate it is regressive.

The CHAIRMAN. It is a word that is very much used when somebody wants to get rid of a tax.

Mr. ELA. Then the committee is accurate, apparently, in using the term. But it applies with absolutely equal force to our scrap chewing tobacco, because of its usage, as Mr. Boyd has pointed out. And the effect upon our situation, if the tax is not reduced, is that it may well seriously impair if not destroy the market for our Wisconsin growers for about 20 million pounds of tobacco annually.

I think Mr. Boyd made that plain in his statement. And this, again, as I say, seems to us unfair, unjust and destructive. If the tax on scrap chewing tobacco is reduced the 10 cents per pound to equalize it with the highly competitive products that it has to meet, it would benefit our growers.

Senator CONNALLY. I thought Mr. Boyd said 8 cents.

Mr. ELA. Reduced 10 cents; from 18 to 8. If I misstated it, that is it accurately.

It would improve and preserve our market for about 70 percent of our production in Wisconsin. And I say confidently that it would increase the price per pound that our growers would receive for tobacco. I will not take the time of the committee to prove that statement. I made the statement several years ago before the House Ways and Means Committee, and at that time was able to bring proof of that fact. We have watched that, in our experience in marketing tobacco, and I have been actively connected with the operation for this large group of growers for now 28 years, and I think I know that a reduction in tax inures directly to the benefit of our growers.

Now there is a little incidental item there that perhaps need not even be mentioned or dwelled upon, but it is in the picture. That is that the Federal Government, the United States Government, is now giving us price support in Wisconsin on tobacco. And obviously if the market for our Wisconsin tobacco should be impaired, there will be a backwash on the Commodity Credit Corporation of increased quantities of tobacco that will have to receive support prices.

The Commodity Credit Corporation has now, in its warehouses in Wisconsin, approximately 2,000,000 pounds of the 1948 crop of Wisconsin tobacco which has not yet been sold, after the loan was made in support of prices.

Gentlemen, I have tried to be rather brief and concise on this matter. I have no prepared speech. I have spoken extemporaneously from a brief outline. And I submit that it is not only not fair but grossly unfair to our Wisconsin growers to discriminate against our Wisconsin tobacco in the way that this does discriminate.

We urge that the 10-cent reduction on scrap chewing tobacco be made applicable solely and only for the good it will do our Wisconsin tobacco growers.

I thank you, sir.

The CHAIRMAN. Thank you very much, Mr. Ela, for your appearance.

Mr. Hayes? Mr. Patrick Hayes, of the National Association of Concert Managers?

Mr. Hayes is not here.

We shall place in the record at this point a statement by Mr. A. B. Culbertson, vice president of the Baptist Foundation of Texas, on behalf of the Southern Baptist Convention, the Southern Baptist Foundation, the Baptist General Convention of Texas, and the Baptist Foundation of Texas. Also a statement of Joseph M. Dawson, executive director, Baptist Joint Committee on Public Affairs.

(The statement referred to follows:)

STATEMENT OF A. B. CULBERTSON, VICE PRESIDENT OF BAPTIST FOUNDATION OF TEXAS

Mr. Chairman, I am authorized to speak for the Southern Baptist Convention, the Southern Baptist Foundation, the Baptist General Convention of Texas, and the Baptist Foundation of Texas.

We believe the language of the bill unintentionally excludes these church organizations from the exemptions contained in section 301 (b) (1) of title 3 of the Revenue Act of 1950. The spirit of the act evidences an intention to treat religious organizations without discrimination but unfortunate choice of language probably defeated that objective. Section 301 (b) (1) names among those excluded "a church." There is no Baptist Church in the sense in which we speak of the Lutheran Church or the Episcopal or Methodist or Catholic Church. Every local Baptist church is completely autonomous. It is independent of every other Baptist church. They have no central organization and recognize no ecclesiastical authority or overlordship.

The churches of the Baptist faith do cooperate in a great common religious, charitable, benevolent, and educational effort such as associations, conventions, fellowships, etc. In the case of the people I represent, we call them conventions. The Southern Baptist Convention is the agency through which the members of churches cooperating with that agency function. In my State of Texas, the agency through which the members of over 3,000 Baptist churches function is the Baptist General Convention of Texas.

Therefore, the exemption of "a church" does not protect these independent churches in their cooperative religious activities as it does the churches of other faiths integrated into an organic church having over-all ecclesiastical authority, and being itself autonomous.

To illustrate: The Southern Baptist Convention owns and operates several large seminaries where thousands of ministers and religious workers are trained annually. It operates many other charitable and benevolent activities. None of the churches or their members profit from these activities but finance them solely in the interert of the public. It has an investment agency called the Southern Baptist Foundation, which has no functions at all except to invest such funds as may be entrusted to it by the Southern Baptist Convention and to pay the income to such activity as may be directed by the convention. The Baptist General Convention of Texas owns many public service agencies and institutions such as orphanages, hospitals, schools, colleges, universities, retreat centers and encampments, etc. Obviously neither of these conventions nor the organizations they foster and support are "a church" when used in the usual sense of an integrated organic body having ecclesiastical authority. But the Baptists and their independent churches, doing by free will and without powers of coercion what others are required to do by compulsion under authority of "a church," are entitled to equal and fair treatment under the law.

We represent by far the largest non-Catholic group of Christians in America. Because we deign to cling to what we regard as the New Testament plan of a pure democracy in church affairs, we ought not to be caught in the vagaries of nomenclature and caused to pay taxes for our religious, benevolent, charitable, and educational efforts in the public interest. We thus voluntarily assume social obligations that would otherwise fall on society if not the Government itself.

The endowment and other funds accumulated through the years in Texas were placed in the hands of an investment agency called the Baptist Foundation of Texas 20 years ago. They have been carefully administered by a board of directors of outstanding businessmen, serving without pay and elected annually by the convention, and have grown by added gifts and bequests to more than 16 million dollars. The income goes to the schools, orphanages, hospitals, etc., whose funds were invested to produce it. All accretions to capital have been placed in a reserve for possible losses now in excess of $1,000,000.

We respectfully say that these conventions and their subsidiary agencies, all being a part of the correlated and combined efforts of these many independent churches, for common causes fostered and supported by these churches, should be exempt. We, therefore, suggest the amendment of section 301 (b) (1) to read as follows:

"(b) Organizations subject to the tax.

"(1) Organizations taxable as corporations.

"The taxes imposed by subsection (a) (1) shall apply in the case of any organization (other than a church and other than autonomous individual churches alone or cooperating together by means of a convention or other form of cooperative religious organization controlled by or principally supported by such independent churches or their members, together with such subsidiary agencies as they may use and control to carry out their religious, charitable, benevolent, and educational objectives; and other than a trust described in paragraph (2) which is exempt except as provided in this supplement from taxation under this chapter by reason of paragraphs (1), (6), (7) of section 101. Such tax shall also apply in the case of a corporation described in section 101 (14) if the income is payable to an organization which itself is subject to the tax imposed by subsection (a) or to a church."

We further suggest that section 424 (1) (A) be amended to read:

"A religious organization and those exempted under section 301 (b) (1) of this title."

PRIVATE FOUNDATIONS

Our interest in private foundations is limited to the benefits which have accrued and will accrue to our Baptist causes and to the public in general through such foundations. We have no quarrel with the bill insofar as it taxes them when they are engaged in a competitive and unrelated business, nor when substantial benefits to the donors or trustees arise from the selling of securities to or the purchase of securities from the foundations, or borrowing funds from or otherwise profiting personally or permitting the donors' family to profit from the operation of the foundations. We do believe the bill goes too far in its effort to check these abuses.

It ought to be sufficient to take away the exemption of the foundation if any of these conditions are prevalent and it ought not to make any difference whether language to that effect is contained in a trust agreement or document creating the organization, as this might reach conditions over which the foundation now cannot exercise control but it can, in any event, exercise control in respect to personal dealings by the donors or their families or trusts with the foundation.

It should make no difference whether the donor or his family selects the trustees of such a foundation as long as the method of its operation and its objectives are safeguarded from tax evasion by the act.

CONCLUSION

It is as important to prevent the welfare-state theorists from throttling religious and private charities and benevolences, for the purpose of expanding Government welfare, as it is to prevent private foundations and trusts from evading equal treatment under the tax law. All religious, charitable, benevolent, and educational organizations, foundations, and trusts designed to relieve the burden of social problems should be encouraged and protected by a sympathetic government, as they relieve society, if not the Government, to that extent from such burdens. Reasonable safeguards to prevent evasion should be encouraged but should go no further than necessary to prevent such abuses.

STATEMENT SUBMITTED BY JOSEPH M. DAWSON, EXECUTIVE DIRECTOR, BAPTIST JOINT COMMITTEE ON PUBLIC AFFAIRS

On page 97, line 17, I think that section 421 (b) (1) should be amended to provide that "the taxes imposed by subsection (a) (1) shall apply in case of any organization (other than churches or nonprofit organizations controlled by

churches where their income is to be distributed exclusively to religious, benevolent, or charitable purposes, and other than a trust described in (2), etc.)." The last sentence of that paragraph should be eliminated.

On page 99, section 422 (a) (1), amendment should be made to include "income from oil payments."

Page 102, section 422, (b) and (1) should be amended to eliminate (1), beginning at line 18 on such page. If the purpose of the act is to tax income from unrelated business engaged in competition with private enterprise, and thus escaping taxation, it should not be discriminatory because the trade or business is performed without compensation, as this aggravates rather than mitigates the offense.

Page 106, section 424 deals with accumulated invested income and provides that it apply to any such organization except (A) a religious organization; (B) certain educational institutions; (D) "an organization operated, supervised, controlled, or principally supported by a religious organization (other than a trust) exempt from taxation under section 101 (6)." This might eliminate the Baptist Foundation as to accumulated income.

Page 115, line 12, subsection (c): I think there should be added to it the same exemptions contained in 421 (1) on page 97. It might be added to (a), line 19. The Baptist Foundation is a Texas corporation with power only to invest endowments and other funds of institutions controlled by the Baptist General Convention of Texas, and distribute the income to those institutions. It might not be a religious organization. I suggest adding to religious organizations, churches or organizations controlled by churches, the income from which is distributed to religious, benevolent, educational, or charitable causes as directed by such churches or religious organizations.

The CHAIRMAN. We shall also place in the record at this point a telegram from George J. Burger, vice president in charge of the Washington office of the National Federation of Independent Business.

(The telegram referred to follows:)

WASHINGTON, D. C., *July 6, 1950.*

Hon. WALTER GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

This is not to inflict further delaying action upon your committee, Finance, in the present hearings on the tax bill by requesting a personal appearance, which request I believe would be granted, but I trust that this message will be noted by you and brought to the attention of your committee for immediate action. The request in this instance is not for the elimination of the excise tax, or for the reduction, but the request is made for equality in the levying of the tax. I am referring to the excise tax levied on the stocks of tires in the hands of independent retailers numbering 300,000 or more. They are compelled to pay the tax immediately on possession of the goods, tires and tubes, and, on the other hand, approximately 2,000 retail their stocks of tires and tubes are sold to the ultimate users. I refer to stores such as operated by Goodyear, Goodrich, Firestone, General and others. For 8 years we have been trying to get this correction made. We have appeared before the House Small Business Committee twice and in both instances the committee was unanimous in recommending the correction. In the Eightieth Congress in an appearance before the House Ways and Means Committee the same request was made. Tire manufacturers owning and operating retail stores are in a much better financial position to advance the tax than are the 300,000 or more independent retailers. I am sure that upon a directive from your committee to the Treasury and Internal Revenue that this long overdue correction be made The above statements can be verified by the many retailers not alone in your State but in the States represented by Senators Millikin, Taft, Martin, and other Senators who were present at the hearings this morning. May I urge, in behalf of fair play and justice that this correction be made immediately?

GEORGE J. BURGER,
Vice President in Charge, Washington Office,
National Federation of Independent Business.

The CHAIRMAN. I dislike very much to meet on Saturday, but it will be necessary that we hold sessions tomorrow.

We will recess until 10 o'clock tomorrow morning.

(Whereupon, at 1:20 p. m., the committee recessed to reconvene Saturday, July 8, 1950, at 10 a. m.)

REVENUE REVISIONS OF 1950

SATURDAY, JULY 8, 1950

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D. C.

The committee met, pursuant to recess, at 10 a. m., in room 312, Senate Office Building, Senator Walter F. George (chairman), presiding.

Present: Senators George, Connally, Hoey, Kerr, Millikin, Taft, and Butler.

Also present: Mrs. Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will please come to order.

Our first witness this morning is Mr. Ramspeck.

Mr. Ramspeck, some of the other Senators will be coming in but it is difficult to get in on Saturday.

You may proceed.

STATEMENT OF ROBERT RAMSPECK, EXECUTIVE VICE PRESIDENT, AIR TRANSPORT ASSOCIATION OF AMERICA, WASHINGTON, D. C.

Mr. RAMSPECK. My name is Robert Ramspeck. I am executive vice president of the Air Transport Association of America. Our membership includes practically all of the certificated airlines of the United States.

The airline industry urges you to amend H. R. 8920 to remove completely the tax on the transportation of persons.

The airlines, the railroads, the bus lines, and the water carriers, are becoming increasingly concerned with the amount of intercity passenger traffic carried by the private automobile, traffic which is, of course, not subject to the transportation tax. Each year a larger percentage of this traffic is carried by private automobile. The figures for the postwar years 1947–1949 are as follows:

	Private automobile	Common carrier
	Percent	*Percent*
1947	78 01	21.99
1948	79 70	20 30
1949	83 88	16 12

Senator Taft. How do you make those statistics?

Mr. RAMSPEK. Well, the figures for the common carriers are taken from reports made to the Government. The private automobile

figures are based upon the records of the Bureau of Public Roads, estimates which they make.

I might say, Senator Taft, that they are verified in my opinion from information which comes from the American Hotel Association which says that more than 80 percent of the guests who check into their hotels arrive in their own automobiles. The Curtis Publishing Co. has just issued a booklet on vacation travel based on personal interviews with 4,000 people in every State of the Union and it shows that 79.5 percent of the vaction travel is by private automobile.

Complete repeal of the 15 percent transportation tax would be a powerful factor in reversing this dangerous trend.

The necessity for an economically sound, common carrier, national transportation system, particularly in periods of national emergency, is obvious.

The difficult problem facing the Congress has been to grant relief from the discriminatory and burdensome World War II excise taxes, and still preserve to the fullest extent possible the Federal tax revenues. The 15 percent transportation tax is universally regarded as one of the most discriminatory and burdensome excise taxes.

H. R. 8920 provides for a 5 percent reduction in the passenger tax and a 1½ percent reduction in the present 3 percent tax on the transportation of property.

On the basis of figures released by the Treasury Department, complete repeal of the 15 percent tax on persons and retention of the 3 percent tax on property would cost the Treasury approximately $5,000,000 less per year than the reductions in these taxes contemplated in H. R. 8920. This would cut almost in half the net annual loss in revenue which it is estimated H. R. 8920 will produce.

H. R. 8920 provides for complete excise tax exemption for various articles. Surely, a necessity like the commercial transportation of persons merits similar treatment.

May I add, Mr. Chairman, that my justification for the argument is that the tax on freight does not result in any diversion from common carriers, whereas, unquestionably, the tax on passengers does have a tendency to divert traffic to the private automobile to avoid the cost of the tax.

Thank you very much.

The CHAIRMAN. Any questions?

Senator TAFT. Are you worried about this Canadian business of buying tickets in Canada?

Mr. RAMSPECK. Senator, it has been a very troublesome thing for the airlines because many people have bought tickets in Canada and while, under the direction of the Treasury, we have done what we could to discourage the practice, we cannot dishonor them.

Senator TAFT. Do you not think that something ought to be worked out about the tax?

Mr. RAMSPECK. It is a discrimination against people who cannot go to Canada and buy them.

Senator TAFT. A man buys a ticket in Windsor to take him from Detroit to Miami; he does not have to pay the tax?

Mr. RAMSPECK. That is correct.

Senator TAFT. Although if he buys it in Detroit he pays the tax?

Mr. RAMSPECK. That is correct. He can go to Windsor and avoid the tax although his trip starts at Detroit.

Senator TAFT. There should be something in the law to stop that.

Mr. RAMSPECK. It certainly does put a difficult situation on the common carriers themselves as well as furnishing an opportunity for some people to save money where others cannot save.

There grew up a practice in the early days of that situation where people were mailing checks up there. The Treasury ruled against that. I think that has been largely stopped but the people who live on the border, in Mexico and in Canada, can still avoid the tax.

Senator CONNALLY. Could that not be met, however, by a special provision taxing transportation that is purchased abroad, out of the United States?

Mr. RAMSPECK. It could be, Senator. However, it would be a difficult administrative problem, I think.

Senator CONNALLY. We do not administrative, we just pass the law.

Mr. RAMSPECK. Yes, sir.

The CHAIRMAN. Do you not have before the Foreign Relations Committee another tax treaty?

Senator CONNALLY. No.

The CHAIRMAN. I thought there was work which had just been concluded and that it was coming down.

Senator CONNALLY. It may be.

The CHAIRMAN. Mr. Kirby, does that touch this problem?

Mr. KIRBY. It does not touch this problem, Mr. Chairman, but there is a treaty that was just negotiated and I think it is being presented to your committee.

The CHAIRMAN. Yes. There is a new Canadian treaty that deals with taxes.

Senator CONNALLY. It has not gotten to us yet.

Senator TAFT. There would be no constitutional or treaty problem, it is purely one of administration.

Mr. KIRBY. That is right.

Senator TAFT. You can tax transportation in the United States no matter where the tickets are sold.

Mr. KIRBY. We tried to work out something prior to the House hearings. Tentatively, something went into the House bill on the transportation of persons. It was felt that administratively it would be exceedingly difficult to handle and we are still working on the problem, and I think we will want to present something to your committee very shortly in connection with this bill.

The CHAIRMAN. Mr. Ramspeck's position is that it simplifies it very much if you take the whole tax off.

Mr. RAMSPECK. That is right. The problem arose in that Canada repealed its transportation tax something over a year ago.

The CHAIRMAN. That is right.

Mr. RAMSPECK. We did not have this problem before. At the present time they have no tax.

Senator BUTLER. Mr. Ramspeck, apparently there are devices whereby this tax can be avoided entirely and legitimately?

Mr. RAMSPECK. Yes, sir.

Senator BUTLER. By the handling of the financial end of the transaction in Canada?

Mr. RAMSPECK. That is correct.

Senator BUTLER. My question is this: If that will work on the transportation of persons, why will it not work on the transportation paid for the handling of freight?

Mr. RAMSPECK. It does, Senator, and there has recently developed considerable avoidance of the freight tax just through that process.

The CHAIRMAN. Canada has no freight tax?

Mr. RAMSPECK. That is right. They repealed their transportation tax.

The CHAIRMAN. They repealed all the transportation tax?

Mr. RAMSPECK. Yes, sir.

The CHAIRMAN. Any further questions?

Thank you very much, Mr. Ramspeck.

Mr. RAMSPECK. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Reese Mills?

STATEMENT OF REESE MILLS, CHAIRMAN, EXCISE TAX ADVISORY COMMITTEE, NATIONAL ELECTRICAL MANUFACTURERS ASSOCIATION, WASHINGTON, D. C.

Mr. MILLS. Mr. Chairman, my name is Reese Mills, chairman, excise tax advisory committee, National Electrical Manufacturers Association, whose 481 member companies account for at least 80 percent of the total production of the electrical manufacturing industry. I am connected with the Westinghouse Electric Corp. of Mansfield, Ohio.

Of this membership, 70 are manufacturers of products subject to manufacturers' excise tax (secs. 3405 (a) and (b) and 3406 (a) (3), of the Internal Revenue Code). These products include electric appliances, such as refrigerators, ranges, water heaters, fans, air circulators, air heaters, commercial cooking equipment, and many houseware items such as flat irons, toasters, roasters, coffee makers, food mixers, warming pads, et cetera. These 70 manufacturers account for 75 to 80 percent of the total industry sales of electric appliances.

These products are distributed to the public through more than 3,500 wholesalers and 140,000 retailers. These retailers include department stores, jewelry, hardware, farm equipment, drug, furniture, and electric appliance stores. Most of these retailers are small shopkeepers serving neighborhoods, small towns, and rural areas.

H. R. 8920 removes the excise taxes on certain essential household appliances, such as ranges, water heaters, irons, toasters, warming pads, and electric blankets. The tax on refrigerators would be reduced only from 10 to 7 percent and a new 7 percent tax would be imposed on farm and home freezers.

The CHAIRMAN. Let me ask you a question at this point, Mr. Mills. Electric toasters are removed, but what about the gas toasters?

Mr. MILLS. I assume they are, too.

The CHAIRMAN. I assume so, too, but there is some question about it.

Mr. Kirby, I wish you would make a note of that.

Mr. KIRBY. I do not have the bill with me, Mr. Chairman, as to where the gas toasters are covered if the electric toasters are to be removed and the tax is to be repealed. I think this applies to toasters of the household type, and I am not sure that there are gas toasters of household type.

The CHAIRMAN. Perhaps most of the gas toasters are commercial.

Mr. KIRBY. Yes.

The CHAIRMAN. All right. I thought perhaps you had that information, Mr. Kirby.

Mr. MILLS. This 7 percent tax on quick freezers was totally unexpected by, and a shock to, members of this pioneering freezer industry—particularly since two-thirds of its sales have been made in farm and farm supported markets.

Senator CONNALLY. May I ask a question?

The CHAIRMAN. Certainly.

Senator CONNALLY. You say a new 7-percent tax would be imposed on farm and home freezers; is that true?

Mr. MILLS. That is true, they were not taxed before.

The CHAIRMAN. That is right.

Senator CONNALLY. Thank you.

Mr. MILLS. This is the only product penalized in the House bill by the imposition of a new excise tax. At House committee hearings there was no discussion of such a tax.

Owing to slow growth of sales, the freezer business for most manufacturers has been operated at a loss. Less than 75 of the more than 200 companies, which have started in the freezer manufacturing business, since the war, remain in it today. The great majority of these do not manufacture household refrigerators.

The House of Representatives wisely declined to handicap television, a new industry, by imposing a tax on sets, which provide entertainment and education. The same principle should apply to the quick freezer industry which provides food conservation.

While television has acquired an immense entertainment appeal; the freezer is still in its early struggling stage and has to be explained and sold vigorously. An excise tax might cripple this young food conserving industry at its present critical stage.

We urge that no tax be imposed on quick freezers.

A supplemental statement on this subject is attached.

Mechanical refrigeration for the American housewife is essential and the proposed tax is an indirect tax on food. We urge that no tax be imposed on any household refrigeration equipment.

Mechanical refrigerators are necessary for safe and economical preservation of food, and prevention of spoilage and waste. They are recommended by Government bureaus and food experts.

Even though the tax is reduced, the 7 percent remaining will prevent many of the Nation's 8,000,000 low-income families, who have electric service, but do not have a refrigerator, from owning a refrigerator—their only economical method of preserving food.

Household washing machines, vacuum cleaners, and water heaters were rightly exempted from this tax. Surely, the refrigerators, which contribute so much to a family's well being, should also be exempt.

Senator MILLIKIN. Mr. Chairman?

The CHAIRMAN. Yes, sir.

Senator MILLIKIN. How many refrigerators are there in the United States, electrical?

Mr. MILLS. How many are there in service?

Senator MILLIKIN. Yes.

Mr. MILLS. I think there must be pretty close to 20,000,000, somewhere in that neighborhood.

Senator MILLIKIN. How many deep freezers are there in service?

Mr. MILLS. I would say somewhere between two and three million.

Senator MILLIKIN. Thank you.

Mr. MILLS. Many of those are in commercial establishments where they operate them to keep food already frozen.

Senator MILLIKIN. Has there not been a rapid growth of deep-freezer installations in residences?

Mr. MILLS. It has been a very slow growth, Senator.

Senator MILLIKIN. Is that right?

Mr. MILLS. Yes, sir.

Senator CONNALLY. There are a good many community deep freezers, are there not?

Mr. MILLS. Quite a few locker plants.

Senator CONNALLY. Where they bring their food and pay a fee for keeping it. I just had a letter in regard to that.

Mr. MILLS. That does not solve the problem, particularly on the farm, because it brings about so much transportation to and from a locker plant. In many cases it involves a trip of 15, 20, or 25 miles.

Senator MILLIKIN. They like to take that trip.

Mr. MILLS. Some do, but when they are busy with their harvest they certainly do not like it, I do not believe.

Commercial cooking equipment for food preparation in restaurants, hotels, hospitals, schools, cafeterias and industrial in-plant feeding—is subject to a 10 percent tax. Since electric, gas, and oil equipment of this type is the most efficient and adaptable and is a productive tool of business, it should not be subject to tax, while other similar equipment used for the same purpose is untaxed.

Household cook-stoves were rightly exempted—but roasters, griddles, and hot plates are still taxed. These are cooking devices used generally used in rooming houses and small apartments. We strongly urge that these and other small appliances be freed from tax.

The variety of small appliances, together with their relatively low prices, make cost of collecting taxes disproportionately high in relation to revenue received. It is debatable whether the cost of collection, to the Government, does not offset a large share of the tax yield.

The purpose of electric fans in household, commercial, and industrial applications is movement of air. Fans are needed in many areas to provide livable and productive working conditions.

Therefore, we urge the elimination of the tax on fans and air circulators.

The unfairness of H. R. 8920 in not providing protection to wholesalers and retailers on "floor stocks" when the revised taxes go into effect is alarming.

Practically all electric, gas, and oil appliance manufacturers—probably exceeding 1,000—use wholesaler-retailer distribution. Competition is keen at both wholesale and retail levels and between manufacturers. More than 3,500 wholesalers compete for business from 140,000 retailers who sell electric appliances. This competition has narrowed margins between cost and selling price, both for wholesalers and retailers.

When taxes on some appliances are eliminated, retailers, who must by necessity operate on margins narrower than the amount of the excise tax, cannot afford to absorb the resulting loss; 135,000 of these retailers are small-business men with limited capital. They would lose taxes they have already paid on appliances remaining in "floor stocks" or en route from the wholesaler or manufacturer.

Stocks in distribution channels are normally twice the volume of sales to consumers in any month. When the tax is removed, publicity and consumer agitation for immediate price reductions will make it impossible for wholesalers and retailers to collect from customers excise taxes already paid. The amount of the tax greatly exceeds wholesalers' and retailers' net profit on appliances. The loss would be a serious hardship for all wholesalers and retailers and probably would place many of them in financial distress.

Unless H. R. 8920 is modified to correct this injustice, it will have a crippling effect upon the entire manufacturer—wholesaler—retailer chain of distribution for electric, gas, and oil appliances.

Senator MILLIKIN. Mr. Chairman, I would like to ask Mr. Kirby as so what the Treasury's view is on that.

Mr. KIRBY. Mr. Chairman, the main problem here is the administrative difficulty of handling the possible floor stock refunds. It is all a matter of degree with respect to the reduction or repeal of each type of tax. Some of the taxes, if they were reduced or repealed show a greater need for floor stock refunds than others and among the reasons for giving floor stock refunds are the size of the inventory, the rapidity of the turn-over, the comparative reduction in the tax compared with the wholesalers' or retailers' margin.

Now, we have studied all the tax adjustments in the House bill, and will give your committee our conclusions on them. As I say, it is a matter of degree. There are some that I feel sure all would say there is no need for floor stock refund. There are others where the question is rather difficult to answer.

Senator TAFT. Have you studied this recommended procedure for tax credits?

Mr. KIRBY. I have not seen this.

Mr. MILLS. This was submitted this morning, Senator.

Senator TAFT. As I recollect, in the old days we were always increasing the tax when we had the floor stock tax on liquor, or when we worked it the other way. In theory, certainly, it ought to work the reverse.

Mr. KIRBY. With respect to the liquor taxes, I think there is another question there, particularly when we raise the tax, because then we usually put on the floor stock taxes and should we come to reduce them it might very well be that we would want floor stock refunds.

Senator MILLIKIN. Mr. Chairman?

The CHAIRMAN. Senator Millikin.

Senator MILLIKIN. What would be the amount of refund involved in the segment of business you are talking about?

Mr. MILLS. Of course, I have no idea what the dealers' inventories are. Senator, I did make a study of my own company, and my best estimate, which is just an estimate, would be that it would take somewhere around $50,000,000 to cover the refunds. That might be plus or minus 20 percent.

Senator MILLIKIN. Your own company?

Mr. MILLS. No; that is factoring it for all. It might be high and it might be low.

Senator MILLIKIN. Mr. Stam says they estimate about 40.

Mr. MILLS. I am not too far from that, it might be 40, and that is purely a guess.

The CHAIRMAN. All right, you may proceed.

Mr. MILLS. If any one in this chain were compelled to assume the tax loss, it would force many small concerns into financial embarrassment and would be damaging to all.

We urge the Senate Finance Committee to remove this injustice by permitting tax credits on unsold goods in the floor stocks of wholesalers and retailers and on goods in transit.

Attached is a suggested method of handling these tax credits, based on a widely used procedure. This proposed method would relieve the Government of most of the paper work involved and at the same time safeguard the Government against fraud.

I would like to say, Mr. Chairman, that I had not proposed to read this "procedure" here at this hearing. I would be very glad to do so if you would allow me the time to do that.

The CHAIRMAN. We are somewhat pressed for time but perhaps you could summarize it.

Could you give us the principle involved in it? You have already furnished copies to us and Treasury and the staff will be studying it.

(Recommended procedure for tax credits referred to follows:)

RECOMMENDED PROCEDURE FOR TAX CREDITS

(1) All retailers handling these taxed appliances would be required to make a report of their inventories (including appliances en route for which the retailer is obligated to pay) separately by each manufacturer's line of product, showing type of product, model number, serial number, and any other identification applying to each appliance. This inventory would then be supported by a sworn affidavit made by the retailer stating that these appliances were actually in his inventory or en route and unsold as of the date established for making the report. These certified reports would then be sent to the distributor from whom the dealer purchased these appliances.

(2) The wholesaler would be required to check the retailer's report with his records to determine if he had shipped such appliances to the retailer. If the wholesaler finds that the retailer's report is correct, he would certify that the retailer's report is correct to his best knowledge and belief and would then send these certified reports to the manufacturer from whom he purchased the appliances. If the wholesaler found irregularities in the retailer's report, such report would be returned to the retailer for correction.

(3) In addition to certifying the reports of his retailer, the wholesaler would also make a separate report and sworn affidavit for his own inventory (including appliances en route for which the distributor is obligated to pay), showing type of product, model number, serial number, and any other identification applying to the product. These reports would also be sent to the manufacture of the appliances involved.

(4) The manufacturer would check both the retailer's and wholesaler reports with his record of shipments to each wholesaler, and to the retailer where shipments were made direct. If the manufacturer finds that his records indicate that retailers' and wholesalers' reports are correct, he would then certify to the Government that they are correct to his best knowledge and belief. The Government would then adjust on the basis of these reports.

(5) The manufacturer could submit individual claims to the Government or could consolidate all claims into one with supporting evidence as described above. In either case, the manufacturer would submit certified claims to the Government for reimbursement. Because these excise taxes are determined on a manufacturer's selling price basis, the manufacturer is the only party in a position to determine the exact amount of excise tax paid on the products when it sold the product to the distributor or retailer. It, therefore, seems logical that all claims should be cleared through the manufacturer for accuracy.

(6) The Government could pay each individual manufacturer the total amount of all claims cleared by that manufacturer. The manufacturer would certify that he, in turn, would reimburse his wholesaler who would certify to the manufacturer that they would reimburse their individual dealers.

(7) Penalties could be established for any fraudulent statement. This would insure careful compilation of floor stock and inventory reports.

This plan of redistribution appears to be the most satisfactory, as well as most reliable, method of handling it.

Statement Protesting Excise Tax on Quick Freezers

Much has gone on record in congressional inquiry in respectful protest to the discriminatory character of excise taxes which adversely and inequitably affect the free flow of health saving home appliances in today's retail market. Most of these arguments apply likewise to the quick freezer and there seems little need to elaborate further on this phase of our case against the excise tax now contemplated for levy against this relatively new industry.

However, there are several additional conditions pertaining particularly to the freezer industry on which we herewith present facts in support of our contention that freezers should remain free of excise tax.

The excise tax on quick freezers passed by the House of Representatives on June 28 is the only new tax. Its imposition was a shock to all engaged in this new industry since no hearings were held on this subject.

Conceived early in the postwar period, the freezer industry is still in its early, struggling stages. Millions have been invested in plants, equipment and manpower to produce and introduce this new appliance to the consuming public. Sales volume has not yet progressed to the point where the business is a profitable one. An excise tax would inevitably increase the price to the public and seriously hamper the expansion of an industry which contributes much to farm life. Out of the several hundred companies which began manufacturing freezers since the war, only about 75 remain today. An excise tax probably would cause further failures, with consequent reduction of employment, taxable corporate income and payrolls.

In its deliberations and decision with regard to television, the House Ways and Means Committee has wisely established the sound principle of not handicapping a beneficent industry with excise taxes in its development stages. In all consistency, this same reasoning should apply in the case of freezers which are designed for food storage in the home and to assist the farmer in his business.

Furthermore, freezer industry sales have shown slow growth and still are relatively low, amounting actually to only about one-half million units in 1949. Retail dollar sales of television have grown ten-fold in the past 2 years and in 1949 amounted to over $880,000,000 compared with less than one-fifth this sum for freezers.

In addition it is a fact that the potential for food freezers is found mostly in the farm market where they are used by the farmer in his home and in conducting his business. In fact, a recent survey indicates that two-thirds of industry sales of food freezers have gone to the farm and farm supported markets.

Farmers are reluctant to buy luxuries and their acceptance of the food freezer as a useful farm tool precludes its classification as a luxury. The Government has invested millions of dollars in its program to help take the convenience of electricity to the farm areas. It seems inconsistent indeed to restrict the farm use of electricity by taxing an important medium of its use, the electric farm freezer.

The proper development of the freezer industry is also directly related to the growth and expansion of the frozen foods industry and any reduction of freezer sales volume will adversely affect the frozen food industry.

Today the freezer industry is developing and pioneering a new business. Compared to the television industry where entertainment and educational value is readily apparent to customers, the freezer must be thoroughly explained and consumer education considerably expanded before volume sales result.

An excise tax now on this new industry might well cause a crippling effect resulting in further failures and reduced sales at this critical stage.

We urge that no excise tax be imposed on quick freezers.

Brief Requesting Repeal of Excise Tax on Electric Housewares Prepared For Presentation at Public Hearings of the Senate Finance Committee, July 8, 1950

The industry term "electric housewares" includes a great variety of small electrical household appliances. As the term implies, most of these items are "housewares" or "hardware" items which have been electrified. As nonelectric items they are not taxed, but when electrified many of them are taxed. Thus excise taxes as imposed on electric housewares discriminate and restrict the sale of electrical products in favor of their competitive nonelectric counterparts.

There are approximately 200 manufacturers, who produce one or more products in the electric housewares category. They distribute their products through

some 3,500 wholesalers and upwards of 150,000 retailers of all types, such as, department stores. hardware stores, jewelry stores, furniture stores, neighborhood electric appliance dealers, gift stores, drug stores, Army exchanges, ship store, automotive supply stores, and even supermarkets.

Section 3406 (a) (3) of the Internal Revenue Code imposed a tax on a large number of electric houseware products. The House bill recently passed proposes the elimination of excise taxes on electric irons, toasters, heaters, baby bottle warmers, heating pads and blankets from the exicse tax provisions of this act. With this proposal we fully concur since these items were outstanding examples of the discriminatory application of the excise tax—and further, they are items which are either household or health necessities in common use in homes of all income brackets.

A limited number of electric houseware products would remain subject to tax under the House bill. A list of the principal classifications follows together with industry unit and retail sales values for the past year as estimated by Electrical Merchandising, a trade magazine published by McGraw-Hill.

	1949	
	Thousands of units	Thousands of dollars
Broilers	440	$4,667
Coffee makers	2450	39,300
Hot plates and grills	820	6,519
Food mixers	1375	51,562
Roasters	350	13,125
Sandwich grills	1100	16,445
Waffle irons	860	13,760
Total		145,378

Based upon the above figures, we estimate that a manufacturer's excise tax of approximately $7,268,900 would be paid annually on the products listed. Other electric housewares products on which the volume was not known or of sufficient importance to list (corn poppers, deep-fat fryers, juicers, etc.) might add not to exceed $500,000 in excise taxes to the above total. We question whether the application of the excise tax to these items may not in fact represent a net loss to the Government in terms of budget balancing.

Considering the amount of the total tax revenue on electric housewares, which has to be collected from 200 or more companies on many hundreds of thousands of transactions, it is an open question whether the cost of collection to the Government does not eat up a large portion of this tax yield. In addition, an increase cost must be borne by each manufacturer as a result of his activities in segregating, collecting, and remitting the tax.

There are a large number of small manufacturers in this industry and to them, in particular, the tax is burdensome and places on them an unwarranted expense for the amount of the tax collected. It is a nuisance, as well, to the thousands of wholesalers and the many thousands of retailers because they are often confused by the multiplicity of tax provisions, tax exemptions, taxes which they must collect as retailers, along with taxes imposed at the manufacturer's level.

In terms of Federal budget balancing, the net return of this tax is the recovery from the tax, minus the costs to the Government of collecting and checking returns, minus the increased revenue the Government would receive from increased corporate taxes, paid as a result of the increased sales that would result if this discriminatory and burdensome tax were removed.

1. We should like again to point out that the tax as applied on electric housewares is generally discriminatory. It applies to the electric but not to the nonelectric housewares items such as juicers, corn poppers, griddles, fryers, roasters, etc.

2. The blanket provisions of the excise tax on household cooking and warming appliances restricts the development of possible new products by imposing a general tax classification. The development of new products and new businesses should not be so restricted.

3. Relief from excise tax is badly needed to restore volume and profitable operation, particularly by the smaller manufacturers of the electrical housewares industry. Increasing price resistance has curtailed the sales volume on many items during the past 2 years with resultant decreases in total volume. It has

curtailed particularly the sales volume of many of the smaller manufacturers whose products are generally sold on the basis of low competitive prices to homes in lower-income groups. As a result, a number of well-established but smaller companies showed net losses in 1949 compared with favorable profits in prior years. The loss of income-tax revenue to the Government from these sources in 1949 was a substantial one. Prompt relief is needed since many of these manufacturers are now faced with the problems of survival due to capital losses and current curtailment of their sales volume.

4. In addition to the restrictions on sales, application of the tax on electric housewares items imposes costs of segregation and collection of tax upon both Government and business out of proportion to the revenue involved.

We respectfully ask that the Senate Finance Committee give consideration to the elimination of the tax on all electric housewares to eliminate the present inequities of discrimination and to correct the hardships which now exist as a result of the imposition of the tax on this important industry.

Brief Requesting Repeal of Excise Tax on Electric Fans and Air Circulators Prepared for Presentation at Public Hearings of the Senate Finance Committee, July 8, 1950

This brief is presented in behalf of the members of the electric fan section of the National Electrical Manufacturers Association, who manufacture electric fans of the following types:

A. All free air circulating fans, including—

1. Portable and bracket fans.
2. Pedestal fans, which are adaptations of portable and bracket types.
3. Ceiling fans.
4. Air circulators.
5. Radial discharge (floor-type) fans.

B. Ventilating fans adapted from portable or bracket fan parts.

These manufacturers accounted for approximately 70 percent of the total domestic sales of these types of fans. (This estimate of industry coverage is derived from comparison of the data compiled by the association from reports submitted by these companies with data compiled in connection with the 1947 Census of Manufactures.)

The excise tax on electric direct motor-driven fans and air circulators, under section (a) (3) of the Internal Revenue Code, should be repealed, because—

1. Fans are a necessity, not a luxury.
2. The tax is discriminatory and inconsistent.
3. The tax on fans is seriously affecting sales volume and employment in the industry.

The purpose of the electric fan, for domestic, commercial, farm, and industrial applications, is the movement of air. In addition to the common usage for summer cooling, fans used for drying, for ventilation, and as an economical method of heat distribution.

Fans are the average man's air conditioning. In older homes fans are frequently necessary for economic heat distribution. Fans are needed in many parts of the country to eliminate sleepless nights and maintain man-hour efficiency. Ventilation is necessary to keep many apartments livable; small apartments or other congested living quarters must have air movement

Fans are necessary to provide ventilation in commercial establishments, restaurants, and stores. They are required by local ordinance in many cities and towns.

Fans have many necessary applications on the farmstead including essential ventilation of milk houses, barns, and poultry houses.

In industry, both labor and management demand fans to provide healthful working conditions and to maintain working efficiency. During summer months many industrial plants have been forced to close down temporarily for lack of sufficient ventilation. During winter months fans provide adequate and economic distribution of heat in industrial plants.

Fans in all their many uses are necessary to maintain present standards of living and working conditions.

The excise tax on fans is discriminatory and inconsistent.

1. The tax is imposed upon "electric direct motor-driven fans and air circulators." It thus applies to such fans as desk- and wall-type oscillators, ceiling and ventilation fans, and other types of fans where the blades are mounted on the motor shafts.

The tax does not apply, however, to belt-driven fans which are sold in large quantities in cabinets, mounted in windows and in attics, for home cooling as well as for general exhaust and ventilating use in commercial establishments.

The competition between direct motor-driven and belt-driven fans is very keen. Their application in many instances is similar.

The sale of direct motor-driven fans is seriously and unfairly penalized by the tax. Not only is the direct motor-driven fan in general more costly to produce and therefore must sell at a higher price than the belt-driven type, the direct motor-driven fan must also overcome the added excise tax burden.

2. Belt-driven blowers for driving air through ducts for ventilating purposes are not subject to excise taxes, yet they are in competition with direct motor-driven fans for ventilation purposes which are taxed.

3. Evaporative coolers, which are used extensively for summer cooling in the arid sections of the country, even when built with a taxed direct motor-driven electric fan as a component, are not subject to excise tax.

4. Blowers sold to evaporative cooler manufacturers are not subject to excise tax, but direct motor-driven evaporative cooler fans, sold to these manufacturers, are subject to excise tax.

5. If a manufacturer of evaporative coolers buys a motor from one fan manufacturer and the fan blade from another manufacturer he pays no excise tax, and no excise tax applies on the assembled evaporative cooler. If the evaporative cooler manufacturer, however, buys both the motor and the fan from a single manufacturer, an excise tax is imposed on these items.

6. Direct motor-driven fans, air circulators, and self-contained air-conditioning units are taxed. But costly air conditioning systems and installations are not taxed. The average man is thus discriminated against.

In spite of increased population, increased income, and most favorable weather conditions during 1949, the 1949 unit sales figures for taxed electric direct motor-driven fans and air circulators were lower than the sales volume for 1946, 1947, and 1948. Why should consumers buy the more costly taxed fans and air circulators when they can buy an untaxed fan, use it for the same purpose, and pay less? Note also that distributors and dealers are not interested in pushing taxed fans and air circulators—the tax adversely affects distributor and dealer margins.

Reduced sales volume has had its impact on industry employment. A survey shows that from June 1948 to June 1949 productive man-hours worked on the various excise-taxed electric fans and air circulators had declined 32 percent.

The tax also has a serious impact upon smaller manufacturers of the taxed electric direct motor-driven fans and air circulators. Reason?

It has been the custom in the fan industry to start booking and shipping orders in January, February, and March—well in advance of the retail fan-selling season. This procedure is essential to provide adequate stocks in retail outlets throughout the country during the peak sales period which comes during hot weather. Many of the smaller manufacturers, who have insufficient means required for consignment sales, predate invoices or grant preseason price concessions. The law does not, and perhaps cannot, make provision for this situation applicable to the fan industry. The smaller manufacturer, therefore, must remit the tax to the Government at the time of sale; whereas, the company that is able to sell on consignment is not required to remit the tax until final sale is consummated.

The excise tax on electric direct motor-driven fans has thus placed an unwarranted and unfair burden upon smaller manufacturers in the electric-fan industry.

We believe that the facts we have presented call for repeal of the manufacturers' excise tax on electric direct motor-driven fans and air circulators, under section 3406 (1) (3), of the Internal Revenue Code. We believe, also, that, as a protection to smaller manufacturers in particular, provision should be made for rebate of the tax on those fans and air circulators which are in distributor and dealer stocks and which have been purchased in advance of the active selling season, similar to the provisions made for tax rebate on electric light bulbs in section 1657 of the Internal Revenue Code.

Your careful and favorable consideration of this brief is urgently and respectfully requested.

Airmaster Corp.; Chicago Electric Manufacturing Co.; Diehl Manufacturing Co.; The Emerson Electric Manufacturing Co.); Fasco Industries, Inc.; Fresh'nd-Aire Co., (Division of Cory Corp.; General Electric Co.; Hunter Fan & Ventilating Co., Inc.; Knapp-Monarch Co.; National Gas Equipment Co., Inc.; Reynolds Electric Co.; Robbins & Myers, Inc.; Samson United Corp.; Signal Electric Manufacturing Co.; W. W. Welch Co.; Westinghouse Electric Corp.

The CHAIRMAN. Would you summarize it, please?

Mr. MILLS. Yes, Senator.

Practically every manufacturer that I know of has an established procedure for handling his price protection to his distributors and dealers. In other words, when a manufacturer is in a position to reduce a price, he has found from past experience that he has to protect his distributors and dealers and not leave them with appliances that he has bought at a higher price, because even a 10-percent reduction or 5-percent reduction would be very crippling to him, just as I point out it would be here if he had to absorb the tax. So established procedures have been very customary in this business.

I do not know the details of very many of those, of course, but I think they are all pretty closely related.

Taking our own company, for example, if we were to reduce a price on a refrigerator, we would go to our distributor and tell him the price had been reduced to him and we were issuing a credit for so much for each one of those refrigerators that he had in stock as of the date of the price change and he, in turn, would go to his dealers and protect them on price by the amount of the reduction.

Now we can identify all of the major appliances and some of the small appliances by serial number. Manufacturers have to keep records of where these appliances go, what distributors they go to as they leave his plant, because we cannot lose the identity of that machine and we put a serial number on it.

The CHAIRMAN. You have to furnish parts from time to time?

Mr. MILLS. That is right. We want to know where that goes in the end. We actually know to what consumer it goes, because he returns a warranty card that established that machine is going to the consumer from a certain distributor through a dealer, and that is part of the system that is used by everyone. So that we have the dealers issue a claim back to the distributor telling what they have in stock as of that date of the price change and he lists the products and the serial numbers of the machines. The distributor keeps records also by serial numbers and he can tell whether he shipped that refrigerator to that dealer. If he certifies it, then he sends it to us and we check with our records and we identify whether we shipped that serial number to that distributor. If we find we did, why, we issue him credit and he, in turn, issues credit to his dealer.

In the years that this practice has been in effect, there has never been the slightest evidence of fraud and I do not see how it could be accomplished on those products that have serial numbers on them.

Senator MILLIKIN. Who is issued credit if the consumer buys just before the slump in price?

Mr. MILLS. That is a local problem and it is a problem, in some cases.

That, just very briefly, is the way this works. In our suggested program here we say that the dealer should make a certified copy and sworn affidavit that he had in his stock as of this date such and such appliances, giving descriptions that will identify them, and the distributor clears them from his records to see that he shipped them to that dealer.

In addition here we say that we could collect all of the claims, relieve the Government of all of that work. We could certify, if we found any of them wrong, we could send them back as we normally do. We would certify to the Government such and such claims. We

could list them or send all the supporting evidence to relieve the Government of all the paper work or of trying to handle claims from 140,000 electric dealers here in Washington, which would be quite a task, and no one here would ever know the amount of tax on that appliance. Only the manufacturer can establish the amount of tax and even by serial number then, because the price may have changed since that dealer brought it in his stock. We can tell by the serial number exactly in what period that fell and what price he paid and how much adjustment, in the case of a price adjustment, that he is allowed, or in the case of an excise tax how much he should be allowed.

It seems to add up in our minds that this is a very practical method of doing it, eliminating not all, but I would say a large part, of the work for the Government and with the best possible way of prevention of fraud from widely scattered dealers who might not understand it or who might deliberately in some cases try to stretch it.

I do not know whether I have made it clear or not.

The CHAIRMAN. I think so.

Senator MILLIKIN. Mr. Chairman, may I ask a question?

The CHAIRMAN. Yes.

Senator MILLIKIN. This is somewhat off the point, but out of your own experience how much does the manufacturer's excise multiply by the time it gets to the consumer?

Mr. MILLS. I cannot speak for the industry there, Senator, and I imagine that there is some variation, but, general y speaking, there is some mark-up of the tax as the consumer buys it and I think that there is some justification for that. In other words, the dollars that a dealer pays for an appliance, those dollars that he pays for the tax are the same as those dollars he pays for the product. In many cases he has to go out and borrow money to carry his floor stocks. That is quite common in this industry and there is no difference in those dollars than any other dollars. Generally speaking, I would say that it is not a full mark-up, and in some cases it is passed on as nearly as it can be. However, it will vary widely.

Senator TAFT. What is the mark-up as between the wholesale price and the retail price?

Mr. MILLS. I would say it is marked up by the time it gets to the consumer, in our own case, with exceptions, probably as much as 35 to 40 percent.

Senator TAFT. So if it is 40 percent and if there were a full mark-up, there would be a 40-percent in addition to the 10-percent tax, which would be 14 percent to the consumer?

Mr. MILLS. More than 14.

Senator TAFT. A $10 tax would be $14 to the consumer?

Mr. MILLS. It would be $14 or in some cases it might go to $15. I think that the average that I have heard has been somewhere around $16. That is based on the tax being a little more than $10 on an average refrigerator.

Senator MILLIKIN. The reason I am curious about that is that one of the organizations is advocating a general manufacturers sales tax as a substitute for a lot of other taxes and it strikes me as a dubious procedure because of the mark-up we are discussing.

The CHAIRMAN. Are there any other questions, gentlemen? If not, thank you, sir.

Mr. MILLS. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Joseph H. Francis?

STATEMENT OF JOSEPH H. FRANCIS, EXECUTIVE SECRETARY, NATIONAL BOARD OF FUR FARM ORGANIZATIONS, MORGAN, UTAH

The CHAIRMAN. Will you identify yourself for the record?

Mr. FRANCIS. Mr. Chairman, my name is Joseph H. Francis, and my address is Morgan, Utah. I am the executive secretary of the National Board of Fur Farm Organizations.

Mr. Chairman and members of the committee, in view of the desires to expedite the passage of the Revenue Act of 1950, I regret that it becomes necessary to ask that a reconsideration be given to section 102 dealing with the proposed excise tax reduction on furs.

Our request is being based on two reasons. First, that only a minimum of reduction was given to the fur industry which shows the greatest hardship due to the tax.

Second, the impact of tremendous increased volume of imports makes it imperative that we expand the American fur market, a factor which was not considered by the House.

As excise tax receipts are perhaps the best and most accurate barometer in reflecting increase or decrease of business activity of the various industries affected, we draw your attention to the following facts:

An examination will reveal that of all the various general classifications of Federal excise taxes, revenues from "retail excise tax group" shows the largest decrease; which, in itself, warrants the question as to whether retail taxes are not the most severe and objectionable type of taxes that can be inflicted upon an industry.

Furthermore, the following figures show that of the various items subject to retailers excise tax, receipts from furs showed the greatest decrease.

I just want to point out here, Mr. Chairman, that in the retailers excise category jewelry decreased from 1947 to 1949 in the amount of 14 percent; furs decreased 52 percent; toilet preparations decreased 1 percent; and luggage decreased 7 percent.

Regrettable as it may be, the facts disclose that the fur industry shows the greatest decrease in volume of retail sales of any industry subject to excise taxes since 1947, and thereby reflects the adverse position of our industry which is reflected in every branch from the producer to the retailer. No industry can exist under such an adverse condition that is daily growing worse.

To further substantiate the fact that the proposed reduction as contained in the present bill gives the least amount of reduction to those of greatest need; the following table shows the amount of reduction proposed for articles subject to retail tax.

It can be quickly observed that the same rate of reduction applies to all articles, but in the case of jewelry important exemptions were provided and substantial exemptions are given to toilet preparations and luggage, while no consideration was given to similar exemption for furs.

Senator MILLIKIN. Mr. Chairman?

The CHAIRMAN. Senator Millikin.

Senator MILLIKIN. Mr. Francis, do you remember how much excise tax was collected from the fur business within, say, the last year or any period that you have available?

Mr. FRANCIS. In the last year the excise taxes collected on furs, Senator, were $46,000,000. In 1947, it was $97,000,000.

Senator MILLIKIN. Thank you very much.

Mr. FRANCIS. We are also conscious of the fact that the bill provides a reduction, or elimination of rates established in 1941 on articles that were not subject to the increased war tax rates of 1942 and 1943. Included in these are tobacco, tires and tubes, automobile parts musical instruments, radios, refrigerators, electric, gas, and oil appliances, business and store machines, and other minor items.

We are not questioning the soundness, need, or justification of the consideration given to other industries; apparently they are fully justified and needed. But we do feel that the grave condition of the fur industry merits further consideration.

It is both appropriate and important that we point out to the members of this committee—who, in addition to tax problems, are also directly concerned with the import problems of industries—the direct relationship between imports and excise taxes that is confronting the fur industry.

This matter was called to the attention of the Ways and Means Committee in 1947 when consideration ws given the Reciprocal Trade Agreements Act, and again before the Senate Finance Committee in 1949 during hearings on extension of the same bill.

It is not necessary that we go into the import problem in detail as I know you are aware and have been persistently reminded of the facts that exist.

The following comparatively simple table tells a very important story:

Rate of tax on furs compared to volume of imports

	1930 to 1940	1941 to 1943	1944 to 1949
Excise tax (percent)	None	10	20
Imports (value)	$52,000,000	$89,000,000	$150,000,000
Imports, muskrat pelts	783,000	1,621,000	2,766,000

We find that during 1930 to 1940 while we did not have any excise taxes on furs our imports were $52,000,000. During the period of 1941 to 1943, when we had a 10 percent excise tax, the imports rose to $89,000,000. During the period 1944 to 1949 while we had a 20 percent tax on furs, imports rose to a yearly average of $150,000,000.

While our market was purposely curtailed by increasing the excise tax, our volume of imports has increased approximately 300 percent.

Senator MILLIKIN. Where does most of that come from?

Mr. FRANCIS. Russia.

Senator MILLIKIN. Do they pay any tariff for getting in here with their furs?

Mr. FRANCIS. The only kind of fur subject to tariff is the 37½ percent duty on silver fox.

Senator MILLIKIN. The rest of them come in duty free?

Mr. FRANCIS. That is correct.

Senator MILLIKIN. So we tax our fur farmers to carry on a cold war with Russia and permit Russia to put them out of business; is that correct?

Mr. FRANCIS. That is correct.

Senator TAFT. What proportion of the total furs sold in 1944 to 1949 does the $150,000,000 represent, foreign furs as compared to domestic furs? What proportion to the total sales is now foreign furs?

Mr. FRANCIS. About 65 percent.

Senator KERR. $150,000,000 is what is paid for the raw furs?

Mr. FRANCIS. That is correct, Senator.

Senator KERR. Sixty-five percent of domestic production; that means domestic production is about $225,000,000 in raw furs?

Mr. FRANCIS. No, that would mean about 60 percent of $150,000,000; $150,000,000 represents the total dollar volume of imported furs only.

Senator TAFT. The wholesale.

Senator KERR. I understood the Senator to ask you what percentage the imports amounted to either in comparison with domestic production or the total of the two, domestic and imported combined.

Mr. FRANCIS. Of the total of the two it represents about 65 percent.

Senator KERR. Well, then, you are telling us that the domestic production has a value at the producer level of about $75,000,000?

Mr. FRANCIS. That is correct, sir.

Senator KERR. The total production of American furs is about $75,000,000 a year to the producer?

Mr. FRANCIS. Approximately that figure; yes.

Senator TAFT. Supposing we took off the excise tax altogether, could we not get the money back by a tariff on foreign furs?

Mr. FRANCIS. We have been proposing that for a number of years.

Senator TAFT. Without any loss of revenue at all?

Mr. FRANCIS. Yes.

Senator TAFT. Get back from the tariff on foreign furs all of the excise tax. Have you any idea how high a tariff we would have to have on foreign furs for that purpose?

Mr. FRANCIS. I have not figured it out but it would be substantial if not as much as we are getting out of the excise tax. When we figure the effect on retail sales as it reflects back into our income taxes, it would be an increase in revenue for the Government by putting duties on rather than collecting excise taxes.

Senator MILLIKIN. Is it not your opinion that we could invoke our dumping laws and keep those Russian furs out entirely?

Mr. FRANCIS. Our investigations, Senator, with the Treasury Department indicated that we cannot invoke the antidumping laws because we cannot get the factors to enforce the Antidumping Act. One requirement is that we find out from Russia what her cost of production is and a second figure is needed as to what price the furs are selling in their country as compared with here. Inasmuch as we cannot get any information back of the iron curtain we cannot put in effect the Antidumping Act. We have met with the Treasury Department and the State Department on this matter and their testimony will bear out that statement.

Senator MILLIKIN. If you cannot get the facts you can deal on assumptions. They do not hesitate to deal with assumptions when it works against our own interest.

Mr. FRANCIS. We would not mind dealing on assumptions and going along on that basis if the Treasury Department would consider it.

Senator MILLIKIN. The whole fact is that they are putting the fur producers out of business, is it not?

Mr. FRANCIS. Correct.

Senator MILLIKIN. And we are doing nothing about it, is that not correct?

Mr. FRANCIS. That is right.

To erase any doubt that this tremendous rise in the dollar volume of imports is due to increased price of the imported product, I have taken one of our basic furs, muskrat, to prove that the increase in pelt volume is truly representative of the increase in dollar volume. With minor exceptions, the prices of raw furs today are below prewar prices. How would you like to buy a stove today on those terms and conditions? Yet it is proposed to remove the entire tax from these items.

If you will note from the table, you will see that in 1930 to 1940, we had 783,000 muskrat pelts and in the period from 1944 to 1949 that has jumped to 2,766,000 pelts. Gentlemen, 30 years ago, Russia did not raise a muskrat. In 1949 the import from Russia of muskrats was 2,146,000. We shipped them their start about 30 years ago.

I hope that the members of this committee will not sympathize with the cries from industries who may be affected by the proposed raise in income taxes, whose profits are derived from substantial exports of their goods made possible through the importation of goods at tremendous sacrifice to many small industries.

Senator TAFT. On the silver-fox fur, there is a tariff?

Mr. FRANCIS. On the silver-fox fur there is a tariff, yes, Senator.

Senator TAFT. Is that an ad valorem?

Mr. FRANCIS. That is correct.

Senator TAFT. How do they get the basis for the cost of silver-fox furs? Is that an assumption, too?

Mr. FRANCIS. That is pretty well an assumption to date.

Senator MILLIKIN. That comes by virtue of other agreements, but we have no agreements with Russia at all. Our fur situation arises out of our agreements with other nations on furs which Russia gets the benefit of, is that not correct?

Mr. FRANCIS. That is correct.

Senator HOEY. Do silver-fox furs come from Russia, too?

Mr. FRANCIS. Russia is about second in production of silver fox.

The CHAIRMAN. We are able to get the cost of production of silver fox in Canada?

Mr. FRANCIS. That is true.

Is there justification, in addition to the substantial contribution our small industry is called upon to bear, to continue to maintain special tax on the sale of our products to a point of liquidation so as to provide foreign aid to insure an additional exchange of products for the benefit of other industries?

As several members of this committee are also members of the Foreign Relations Committee and are necessarily directly concerned with the major ECA problem of closing the so-called dollar gap by expanding our domestic market for foreign goods, I would like to suggest that I know of no better or more justifiable place to begin than to remove the tax so that we can sell their furs. In all seriousness, I cannot understand the absence of support by the State Department and ECA officials for elimination of taxes that mean so much to the welfare of the foreign-aid program.

To my knowledge nowhere do we find a similar condition existing in connection with any other product or industry subject to excise taxes that remotely compares to the import problem facing the fur industry. For your information this matter was not called to the attention of the members of the Ways and Means Committee because at the time of their hearing legislation providing for import protection on furs was pending in the Senate. But on a very close vote, as you are familiar with, this legislation was rejected.

In view of the lack of support for a limited amount of import control, we have no other choice than to quit our business, or to seek your help, whereby we may expand our market to the extent of not only being able to absorb the present normal production and increased volume of imports, but to rapidly dispose of the untold millions of dollars of furs that have been stored, which have accumulated since 1947. In order to do this we must go beyond the present proposed tax reduction.

I wish it were possible to carry out a financial experiment to the end of proving the statement made by the best financial experts in our industry who state emphatically that if the entire excise taxes on furs were eliminated the increase in Federal income taxes from our industry would more than offset the loss from excise tax. There can be no doubt as to the validity of such a statement if we include the increase in tax revenue that would also occur to States and local governments. Too often overlooked is the fact that we have more than just the Federal tax purse to consider in a matter of this nature, especially if an industry affected is concentrated in a particular region.

If we need more revenue, why handcuff a resource that can and will produce them? It may be good business to shear a lamb for his wool, but it certainly is not good business to kill him just for his pelt.

In view of the conditions which have been pointed out, complete elimination of the excise tax on furs is both advisable and justifiable; Whereas, a further substantial reduction in the rate would bring us nearer to the measure of relief that is necessary. From the point of industry and government the above proposals are the best approach, but from the point of consumer benefits a third approach may seem more advisable in view of the tendency which has been woven into all recent tax policies to offer the greatest relief to the low-income group. This proposal would be to amend the present bill to provide for elimination of the tax on the first $300 of the retail sale price of all fur articles sold. This would be in line with what is already proposed in the present bill for similar products and industries, and parallels the policy of personal exemptions provided for in both Federal and State income-tax laws, which has been in existence for a long time. It is a type of exemption that is fair and equal to all consumers and all branches of our industry. It would remove, to a large degree, the present discrimination and unreasonableness that all fur articles are a luxury. In practice, the proposal would operate in this manner: All fur articles selling below a retail price of $300 would be exempt from tax. Articles retailing for above $300 would be subject to a 10-percent tax on the amount above $300, or a $600 coat would be subject to a 10-percent tax on $300.

As near as we are able to calculate 63 percent of the total volume of fur articles sell at retail for $300 or less. But they only represent

32 percent to the total dollar volume of all fur articles sold at retail. Therefore, we can quite accurately state that the proposed exemption, which would eliminate 63 percent of fur articles from being subject to tax plus $300 exemption on the 37 percent of fur articles sold above $300 would amount to about a further 5-percent reduction in the rate.

Though elimination of the tax would be the most simple and desirable, the exemption proposal would give the greatest relief to both consumer and industry for a minimum amount of loss in revenue.

If there is any doubt that the small loss in revenue from excise tax will not be offset by increased revenue from our industry through income taxes, then raise our income rates.

We sincerely believe that the present situation of the fur industry warrants further consideration to the extent of the proposals made or other equal measures of relief.

The CHAIRMAN. Thank you very much, Mr. Francis.

Are there any other questions of Mr. Francis?

If not, thank you, sir, for your appearance.

Mr. FRANCIS. Thank you, gentlemen.

The CHAIRMAN. Mr. S. R. Carter?

Will you identify yourself for the record, please?

STATEMENT OF STEWARD R. CARTER, JR., LEGISLATIVE COUNSEL TO PRINTING INDUSTRY OF AMERICA, WASHINGTON, D. C.

Mr. CARTER. My name is Steward R. Carter, Jr. I am legislative counsel to Printing Industry of America, Inc., national trade association of the commercial printing industry. Its 3,600 printing-company members do an estimated 80 percent of the sales volume of this $2,000,000,000 industry.

The industry employs in excess of 400,000 persons and yet is composed of a multitude of small plants that qualify us, we believe, as the most typical small business in the country. Traditionally our net profits before taxes have averaged on the low side of 5 percent, and yet this is the first instance in our trade-association history that we have appeared before a congressional committee in reference to specific tax relief. Printing Industry of America has offices at 719 Fifteenth Street NW., Washington, D. C.

As a typical American small business we are concerned not alone with money, but also with the basic principles of equity in the application of our tax law.

We wholeheartedly endorse title I, part 5, section 158 of H. R 8920, relating to photographic excise taxes which provides a business-use exemption therefrom for reasons that are obvious and which you gentlemen have before you in the form of the transcript of hearings held before the House Ways and Means Committee. However, we would like to go one step further and request your attention in reference to an inequitable situation that has been operative since the inception of photographic excise taxes. We refer to the imposition of such taxes on photomechanical film and plate and the fact that such taxes do not apply to high-contrast sensitized paper. In order to clarify our subject matter, it is necessary to explain briefly the utilization of the foregoing media in the reporduction process.

Photomechanical film and plate is the photographic adjunct used by the printing industry to transform a photograph into printable

matter. The physical limitations imposed on the transfer of ink to paper do not permit the reproduction of shadings in illustrations. Consequently, the normal photograph per se cannot be reproduced by printing machinery. What actually happens is that an original photograph taken by normal photographic means is rephotographed on photomechanical film or plate through a half-tone screen, which is a screen consisting of a myriad of tiny dots and such photomechanical film or plate negative exposed for period of 30 seconds plus, gives a black-and-white reporduction with no contrasting tones. By virtue of the fact, however, that such negative is exposed through an intervening half-tone screen, and the dot process heretofore mentioned, it becomes possible to produce an optical illusion of shade when the material becomes part of the printed impression.

High contrast sensitized paper performs generally the same job, is handled the same way. Its sensitized surface consists of the same emulsion and the only difference is the base to which such emulsion is applied. The two materials have overlapping use and the elimination of one from the application of tax places an unfair advantage in the way of the user and of the manufacturer thereof.

Sensitized paper was construed exempt by the Commissioner of Internal Revenue shortly after the original photographic excise tax became effective. Printing industry of America has over a considerable period of time attempted to demonstrate to the Commissioner the analogy that exists between the two products and the fact that, in our opinion, neither were intended to be included under the original excise tax law. To this date no decision nor determination has been forthcoming from the Bureau and the likelihood of the receipt of any decision by virtue of policy reasons within the Bureau will be delayed for a much greater length of time.

We have relief in part in our request for equity upon the apparent intent of Congress as expressed in the report to accompany H. R. 5417 which stated that in the case of sporting goods, luggage, electrical appliances, photographic apparatus, business and store machines, and optical equipment, the particular article, the sale of which is subject to tax is named. At no place in the law did the phraseology "photomechanical" appear. Throughout the industry and throughout the Government, however, photomechanical is a well-accepted descriptive name for a category of product entirely apart from generally accepted photographic products. It is unusable, except as an adjunct to the printing industry. It is unwanted for normal photographic use by virtue of the fact that contrast and shade are lacking from its basic manufacturing requirements.

To impose a tax on this material is, in effect, to impose a tax on the paper on which we print and has the practical effect, by virtue of the elimination of the imposition from sensitized paper, of imposing a tax on a part of our field of use and leaving a part exempt, with obvious competitive disruption.

Therefore, in conformity to what we have said, we believe that this situation should be righted by the implementing of title I, part 5, section 158 of H. R. 8920 which refers to photographic excise taxes, by additional phraseology which will demonstrate that the Revenue Act of 1940 was not intended to apply to photomechanical film and plate.

I might add, gentlemen, that we have spent considerable time in discussing this with the Bureau of Internal Revenue to ascertain the intent of Congress as it was constituted at the time, the results of those discussions and deliberations, and we are of the conviction that it is obvious that it was not intended by Congress to apply this tax to us at the time the Revenue Act of 1940 was passed.

We are in a position with the Bureau of Internal Revenue of not having official acquiescence but informal acquiescence, and we are being held up by a court case, and that is the policy which prohibits the Commissioner from giving us a ruling. We do not believe that the court case is analogous to ours and we do not believe that the holding under the ruling is a fair imposition on us.

Senator MILLIKIN. How much money is involved?

Mr. CARTER. Between two and four million dollars.

The CHAIRMAN. For the future, the House bill protects the photomechanical film and plate?

Mr. CARTER. Yes, sir; the language incorporated in the present bill.

The CHAIRMAN. It would be applicable to the past?

Mr. CARTER. Yes, sir.

Senator BUTLER. Would the bill, as now written, give you the protection with the exception of the retroactive feature?

Mr. CARTER. Yes, sir.

Senator TAFT. It taxes cameras and camera lenses and unexposed film in rolls, is that it?

Mr. CARTER. That is the section, but you will find as you go on in that section a further explanation.

Senator TAFT. Cameras, lenses, motion picture camera lenses, X-ray film, film more than 150 feet in length, and film more than 25 feet in length and more than 30 millimeters in width.

Mr. CARTER. That is it, sir.

According to the Bureau of Internal Revenue, the product that we use would not be taxable under that section.

Senator BUTLER. So you would have what you want from here on if this bill passes?

Mr. CARTER. Yes, sir; we would.

Senator BUTLER. But you would not be taken care of retroactively?

Mr. CARTER. That is right, sir. We have had an inequitable situation existing over a period of years and it has had a real effect upon the growing segments of our industry.

The offset section, which is primarily affected here, is in actuality almost a war baby, although it existed prior to the war. It has been given great impetus during this past war. The printing industry, although a stable industry, is a very low profit industry and has not been able to accumulate surpluses. We have bank credit but we do not have an opportunity to sell stock in acquiring investment capital, and we have not had an opportunity to build any surpluses and the small amount of money that actually would become available if this were retroactive would have a real effect upon the industry, in our opinion.

Senator BUTLER. The retroactive feature is apparently desired to take care of cases pending?

Mr. CARTER. Yes, sir.

Senator MILLIKIN. For what period of time?

Mr. CARTER. Three years, sir. The statute of limitations would operate against us.

Senator MILLIKIN. Did you pass on that cost during those 3 years?

Mr. CARTER. No, sir, it was absorbed. We are the absorption level. In this instance, of course, these taxes are manufacturers' excise taxes; however, we are the taxpayers. In effect, they were passed on to us separately and we have absorbed them into our operating cost. We made no differential from the imposition of the taxes and we are in a position to demonstrate that.

Senator MILLIKIN. You have absorbed them and not passed them on?

Mr. CARTER. That is right.

Senator BUTLER. What amount would it total, the claim against the Government?

Mr. CARTER. Between two and four million dollars, sir. The figures are not accurate on that, but I would say that it would be closer to three million, the average mean between them.

Senator MILLIKIN. Have you submitted any demonstration to the House Ways and Means Committee that you do not pass on the tax?

Mr. CARTER. No, sir; we did not, for this reason: that at that time the House Ways and Means Committee was in session and our discussions with the Internal Revenue Bureau looked as though they were coming to a successful conclusion. Then this case came into the picture and has acted as an inhibiting factor and, will, for a considerable period of time.

So at that time we were happy and satisfied to see the law being contemplated in the form in which it was.

The CHAIRMAN. That is not a case to which you are a party?

Mr. CARTER. No, sir; we are not a party to that case.

The CHAIRMAN. You are not a party to the case, but you have had the matter up with the Bureau, asking for construction that would relieve the photomechanical films and plates almost since the bill was passed?

Mr. CARTER. Yes, sir.

The CHAIRMAN. I remember very well because I went into the matter. I was of the opinion that while you might be technically subject to the tax, it was not the intent of Congress to put it on.

The Bureau took a different view of it, I suppose, at least it was not free of doubt, and the matter has been hanging there for some time.

Are there any further questions?

Thank you very much, Mr. Carter.

Mr. CARTER. Thank you, gentlemen.

The CHAIRMAN. Mr. Harold V. Bozell?

Will you identify yourself for the record.

STATEMENT OF HAROLD V. BOZELL, PRESIDENT, GENERAL TELEPHONE CORP., AND PRESIDENT, UNITED STATES INDEPENDENT TELEPHONE ASSOCIATION

Mr. BOZELL. My name is Harold V. Bozell. I am president of General Telephone Corp., the parent company of a system of independent telephone companies serving in parts of 18 States over the country. I am also president of the United States Independent

Telephone Association, which is the association representing the non-Bell telephone companies in the United States, of which there are about 5,700, serving about one-fifth of the telephones of the United States through about two-thirds of the telephone exchanges covering nearly two-thirds of the area of the United States. I am appearing before you today speaking on behalf of all of these independent companies. Incidentally, the Wall Street Journal, a few years ago, characterized us as "the largest small business in the United States."

To comply with your request to avoid duplication of testimony, may I say that I have carefully read the testimony of Mr. H. S. Dumas, president of the Southern Bell Telephone & Telegraph Co., who spoke to you on Thurdsay on behalf of the companies of the Bell system and that I endorse fully everything that he has most effectively said to you.

May I add these comments. In the report of the House Ways and Means Committee, House Resolution 8920, before the House of Representatives, the committee said on pages 13 and 14:

> Your committee believes that telephone service today is of necessity to the average American.

It seems from the relative reductions in telephone excise taxes compared with reductions in other excise taxes, which the bill as passed by the House makes, that the amount of that reduction was, to say the least, hardly more than lip service to the statement just above quoted.

As I stated when I appeared before the House Ways and Means Committee with reference to this bill, the independent companies believe that all excise taxes except special categories of alcohol, tobacco, and gasoline should be repealed; but if the Congress disagrees and does not do so, then we do believe that the excise taxes borne by the telephone user should be treated at least as well as excise taxes in other categories. May I point out that the excise tax on telephone bills is the only tax of any consequence on any regulated public utility services.

We would urge emphatically that if telephone excise taxes are not entirely eliminated, at least the excise tax on local telephone service and short haul toll should be entirely eliminated. There are no excise taxes at all on local transportation, or on any comparable local service.

Mr. Dumas points, as did I before the House Ways and Means Committee, to the snowballing effect of the corporate tax coupled with the excise tax on the telephone user. As a matter of fact, the corporate tax on regulated industry is almost a tax on capital. We would urge, as forcefully as we can, against any increase.

In this connection, I would like to call your attention to the argument included in the address of Mr. Justus Craemer of the California Public Utility Commission, when he retired as president of the National Association of Railroad and Utilities Commissioners last August, which, with his consent, I introduced as an exhibit to my presentation to the House Ways and Means Committee. The increase in the corporate tax in the telephone industry and all other lated industry must be reflected directly in rates to the consumer.

We have repeatedly urged that there should be—particularly in the case of regulated industry, where, as stated above, the corporate tax is directly reflected in the price of the product or service—that there

should be credits for dividends paid exactly as there is credit for interest paid in calculating taxable net income. In this connection, may I respectfully refer you to an exhibit which I presented to the House Ways and Means Committee, namely, strong argument for and endorsement of this policy by Thomas Tarleau, former legislative counsel of the Treasury Department.

In connection with this dividend credit, your committee and the Congress recognize the inherent soundness of the argument in the Revenue Act of 1942, at the same time recognizing the peculiarities of the financial structure of regulated utilities compared with other industry by the provisions of section 26 (h). We believe that this should be brought up to date to recognize the issuance of preferred stocks between October 1, 1942, and today, by changing the date in that section from October 1, 1942, to July 1, 1950.

The provisions of section 26 (h) are sound, although that is only a partial step in the right direction. However, the preferred stocks of regulated utilities issued between October 1, 1942, and to date are of the same nature as those existing before that date, and that fact should be recognized by revising the date if indeed any reference date is deemed necessary.

I am attaching hereto the necessary language to make the change.

(The suggested language is as follows:)

PROPOSED AMENDMENT TO H. R. 8920

Section 26 (h) (2) (B) (relating to amount of credit for dividends paid on certain preferred stock) is hereby amended by striking "October 1, 1942," and inserting in lieu thereof "July 1, 1950," wherever appearing therein.

Mr. BOZELL. We are an industry on which continuing major demands for additional service are being made. These call for huge additional amounts of capital which can come only from the public buying our securities. We cannot supply the capital from earnings, the capital demand being some 8 to 12 times our total net income. The present corporate tax is a serious deterrent for obtaining this capital and we urge your serious consideration of this fact.

May I conclude by reemphasizing the discrimination which the telephone industry feels the proposed bill makes against telephone users in both the excise tax and the corporate tax, and by expressing the belief that the increase in the corporate tax is harmful in general and that it has the further objection of hurting the small stockholders of a big company, as compared with the large stockholders of a small company.

We believe that if the entire revenue act were repealed and you started anew to write a revenue act which would equitably distribute the tax load and operate to the best interests of the country the result would not be very similar to the present act as amended and with what we believe are major imbalances. We believe if we are to continue under the present act as amended and if it is to be further amended at this time—as we think it should be—then we believe it should be amended along the lines we have suggested.

Sir, in the interest of saving time, I would appreciate it if I could have an opportunity to supplement this next week, as your telegram advised, with certain supporting information. It would be a help to your staff.

The CHAIRMAN. You may do so. We shall be glad to have it for the information of the committee.

The CHAIRMAN. Are there any questions by members of the committee? If not, we thank you for your appearance before the committee.

Mr. BOZELL. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Walter Rivers.

STATEMENT OF WALTER RIVERS, DIRECTOR OF REPERTOIRE FOR CAPITOL RECORDS, INC., EASTERN DIVISION, NEW YORK, N. Y.

Mr. RIVERS. Mr. Chairman and gentlemen of the committee, my name is Walter Rivers. I am director of repertoire for Capitol Records, Inc., eastern division, 250 West Fifty-seventh Street, New York, N. Y. I am speaking in behalf of the phonograph-record industry. Representatives of other phonograph record manufacturers are present with me.

Phonograph-record manufacturers have been represented here and in the hearings before the House Ways and Means Committee by the officers of the National Committee for Repeal of Wartime Excise Taxes. We are supporting that committee and endorse the statements previously made by its officers at these hearings.

We cannot understand why phonograph records were omitted from the House bill recommending relief from wartime imposed excise taxes. We are appearing specially to supplement the statements made by the national committee, with facts respecting the circumstances of our own industry.

Relief from the tax is now urgent. Operations are at a desperately low level. And volume continues to decline.

On the basis of excise tax collections—which reflect accurately our sales volume—sales for the current fiscal year to May 1 were more than 13 percent below the same period last year. Sales for the month of May were 20 percent less than May 1949. At that rate, it is estimated our sales volume for 1950 will be approximately 80 percent of 1949 and only 60 percent of 1947.

The impact of declining volume if keenly felt throughout the industry. It is estimated that in the last 12 months as many as 200 phonograph-record firms have stopped producing and selling phonograph records. Scores of retail outlets have abandoned their phonograph record departments.

Senator KERR. Further on in your statement do you give us the total number of such firms?

Mr. RIVERS. We got these figures from AFM to license all producers of records and the largest I can remember is Musicraft Records which has gone out of business, a company called Queen Records, and there is a GI Record Co. There are any number of smaller record companies that can not make it.

Senator KERR. The question I had in mind is how many such firms are there?

Mr. RIVERS. At the beginning, I would say the middle of 1949, the AFM licensed approximately 750 companies. There are less than half that number.

Senator KERR. You think the total number now doing the business of manufacturing phonograph records is approximately or not to exceed 350?

Mr. RIVERS. I would say that, yes sir.

Senator MILLIKIN. What is the minimum amount of capital necessary to operate that kind of plant?

Mr. RIVERS. To go into the record business does not take very much capital because most of the smaller companies would produce a record, that is, musically make a record in a studio with musicians. They would go to a company that had a plant and have their records pressed by some outside firm. The amount of actual capital necessary to go into business is very small. Making it pay for itself is pretty tough.

Leading manufacturers have been compelled to curtail production and close plants. Employment in the plants of four leading record manufacturers ranges from 33 to 60 percent of the 1947 level. Since 1947, these manufacturers have closed five record plants. A plant has been closed in Camden, N. J., where 1,092 were employed; in Kings Mill, Ohio, where 900 were employed; in Richmond, Ind., where 750 were employed; in New York City where 650 were employed; and in Hollywood, Calif., where 257 were employed.

Whereas 3 years ago our plants were operating overtime and with double shifts, today, the fewer plants are not even producing at capacity. One large manufacturer closed its plant one full week in May to prevent additional permanent lay-offs after personnel and production had been already materially reduced.

Although we have retrenched, our problems are becoming even more acute. Today, we are faced with increasing competition from other new media of home entertainment and education. Television, which was nonexistent in 1941, now commands a large listening audience.

Senator CONNALLY. You say that 3 years ago your plants were operating overtime and with double shifts?

Mr. RIVERS. Yes, sir.

Senator CONNALLY. Was the tax in effect then?

Mr. RIVERS. Yes, sir; it was.

Senator CONNALLY. Then the tax did not cause the reduction?

Mr. RIVERS. I think it contributes to it, sir. You see, our problem we feel is that business is off and we need help.

Senator CONNALLY. We all need help. I have been in that fix all my life. The point I make is that you are talking about the effect of this tax.

Mr. RIVERS. Yes, sir.

Senator CONNALLY. Yet you say that 3 years ago you were operating overtime and with double shifts, and the tax was on you then. How did you get by?

Mr. RIVERS. There are a lot of factors that have come up. Television is one factor.

Senator CONNALLY. Exactly. It is not the tax alone; it is the development of other things that are competing with you. Is that true?

Mr. RIVERS. I think that is true.

Senator BUTLER. Was there a backlog of business 3 years ago? Did your industry get behind during the war effort?

Mr. RIVERS. No, there are more factors than that, Senator. You see, recently, say, 2 years ago, all the companies went into new reproduction methods, the so-called long-playing record, which forced us to recoup all our factories. A lot of research went into them, the new

45-revolution per minute, of which you have heard. In other words, the industry is going through a new phase.

We feel that the Congress has always not wanted to tax new industry and we feel that we are almost a new industry in the last 2 years since the long-playing record, tape recording. Almost the entire industry has been revolutionized. We are having a tough time making it.

Senator MILLIKIN. Is television injuring you seriously?

Mr. RIVERS. We think so.

Senator MILLIKIN. You have a situation where you are paying a tax and the competing business is not paying a tax?

Mr. RIVERS. That is true, yes sir; and we feel that in a sense we are almost a new industry in the last 2 years as far as production and new items are concerned on which we have had to spend a lot of money.

Senator MILLIKIN. As your business declines, for whatever the reason, the tax becomes more burdensome; is that not true?

Mr. RIVERS. That is true. That is why I say we need help.

Senator MILLIKIN. The foam is off the beer in a lot of these businesses.

Mr. RIVERS. That is true.

The CHAIRMAN. All right, you may proceed.

Mr. RIVERS. Congress has never imposed an excise tax on new products or on new industries because the tax would impede its development and block the expansion of our economy. While the phonograph record industry is not new, its current products are new. These deserve the same consideration which Congress has accorded other products and new industries.

The new phonograph records were introduced to provide greater pleasure to our customers and to meet the competition from other media. The new records are the result of prolonged search and experiment. They represent the first wholly new systems of recording reproduction in 50 years.

The new records are completely different products. They require adaption of players or a wholly new record player. Through the new records we have created higher standards of fidelity and clarity in reproductions of recorded sound. They are more perfect reproductions of original performances. With the new records we have been able to give our customers more product and a better product for the same amount of money.

Senator CONNALLY. Does your concern deal in this new wire recording?

Mr. RIVERS. No, sir.

Senator CONNALLY. Is that a competitor of yours?

Mr. RIVERS. I do not think that enters into competition with us.

Senator CONNALLY. You know what I am talking about?

Mr. RIVERS. Yes sir, a wire recorder as we call it.

Senator CONNALLY. All right.

Mr. RIVERS. The only way it could enter into competition with us is if people turned on the recorder when listening to the radio and took the song off and recorded it and then replayed it.

Senator MILLIKIN. Does your product use up material that is needed in the war effort?

Mr. RIVERS. Well, in the last war shellac was very hard to get, I understand.

Senator MILLIKIN. What goes into the make-up of the record? What material?

Mr. RIVERS. Shellac, lampblack, vinylite, wax. Our original platters have to be manufactured with a nickel-plated process.

Senator MILLIKIN. What is the main material that makes the mass?

Mr. RIVERS. The main material is shellac. It is gradually going over to vinylite.

Senator KERR. Will you say that again?

Mr. RIVERS. The main material is shellac. We are gradually going to vinylite.

Senator KERR. What is vinylite?

Mr. RIVERS. It is a plastic, unbreakable material. That is a new, unbreakable record.

Senator KERR. Is it made basically from resins?

Mr. RIVERS. No, sir. It is a synthetic. Now you have me. It is one of the newer plastics that have come along.

Senator BUTLER. It probably comes from petroleum byproducts.

Mr. RIVERS. I think that is what it is; yes.

Senator KERR. I would be quite interested to know.

Mr. RIVERS. I could send the committee a breakdown of the materials that we use. That is out of my line, sir.

Senator KERR. I understand the question the Senator asked was calculated to ascertain the source of basic material that goes into the product.

(The information is as follows:)

CAPITOL RECORDS, INC.,
New York, N. Y., July 13, 1950.

Senator WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Washington, D. C.

DEAR SENATOR GEORGE: At the hearing granted to me as representative of the phonograph record manufacturers on Saturday, July 8, I promised to supply information in response to questions by Senators Millikin and Kerr. They inquired as to the raw materials used in the manufacture of phonograph records and the source of Vinylite. Upon investigation, I find that phonograph records are generally composed of two different compounds.

First, the industry's new records (45 and 33⅓ revolutions per minute) are made almost exclusively from Vinylite, i. e., vinyl—a petroleum byproduct. Generally, in these records, vinyl represents 90 percent or more of the compound. The remaining materials comprise carbon black or dye, a stabilizer such as calcium, and miscellaneous materials.

Second, the composition of the older-type records (78 revolutions per minute) differs with almost every manufacturer. Generally, the principal ingredient is a hard substance such as slate limestone or filler, which comprises about 50 percent of the materials. The remaining 50 percent is made up variously of ethyl cellulose, resin, vinsol, vinyl, barytes, waxes, and miscellaneous materials.

Although shellac was an important ingredient before the war, its scarcity during the war led to the use of substitutes to the extent that, by 1947, it had been abandoned by the industry generally.

Senators Millikin and Kerr also expressed interest in the decline in phonograph-record sales. In this connection, I would like to point out that my testimony related facts dealing only with the decline at the manufacturers' level. The decline in sales of phonograph records at the retail level has apparently been more serious. The effect of the retail slump is only now depressing manufacturers' sales. In this respect, I quote below two paragraphs from the article in the Wall Street Journal of June 23, 1950, entitled "Sad Music—Sales of Phonograph Records Turn Sour," reprinted copies of which you kindly accepted at the conclusion of my testimony.

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"Demand for phonograph records has hit the toboggan in recent weeks. Retailers in some cities glumly report sales are limping as much as 60 percent behind a year ago.

* * * * * * *

"Record makers report their business isn't off as sharply as retailers', though they fear it's only a question of time before they begin to feel the full effects of the retail slump."

I sincerely appreciate having had the opportunity to appear before you and the members of your committee to tell you of the serious circumstances facing our industry. Your interest in our plea was most gratifying. If the committee should desire any further information, I would be most happy to furnish it.

Very truly, yours,

WALTER RIVERS,
Director of Repertoire, Eastern Division.

Mr. RIVERS. Although our new records are completely different from the old and require new and different playing devices, they come within the statute and are subject to tax.

The same motives which have led Congress never to impose a tax on a new product should prompt Congress to relieve a new product of an existing excise.

In the past, an excise tax on phonograph records has been levied and kept in force only during times of emergency. The first tax on phonograph records was imposed in 1917 and renewed in 1918. Legislative history suggests that that levy was intended as a war-profits tax.[1] The tax was repealed by the Revenue Act of 1921. An excise on phonograph records was again imposed in 1932. There, the depression created the urgency for new and heavier taxation. At the end of the emergency, in 1938, that tax was repealed. The present levy was imposed in 1941. It served a wartime purpose: to discourage civilian production and mobilize resources for defense. The tax has served this purpose. An emergency no longer exists. It is time for repeal.

As I have indicated, sales of phonograph records have declined to a dangerous level. The decline can be traced, in a measure, to the depressive influences of the tax. This is shown significantly by the very purpose of the 1941 excise levy on phonograph records.

The facts respecting the excise taxes imposed by the Revenue Act of 1941 have been clearly set forth. The excises were intended to discourage manufacture and production.[2] The phonograph-record business among others was "singled out" for this special wartime levy because it was not essential to the preparedness program.[3] Because phonograph records were nondefense articles, users of them were asked to pay an "additional" tax.[4] These facts appear as a matter of

[1] Following is an extract from the hearings in the Ways and Means Committee, the Revenue Act of 1918, p. 1452

"Mr. TREADWAY (Representative). Some of that prosperity is due to war orders, is it not?

"Mr. DORIAN (spokesman of the phonograph industry). We have no war orders.

"Mr. TREADWAY. You supply the training camps, and so on.

"Mr DORIAN. Yes.

"Mr. TREADWAY. So there is really a distinct war profit in your business."

[2] "Turning first to the proposals for excise taxes, the only case which may be made out for such additional taxation at the present time from a total defense point of view must rest upon its effectiveness in discouraging civilian production which competes with the defense program for men, materials, and machines." Statement of Leon Henderson, Director of the Office of Price Administration and Civilian Supply, hearings before the Committee on Ways and Means, 77th Cong , 1st sess., revenue revision, 1941, p. 645.

[3] "The Treasury is prepared to suggest * * * new excise taxes on a number of commodities which are not essential to the defense program." Statement of Henry Morgenthau, Jr., 1941 House hearings, supra. Rather than levy a general sales tax "* * * it is better to single out those less important commodities (to the defense effort) and levy special excises on them." Statement of John L. Sullivan, Assistant Secretary of the Treasury, 1941 House hearings, supra, p. 63.

[4] "It is suggested that in the light of our over-all revenue requirements the users of these (nondefense) articles may now be asked to pay additional taxes." Statement of John L. Sullivan, 1941 House hearings, supra, p 50.

official record in statements made by officers of the Treasury Department and other Government agencies before this committe eand the House Ways and Means Committee when the revenue bill of 1941 was under consideration.

The need for the excise tax has long passed. There remains no justification for discouraging production and for "singling out" producers and consumers of phonograph records for "additional" taxes. The retention of a tax on our industry while other consumers' products are tax-free is clearly discriminatory.

Since the excise tax is imposed on the sales price of the manufacturer, the burden of the tax is passed along to the consumer. About one-half of this burden falls on children and youths who are nonwage earners. Children's records—a development which has occurred since the war—comprise the bulk of the output of some manufacturers. A recent survey conducted by an independent source shows that 53 percent of the primary listeners of newly purchased phonograph records are children and youths under 24 years of age—31.5 percent of all primary listeners are children under 14 years of age.[5]

The excise tax on phonograph records burdens education. The large percentage of children's records are almost exclusively educational. Nursery rhymes which our parents paraphrased are now heard by a vast number of children from phonograph records. Phonograph records are now used for teaching the blind and for music appreciation courses in schools and universities. During the war records proved a valuable aid in teaching squads of soldiers, and as a result they are assuming increasing importance in group education. Phonograph records of symphonies and operas are subject to tax. Recorded instructions accompanying these classics and explaining musical movements and the composer's theme are subject to tax. Collections of outstanding speeches such as President Roosevelt's speeches "Rendezvous with Destiny" are subject to tax. Taxation of that nature is inconsistent with the liberal policy which exempts from tax books, paintings, works of art, and other educational and cultural media.

The tax on phonograph records is clearly discriminatory. Sheet music has never been taxed. The House bill proposes to reduce the tax on musicial instruments, but retain the tax on phonograph records at its wartime rates. And yet our volume of business is less than the musical instrument industry.

In fact, on the basis of excise tax collections (and taking into account respective rates) we have the smallest volume of business of any industry subject to excise tax.[6]

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[5] Consumer Panel Report of J. Walter Thompson Advertising Agency for March and first quarter of 1950:

Age groups:	*Primary listeners—all types of newly purchased records, percent*
Under 14 years	31.5
14–24	22.2
25–44	37.0
45 and over	9.3

[6] Treasury Department publications of Collections of Internal Revenue (Form 709F) tabulate collections for the following products. Manufacturers' excise taxes Lubricating oils; gasoline; tires and tubes; automobile trucks and busses; automobiles and motorcycles; parts and accessories for automobiles, electrical energy; electric, gas, and oil appliances; electric light bulbs and tubes; radio sets, phonographs, components, etc.; phonograph records; musical instruments; mechanical refrigerators, air-conditioners, etc.; matches; business and store machines; luggage—manufacturers' excise (suspended April 1, 1944); photographic apparatus; sporting goods; firearms, shells, and cartridges; pistols and revolvers. Retailers' excise taxes. Furs; jewelry; luggage, toilet preparations. Pistols and revolvers may be considered a part of the firearms industry Published receipts from July 1, 1949, to April 30, 1950, show that less revenue is collected from phonograph records than from any other industry.

We are a very small business.

There are approximately 20 industries subject to manufacturers' and retailers' excise taxes. Our industry pays less than one-half of 1 percent of these excises. It is almost certain that collections from our industry for the current fiscal year will not exceed $6,000,000.

The quantum of revenues from phonograph records indicates that the tax was intended as a restrictive levy rather than revenue-producing measure.

Senator MILLIKIN. What percentage of the total volume of records is devoted to classical music and educational records as distinguished from pure entertainment?

Mr. RIVERS. Classical is about 20 percent of the entire output. In the educational field it is a little more than that, especially in the children's field. I think my own company is the leader in the children's field and approximately half of our children's albums are musical-appreciation-type albums or songs about manners and how to grow up.

Senator MILLIKIN. Would you say roughly that a quarter of the whole production is classic and a quarter is educational?

Mr. RIVERS. That is correct, sir.

Senator MILLIKIN. And the rest is miscellaneous?

Mr. RIVERS. Miscellaneous, popular, and hill-billy music.

If the objective had been to raise revenue, phonograph records would have been the last industry selected.

We have but a single product. Record manufacturers who are engaged in no other manufacturing activity account for approximately 80 percent of all the phonograph records sold.

In such a small business, wholly dependent on a single product, the impact of depressive influences of the tax are keenly felt.

Congress has always demonstrated a constant alertness to the problems of excise taxes and has repeatedly amended or repealed certain of them as new economic conditions have manifested themselves. The economic conditions which have developed in the phonograph record industry compel us to beg for equally alert and speedy action.

Mr. Chairman, may I add one thing? Just 2 weeks ago on June 23, 1950, in the Wall Street Journal there was an article called Sad Music which refers to our industry. I find that the figures in there are even a little worse than what we have outlined.

Senator KERR. You find that the situation is even worse than you thought?

Mr. RIVERS. Yes, sir; that is true. So I would like to leave copies of this article with the committee, if I may.

The CHAIRMAN. You may do so.

(The article referred to follows:)

[From the Wall Street Journal, June 23, 1950]

SAD MUSIC—SALES OF PHONOGRAPH RECORDS TURN SOUR; TV IS PARTLY BLAMED—DEALERS REPORT BUSINESS IS 20 TO 60 PERCENT BELOW 1949; LAMENT THREE-SPEED WAR—PRODUCERS PUSH PROMOTION

(By Joseph M. Guilfoyle)

The men who put Bach and bebop in the groove are hearing some sad music these days.

Demand for phonograph records has hit the toboggan in recent weeks. Retailers in some cities glumly report sales are limping as much as 60 percent behind a year ago.

One of Philadelphia's largest record dealers, staggering under a 25 percent drop in business, laments: "Business is in a rut—and a deep one at that."

Across the country in Los Angeles, a retailer reports that sales in May were 33 percent below a year ago and 44 percent under the like 1948 month. Another dealer in the west coast glamour city claims business this year is 20 to 25 percent behind 1949.

TOUGH IN CHICAGO

In Chicago, Herman L. Forst, vice president of Hudson-Ross, Inc., one of the Windy City's biggest record sellers, chimes in:

"In the last week or 10 days our business has taken a decided drop. The way it looks now, this month will be very, very much below June 1949 for us and probably for most record dealers in the city."

One of the sharpest declines in reported by Detroit's Davy's Music Shop. A spokesman states that business currently is dragging 50 to 60 percent behind a year ago.

Record makers report their business isn't off as sharply as retailers', though they fear it's only a question of time before they begin to feel the full effects of the retail slump.

RCA Victor, for instance, notes that since the middle of May sales have been "running slightly behind a year ago."

Milton R. Rackmil, president of Decca Records, Inc., chimes in:

"Our sales are slightly behind a year ago and we'll show a profit for the second quarter. Basically, the record industry is healthy; it can't be any other way so long as phonograph players are being purchased in the quantities they are by consumers. Last year alone more than 1,300,000 record players were purchased by consumers."

BEATING THE BUSHES

Columbia Records Vice President Paul Southard reports that sales so far this month are ahead of a year ago. "We're out beating the bushes for business and it seems to be paying off," he explains.

Why are sales skidding? Record makers and retailers expect a seasonal lull in business about this time each summer, but they're puzzled by the worse-than-seasonal slump this year. Some think a variety of causes may be to blame. Here's how an official of Capitol Records sizes up the picture:

"First, TV has cut in on business. Next, the confusion of the three playing speeds—33⅓, 45, and 78 revolutions per minute—has retarded interest in phonograph music. And then people seem to be more interested in buying new homes and automobiles today than in purchasing records."

For a while late last year, the industry enjoyed a substantial revival in business, and record men generally thought that the three-speed confusion problem finally had been licked. But it appears now they were wrong.

A TYPICAL TRADE

Many dealers bitterly take disc makers to task for the "confusion of the speeds." M. L. Kevreson, owner of Detroit's Uptown Radio Shop, launches a typical tirade.

"With all their gadgets and speeds the manufacturers have created so much confusion that the public doesn't know what's what. They won't buy until the manufacturers get together and come out with one speed that's satisfactory to all."

Here's how another dealer puts it:

"All the advertising of one speed against the other is scaring a lot of people away from buying. They don't know what to do and when they stay away long enough they decide they can get along without any records."

Dealers also complain that the three-speed mix-up creates a terrific inventory problem for them. Many claim they don't have the space or the money to stock all selections in all the speeds.

"Sure, we're probably losing business because we're not carrying a complete line," grumbles a disgruntled retailer, "but it's better to lose some sales than have all your dough tied up in stock that gathers dust on your shelves."

As for the TV evil, which is being blamed for everything these days from turning the younger folks into a generation of morons to emptying restaurants, one disc presser has this to say:

"When the average family buys a television set it doesn't have much time for anything else, it seems. We hope when the novelty wears off they'll start buying records again."

SOME POTENT PROMOTION

Whatever the reason for the slump the men who put the country's tunes on wax are plotting some big promotion pushes to start the music going round again.

Columbia Records, for instance, will shell out some $2,000,000 in the next 6 months to push its discs. "That's more than we've spent in any full year," says Vice President Southard.

Here are some of the things Columbia is doing: It's offering cash prizes to its distributors and their salesmen who exceed monthly sales quotas. It also is conducting a series of special promotions for its long-playing platters, spinning 33⅓ times a minute. Under way now is a dance-date drive which offers music in uninterrupted segments of approximately 15 minutes just like you'd hear it in a ballroom or dance hall. Another L. P. promotion is scheduled for July and a "whopper" is in the works for September.

Columbia's biggest customer bait at the moment, though, is a new low-cost changer attachment which plays automatically all sizes—7, 10, and 12 inches—of long-playing records. Price-tagged at $16.95, the new changer, first of its kind, will play up to 4 hours of music with a single loading of 10-inch or 12-inch L.P.'s. The machine also plays a mixture of 10-inch and 12-inch platters at the same time.

DEATH OF A SALESMAN

Decca Records will try to turn the sales tide with some of the most important long-play works it has brought out yet. This week it is offering the first platter version of the Broadway hit show, Death of a Salesman, recorded with the original cast. This will be followed next month with a waxing of the musical drama, The Consul.

RCA Victor, apparently operating on the theory that there's nothing wrong with the record business that a good tune won't cure, is going to try its hand at being a Broadway angel. It is backing a new show entitled "Call Me Madam" to the tune of $200,000 for the exclusive right to record the music composed by Irving Berlin.

RCA is attacking on another front, too. Realizing that many distributors and dealers are losing business because much of their assets are tied up in slow-moving platters, it is inaugurating a new, revolutionary merchandising program.

Under the new program, all discs which fail to attain a minimum sales level during a specified 6-month period will be eliminated from the RCA Victor record catalog. A new catalog will be issued listing only those records which have proved to be sure-fire sellers. Platters that are slow, but consistent sellers, will not be carried in inventory by the average dealer or distributor, but will be available to consumers through dealers on special orders.

RELIEF FOR THE DEALER

"The immediate effects of such a program," states Paul A. Barkmeier, vice president of RCA Victor's record division, "are apparent. The manufacturer, the distributor, and dealers especially are relieved from operating with capital frozen in slow-moving or dead merchandise."

Retailers, too, are using all sorts of come-ons to lure record buyers into their shops. Philadelphia's Witte Television & Radio Co., for instance, whose sales are only about 10 percent below last year, attributes its relatively good showing to a program of aggressive personal service.

"Instead of waiting for customers to come in," explains a firm spokesman, "we phone them with news of the latest platters. This system proved particularly helpful recently when we heard we would soon receive albums of music from one of the hit shows. By the time the shipment arrived we had most of the albums sold."

Others are relying on price cuts to stimulate trade. A dealer in a large eastern city is offering 50 percent off on certain classical and popular albums. He also exhorts customers: Buy one album of "pop" tunes at the regular price and get a second one for $1.

So far, groans the proprietor, the results haven't been very good.

The CHAIRMAN. Mr. George A. Lamb.

STATEMENT OF GEORGE A. LAMB, ON BEHALF OF THE NATIONAL COAL ASSOCIATION

Mr. LAMB. Mr. Chairman, my name is George A. Lamb. I appear for the coal industry represented by the National Coal Association and ask to file a statement for the record.

Senator CONNALLY. Does that association include the southern mines and the northern mines both?

Mr. LAMB. It does, Senator.

Senator CONNALLY. It is supposed to represent them all?

Mr. LAMB. Yes, sir. It includes, I believe, on the last count something over 70 percent of the commercial tonnage. Now it does not include some of the captive operations such as owned by the steel companies.

The CHAIRMAN. You may put your statement in the record.

(The statement referred to follows:)

STATEMENT OF GEORGE LAMB, NATIONAL COAL ASSOCIATION

My name is George Lamb. I appear for the coal industry as represented by the National Coal Association and ask to file this statement for the record.

Mindful of the short period of time available to this committee in connection with the pending tax bill, I desire briefly to urge this committee to increase the excise tax on imported oil. This type of remedial action is reflected in S. 3334 introduced by Senator Thomas of Oklahoma which has been referred to this committee.

Because of time limitations, I shall not detail here the overwhelming considerations both of military security and protection against unemployment which makes this relief imperative. They were all set forth very fully in the several weeks of hearings which were conducted before a subcommittee of the Senate Labor and Public Welfare Committee pursuant to Senate Resolution 274.

It is the expection that prior to the completion of these hearings the Senate Committee on Labor and Public Welfare will have issued its report and that the full record of those hearings will be made available to this committee.

I understand that Senator Neely expects to appear before this committee.

We all hope that the ominous military situation which has beset us within the last 2 weeks will be shortly resolved and that it will not spread into a general conflagration. Irrespective, however, of the immediate outcome of the Korean episode, there can be no question that military preparedness is our prime obligation. The ability of the coal industry to assume its security responsibility requires that a tax of $1.05 per barrel be imposed on imported oil. The prospects for revenue raising of such legislation and the traditional position that excise tax on imported oil has had in the Internal Revenue Code, make the granting of this relief a matter of proper concern for this committee.

I should say just one word in explanation of the relief that is being sought. The world surplus of oil has produced a price pressure which has resulted in a displacement during the first quarter of 1950 at the annual rate of 50,000,000 tons of coal a year. The mine and well abandonments, shut-downs and reduced working time and unemployment in the coal, railroad, and domestic oil industries which have resulted, carry with them the threat of so weakening those industries as to endanger their ability to make the immediate step-up in production that would be required if we were to be plunged into a general military situation. For example, the effect of this importation has not been confined to the coal industry but its detrimental impact has extended to the field of railroad transportation where thousands of railroad employees have lost their jobs.

The tax relief that has been requested is designed merely to restore to the coal industry a fair competitive opportunity to maintain the working time essential to its continued availability for security purposes. In the absence of that relief, because of a combination of advantageous cost factors enjoyed by foreign oil, the flood of imported oil will force coal production below the minimum essential level.

Primarily, the damaging factor in oil importation, as far as the coal industry is concerned, is to be found in the byproduct called residual oil. This is the residue left to the oil industry after gasoline and other refined products have been dis-

tilled out. It represents the prime headache of world oil since world markets for residual disposition are not unlimited. Perhaps it will help convey the thought if I indicate that one journalist has described residual as the "waste or garbage" of refining. It is this "garbage" now being dumped on the eastern seaboard at an unprecedented rate that is directly competitive with coal and is causing the debilitation and unemployment to which I have referred.

Residual is now being imported at twice the rate of importation in 1949. This factor is demonstrably evident from the figures which show that over 39,400,000 barrels of residual were directly imported in the first 4 months in 1950 compared with 19,987,000 barrels in a comparable period in 1949

Furthermore, the increasing percentage of residual in the total importation can be gathered from the fact that in the 4-month period in 1950, residual represented 40 percent of the total importation while in the comparable period in 1949 it was 28 percent.

Direct importations of residual as such do not tell the whole story. Additionally, the large companies that control the importing industry have concentrated on an importation of heavy crude which has the maximum residual yield. For example, it is our estimate that of the 56,444,000 barrels of heavy-grade crude imported in the 4 months of 1950 a sizable percentage became residual after refining in this country.

If our estimates are correct, this has unleashed on the market to displace bituminous coal a total of 50,000,000 barrels of residual oil comprised of the 39,000,000 imported as such plus that which was refined in this country from imported crude and is additional to what would have been obtained from American crude.

It can easily be seen that from the coal standpoint the primary cause of the disturbance and the item most immediately requiring the attention of the Congress is the direct and indirect residual importation.

The continuing increase in over-all oil importation and in the residual content of the importation demonstrates that the importers are ousting and displacing domestic production. They are violating their self-expressed policy of supplementing rather than supplanting domestic production. Their tactics have caused us to lose confidence that any voluntary restrictions will be applied. Accordingly, legislative action by the Congress is required.

With the permission of the committee, I would like to reserve the privilege of filing a fuller statement with the committee prior to the close of these hearings.

Mr. LAMB. My statement, Mr. Chairman, has the endorsement of the United Mine Workers, the eastern railroads, the Brotherhood of Railway Trainmen. These and also the Independent Petroleum Association and others presented materials in the recent Neely hearings essentially similar to the principles in the statement that you have before you.

Because of the limitation in time and a desire to cooperate with the committee, I shall be glad not to read my prepared statement but shall file it for the record in support of our request for a tax of $1.05 per barrel on imported oil. Or, I shall be glad to present my statement in any way you wish, sir.

The CHAIRMAN. Your statement will go in the record. You may present whatever you wish to supplement it.

Mr. LAMB. I believe I have nothing else to add, sir, except that it is a somewhat detailed problem. I would be glad to summarize, if you wish.

The CHAIRMAN. Yes sir; we shall be glad to hear you.

Mr. LAMB. Briefly, the coal industry feels that it needs a fair competitive opportunity to maintain its continued availability and is asking for relief in the form of increased taxes on foreign oil coming into this country.

The CHAIRMAN. Did you also ask for an increase in the percentage depletion allowance?

Mr. LAMB. Yes, sir; there was an adjustment in the percentage depletion that has been worked out. There is a varying rate as

between the several extractive industries and an adjustment was asked on that.

The CHAIRMAN. The House bill gave you an increase?

Mr. LAMB. Yes, sir; that was increased from 5 percent to 10 percent.

Senator MILLIKIN. Would you object to a quota as distinguished from an additional tax or perhaps both an additional tax and a quota?

Mr. LAMB. No, sir. What we would like to get would be relief from the foreign oil, whether it is obtained by quota limitation or tax. The reason the tax policy was followed was that this problem got rather serious in more recent months and it seemed to be the more expeditious way to handle it. Separate legislation, particularly at this time, and particularly in the last few months, I may say would have been very difficult.

The CHAIRMAN. The abrogation of the Mexican Trade Treaty affects the rate, does it not?

Mr. LAMB. Yes. About 6 months hence it will increase the rate, which has been 10½ cents per b rrel, to 21 cents per barrel. That will become effective around the first of next year.

Senator MILLIKIN. Do you feel that the hearings to which you referred made a pretty sound case for the $1.05 differential?

Mr. LAMB. A great deal of detail was presented by members of the oil industry, the coal industry, railroads and various labor groups. I think they have a very sound record, sir.

Senator CONNALLY. You said $1.05 a barrel. You mean on imported oil?

Mr. LAMB. On all imported oil; yes, sir.

Senator KERR. Crude or refined?

Mr. LAMB. Crude or refined.

Senator CONNALLY. As Senator George pointed out, the suspension of the Mexican Trade Treaty will have the effect of increasing the duty on Mexican oil, will it not?

Mr. LAMB. Yes, sir; and I believe, Senator, that also applies to other foreign oil because of the relationship of the treaties made at the particular time. Twenty-one cents, as I remember, originated in the 1932 Tariff Act and as a result of the Trade Treaty Act in 1939, which was the Venezuelan Agreement and followed by the Mexican Agreement and later by the agreement formulated in Geneva, all oil products had a reduction in the schedule as against the original schedule. As I remember, in most all cases they are given the right to cut the tariff in half when these treaties are established.

Senator TAFT. It is now 10½ cents?

Mr. LAMB. It is now 10½ cents, that is right, sir.

Senator TAFT. The Venezuelan Agreement brought it down from 21 cents to what?

Mr. LAMB. That brought it down from 21 cents to 10½ cents.

Senator TAFT. Then the Mexican Treaty has nothing to do with it?

Mr. LAMB. I may not be too clear on this, Senator, but I understand that these treaties are all related. As a result of the Mexican Agreement where the reduction had been made previously it was extended to other commodities.

Senator TAFT. Yes, but the denunciation of the Mexican Agreement because of the Mexican failure to comply with it is not going to void the Venezuelan Agreement and the Venezuelan Agreement will still be in effect. I do not think there will be any increase in tariff

by reason of the abrogation of the Mexican Agreement. Of course 10½ cents is not anything today; it is negligible.

Mr. LAMB. That is right, sir.

The primary factor in the imports of oil as far as the coal industry is concerned pertains to residual fuel oil. It is the residue or waste product which is left to the oil industry after gasoline and other refined products are derived from the crude.

Now during the first 4 months of 1950 residual oil was imported at twice the rate of importation in 1949. I might add that residual oil is burned under boilers in the same manner as coal and competes directly with coal. The importation of this product means that it is displacing coal and of course, as to coal, we have centuries of reserve in this country.

Senator MILLIKIN. The same thing occurs even if it does not come in as residual oil. If you bring in natural oil, in its natural state, you break it down into residual in this country, the effect is exactly the same?

Mr. LAMB. That is true.

Senator TAFT. The claim is that it is not. They claim the other way. Our total production of oil is determined by the demand for lighter products and if we do not import it, we make it here and we have about the same amount of residual oil; but there is a substantial displacement of coal anyway, no matter which way you figure it.

Senator MILLIKIN. I repeat that in the process of refinement you vary your products according to your market but you always have residual oils and they are used in competition with coal.

Mr. LAMB. That is true, sir.

Senator MILLIKIN. The same is true whether you bring in the whole oil or whether you bring in fractionated oil.

Mr. LAMB. Some of the crude oil imported is of a low grade, that is, heavy crude oil which gives a large yield of residual oil. For example, in the refineries in Venezuela and the Netherlands East Indies the yield from the crude is 60 percent residual, while in this country the yield is only 20 percent.

Senator MILLIKIN. It depends on the gravity of your oil. If you have heavy oils, you have larger residual; if you have light oils, you have less residual. You can break light oils into more gasoline than you can heavy gravity oil; is that not true, Senator Kerr?

Senator KERR. The percentage of residual oil depends on two factors, whether it is light or heavy gravity, asphalt base. On the other hand, the refining process, whether it is what we call a skimming process or cracking process, one takes off 15 to 30 percent in lighter fractions and the other takes off 75 percent in lighter fractions.

Senator MILLIKIN. It depends on what you set out to make and you set out to make according to the market.

Mr. LAMB. That is true.

Senator KERR. What is the total production of coal for 1948 and 1949 and the present rate? I would rather have you answer it in terms of consumption.

Mr. LAMB. In 1948 the consumption plus exports was about 570,000,000 tons.

Senator KERR. What part of that was exported?

Mr. LAMB. The exports were about 45,000,000 tons of the total.

Senator KERR. That means that the local consumption was 5,000,000 tons.

Mr. LAMB. Yes, sir; that is true. In 1949 the consumption plus exports was 475,000,000 tons, of which about 30,000,000 tons were sold in the form of export coal.

Senator KERR. Four hundred and forty-five million tons domestic consumption compared to five hundred and twenty-five million tons in the year 1948.

Mr. LAMB. That is right, sir.

Senator KERR. What is your estimate of the domestic consumption for 1950?

Mr. LAMB. It has been estimated that it will run somewhere between 450,000,000 tons and 475,000,000 tons. In fact, one trade group in the industry estimated that it may go as high as 500,000,000 tons because of recent developments.

Senator KERR. What do you figure that your exports will amount to this year?

Mr. LAMB. The exports this year will amount to nothing practically except the movement to Canada.

Senator KERR. The movement to Canada is relatively small?

Mr. LAMB. Yes. The movement to Canada will probably total about 20,000,000 tons.

Senator KERR. That was the principal export for last year, was it not?

Mr. LAMB. That is right, sir.

Senator KERR. This reduced rate of domestic consumption is an actuality in spite of the enormous increase in the domestic industrial production generally?

Mr. LAMB. Yes, sir; that is true.

Senator KERR. This means that your normal market is being gradually replaced by fuel oil?

Mr. LAMB. That is true.

The CHAIRMAN. The crude now has a half cent per gallon tariff, has it not?

Mr. LAMB. I believe it is 10½ cents a barrel. Section 3422 in the Code reads:

> Fuel oil derived from petroleum, gas oil derived from petroleum, and all liquid derivatives of crude petroleum, except lubricating oil and gasoline or other motor fuel, one-half cent per gallon; gasoline or other motor fuel, 2½ cents per gallon; lubricating oil, 4½ cents per gallon; paraffin and other petroleum wax, 1 cent per pound.

The CHAIRMAN. Your information is that the abrogation of the Mexican Treaty will bring all the other importers back in line with the 21-cent rate but not until January?

Mr. LAMB. I understood that. I might say that I am no expert on that particular phase, sir.

The CHAIRMAN. Can you tell us the real reason for the increase in the percentage depletion in the case of coal? Is it because of the fact that coal has an enormous labor cost?

Mr. LAMB. No. I think the original intention of the depletion provision was to promote exploration and development. In coal there is quite a cost involved in that. For example, it takes on the average for a full-scale mine from 2 to 3 years to get it under full development. During that period you may run into conditions which are quite ad-

verse to your operation, bad roof conditions, water conditions, and other things. Often a mine, after they have tried to develop it for 3 years, may be abandoned. It is the same as in the case of oil or other types of mining; you have those hazards.

The CHAIRMAN. The House gave a double percentage depletion for coal and I was curious to know the reason for it.

Mr. LAMB. I understood one of the considerations in connection with that was the relation of the coal depletion rate with the rate in other extractive industries and coal had asked for an adjustment more in line with some of the other extractive industries which have a higher rate.

Senator KERR. Equalization.

Mr. LAMB. It is not quite equalization but more in line; it is an adjustment of the rate.

Senator CONNALLY. Coal is competitive with oil and naturally your industry is trying to improve its own condition all it can?

Mr. LAMB. That is correct.

Senator CONNALLY. An increase in percentage depletion will help to do that?

Mr. LAMB. That is right, sir.

The CHAIRMAN. I suppose, Mr. Lamb, some of the difficulties of the coal producers are due to the internal situation in the United States, are they not?

Mr. LAMB. That may be true. In connection with the imports the development came at a time when we had a relatively good situation in this country.

Senator KERR. Would you not say that the reduction in the domestic consumption of coal is pretty closely tied to the amount of importation of either residual oils as such or the residual oils made from imported crude?

Mr. LAMB. Certainly the shrinkage in the coal market during the last 2 years is related closely to the import situation.

Senator KERR. One just about offsets the other?

Mr. LAMB. Yes, sir.

Senator KERR. To the extent that importation has existed and increased, the domestic consumption of coal has decreased?

Mr. LAMB. That is right, sir.

Senator TAFT. Do you think that is true? Do you not think there would have been a substantial reduction in the use of coal even if there had not been any imports at all?

Mr. LAMB. I agree with that. I was talking about the general relations. Yes, there was a decline of business activity last year.

Senator TAFT. Not only that, but it is due to the tremendous increase in the use of oil in Diesel engines on the railroad and in other fields, to some extent in homes, but I was surprised to learn how little in home use.

Senator KERR. I think the record will substantiate this conclusion, that the normal increase that has taken place in the over-all consumption of fuels has been more than the increase in the consumption of the oil and gas as fuel, and contemplating that offsets that increase there I think the record will disclose that the actual reduction in the domestic consumption of coal is in almost exact terms with the amount of residuals obtained by direct importation and extracted from imported oil.

The CHAIRMAN. If there are no further questions, why we thank you very much, Mr. Lamb, for your appearance.

Mr. LAMB. Thank you, sir.

Senator MILLIKIN. I suppose all the other members of the committee have received a lot of telegrams regarding the transportation cost as an element in percentage depreciation, transporting the oil, for example, to a cleaning plant, transporting minerals to an extraction plant. Will there be witnesses on that, may I inquire?

The CHAIRMAN. I do not know, Senator. There are several witnesses and some of them may cover that point. I think perhaps some of them will.

The next witness is Mr. H. A. Schumacher.

STATEMENT OF H. A. SCHUMACHER, VICE PRESIDENT, GRAFLEX, INC., ROCHESTER, N. Y., REPRESENTING THE NATIONAL ASSOCIATION OF PHOTOGRAPHIC MANUFACTUERS, INC.

Mr. SCHUMACHER. Mr. Chairman and members of the committee, my name is Howard A. Schumacher. I am vice president of Graflex, Inc., Rochester, N. Y. I represent the National Association of Photographic Manufacturers, Inc., whose member companies produce more than 90 percent of the total volume of photographic products of all kinds and types manufactured in the United States.

To conserve the time of the committee may I have permission of the chairman to submit for inclusion in the record our documented brief which presents specific, factual information concerning the extremely harmful, repressive and discriminatory effects of the present excise-tax law applicable to photographic products.

The CHAIRMAN. Yes, sir; you may do so.

(The brief referred to follows:)

NATIONAL ASSOCIATION OF PHOTOGRAPHIC MANUFACTURERS, INC.,
New York, N. Y., July 7, 1950.

COMMITTEE ON FINANCE,
United States Senate, Washington, D. C.

IN THE MATTER OF THE MANUFACTURERS' EXCISE TAXES ON PHOTOGRAPHIC APPARATUS (SEC. 3406 (A) (4) I. R. C.)

GENTLEMEN: This association, whose member companies produce more than 90 percent of the total volume of photographic products of all kinds and types manufactured in the United States, respectfully presents, on behalf of this industry, information concerning the extremely harmful and repressive effects of the present excise-tax law applicable to photographic products. We sincerely believe that the facts set forth herein not only merit your most serious consideration but also point to the necessity of prompt relief if further and more serious irreparable injury to this industry is to be avoided.

In particular, and by way of summary, may we call your attention to the following facts:

1. The photographic excise tax rates—namely, 25 percent on photographic equipment, machinery, and apparatus and 15 percent on sensitized papers, plates, and films—are excessive. The 25 percent rate in particular is 2½ times the generally prevailing rate of manufacturers' excises.

2. The photographic excise taxes are principally a burden on industry, science, education, and government, over 60 percent of these taxes being a cost of doing business to the purchaser. These taxes apply to livelihood tools, production equipment, and operating supplies of many thousands of establishments throughout the country. The Federal Government itself pays about $2,000,000 (about 5 percent) of the total collections.

3. The present high rates were the first of the penalty regulatory wartime excises. You are aware, however, that photographic products were singled out in the Revenue Act of 1942 and that these increased wartime rates thus become

effective a year and 5 months before the other so-called wartime excises which were enacted in the Revenue Act of 1943. In fairness, they should be the first to be corrected.

4. The photographic manufacturing industry has suffered losses in employment and in sales of an extremely serious nature, many times more seriously than industry in general. As might be expected, the most serious losses are related to products subject to the 25 percent rate of tax, where sales and employment are off about 40 percent for the year 1949 versus 1948.

5. The photographic manufacturing industry is a key strategic industry. Its specialized plants, machinery, and highly skilled and specialized personnel are a major national asset and cannot be expanded rapidly to meet a national emergency. The losses already experienced have clearly endangered the ability of this industry to serve with full effectiveness in an emergency.

6. The photographic excise-tax law involves special inequities and injustices beyond and above those associated with any other excise to our knowledge. In particular, it taxes many general-use products at 25 percent when sold by a photographic manufacturer, even for nonphotographic uses. Identical or comparable products sold in the smae markets fro the same uses by nonphotographic manufacturers are tax-free, even when sold for photographic use.

7. The dollar amount of this tax on a single unit of purchase is often very considerable. Especially as to the 25 percent rate of tax, it is not uncommon for one piece of equipment to involve a tax of $1,000 or more. These taxes, therefore, constitute a substantial drain on working capital and operating funds and curtail employment opportunities not only in the photographic manufacturing industry but in the industries which employ photographic methods and processes.

8. These taxes impose a special burden on retailers and distributors of photographic products in that they must tie up appreciable sums of their working capital in payment of tax on goods in stock.

9. A composite tax and profit-and-loss statement provided confidentially to the committee shows, as to companies whose products are principally or wholly subject to the 25 percent rate of tax, that these companies as a group have gone from a satisfactory profit position to a loss position. These data would indicate that, as to goods subject to the 25 percent rate of tax, there will be a loss to the Federal Government, 1949 as compared with 1948, in Federal corporate income, withholding, old-age benefit, and photographic excise taxes of more than $16,000,000. This probably nearly equals the total collections which will be made at that rate.

10. It is inevitable under such distressing conditions as set forth herein that a number of small and medium-size concerns have either failed or are in financial difficulties, with the ultimate outcome in serious doubt.

11. The revenue to the Government from these taxes is slight, but they impose a tremendous and disproportionate hardship on manufacturers, wholesalers, retailers, and users of photographic products.

12. The injury already caused is real and serious and the need for relief is most urgent.

The following information is in elaboration and support of these points and provides pertinent material as to the industry and its products:

I. GENERAL COMMENTS

Since October 1, 1941, the photographic manufacturing industry, its sales outlets, its customer industries, and other product users have been handicapped seriously by the inequitable and discriminatory situations arising from the phraseology of the present photographic excise tax law. At that time, in the Revenue Act of 1941, 10 percent manufacturers' excise taxes were applied to various products including photographic equipment and sensitized goods.

Then, in the Revenue Act of 1942, photographic excises were singled out for heavy increases, while such taxes on other manufactured products were either eliminated (7 instances) or maintained at 1941 levels (19 instances).

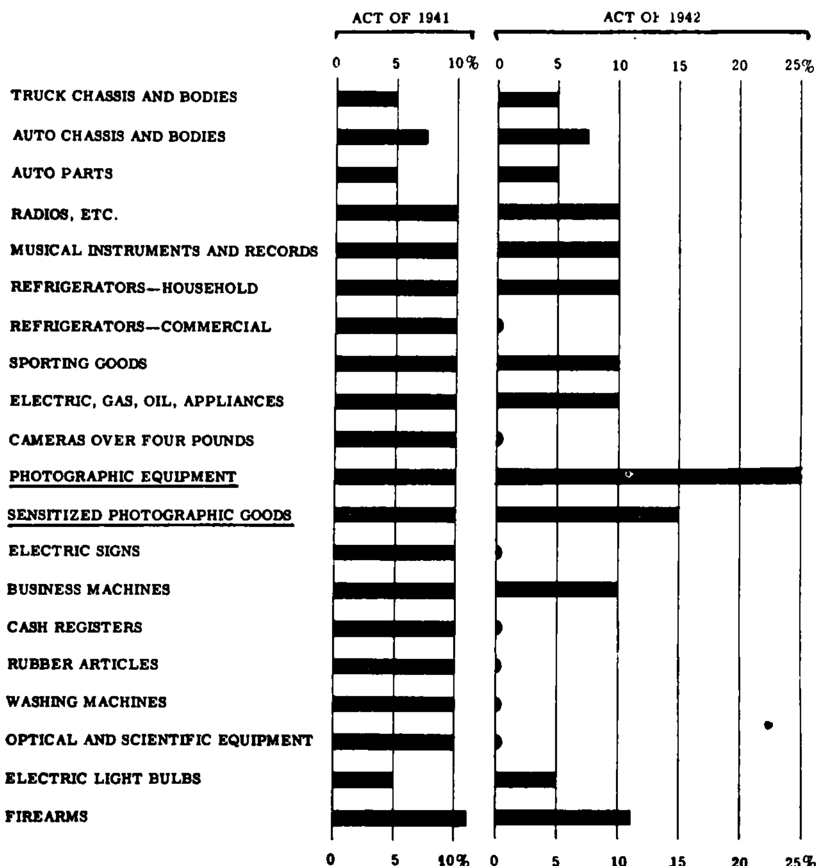
Thus, since November 1, 1942—a year and 5 months before the general list of so-called wartime excise rates were applied—this industry and those it serves have been burdened with excessively high excise rates; 25 percent on equipment, machinery, and apparatus, and 15 percent on sentized materials—films, papers, and plates.

Either of these factors—that is, (1) the phraseology or (2) the high rates—would be detrimental to any industry. The combination of these two adverse factors as applied to this industry has not only seriously impeded its normal growth and expansion but, more than that, especially in the area of products subject to the 25 percent tax and especially with respect to many of the smaller companies who are specialists therein, has resulted in a major depression.

In the Eightieth Congress we appeared before the House Ways and Means Committee and submitted evidence in support of our contention that these high rates of taxes had already caused some injury to the industry. Our greatest concern, however, was that the conditions complained of would become progressively worse unless the requested relief was promptly provided. We also pointed out that these high rates of tax would greatly accentuate the effect on this industry of any period of recessing such as, in our opinion, we could then foresee.

In an unanimous report that committee, after extensive hearings on excises, recommended to the House of Representatives the passage of bill H. R. 4259, stating that the amendments to the photographic excise-tax law provided therein would relieve one of the most acute excise tax hardship cases that had come to its attention. Although the bill was passed by the House, it did not come up for vote in the Senate. This industry therefore remains in the unenviable position of being subjected, in a wide product area, to special discrimination and inequity.

EXCISE TAXES PENALIZE PHOTOGRAPHIC INDUSTRY IN RELATION TO OTHER INDUSTRIES



Note that in the Revenue Act of 1942 excise taxes were eliminated on seven categories, while photographic equipment and sensitized goods were singled out alone to bear the brunt of extremely high rates of 15 percent and 25 percent. This occurred 1 year and 5 months before any of the so-called wartime excises were applied. See table I for data, including Revenue Act of 1943.

TABLE I.—*Changes in United States excise taxes on manufactured articles, excluding alcoholic beverages and tobacco, 1940 to date*

Articles	Prior to Revenue Act of 1940	Revenue Act of—			
		1940	1941	1942 [1]	1943 [2]
Tires, per pound	2¼ cents	2½ cents	5 cents	No change	No change.
Tubes, per pound	4 cents	4½ cents	9 cents	do	Do.
Toilet preparations	10 percent	11 percent	10 percent (retail).	do	20 percent (retail).
Truck chassis and bodies	2 percent	2½ percent	5 percent	do	No change.
Auto chassis and bodies and motorcycles.	3 percent	3½ percent	7 percent	do	Do.
Auto parts	2 percent	2½ percent	5 percent	do	Do.
Radios, etc :					
Radios	5 percent	5½ percent	10 percent	do	Do.
Records and musical instruments.			do	do	Do.
Refrigerators, etc.:					
Refrigerators (household)	5 percent	5½ percent	do	do	Do.
Refrigerators (commercial)			do	0	Do
Self-contained air-conditioning units.			do	No change	Do.
Sporting goods			do	do	Do.
Luggage			do	do	20 percent (retail).
Electric, gas, and oil appliances					
Electric, gas, and oil appliances.			do	do	No change.
Vacuum cleaners (household).			do	do	0.
Photographic apparatus.					
Photo equipment			do	25 percent	No change.
Cameras over 4 pounds			do	0	Do.
Sensitized goods			do	15 percent	Do.
Electric signs			do	0	Do.
Business and store machines:					
Business machines			do	No change	Do.
Cash registers (retail-sale type).			do	0	Do.
Rubber articles			do	0	Do
Washing machines			do	0	Do.
Optical equipment			do	0	Do.
Electric-light bulbs			5 percent	No change	20 percent.
Jewelry			10 percent (retail).	do	20 percent (retail).
Furs			do	do	Do.
Firearms (including pistols and revolvers.	10 percent	11 percent	No change	do	No change.
Matches					
Plain			2 cents per M.	do	Do.
Fancy wood	5 cents per M	5½ cents per M.	No change	do	Do.

[1] Effective Nov. 1, 1942.
[2] "Wartime" excise taxes effective Apr. 1, 1944.

II. FACTS ABOUT THE PHOTOGRAPHIC INDUSTRY

The following information about the photographic industry, its products and their applications, may be of interest to the committee:

1. Nature of the industry

The photographic manufacturing industry is small. Because of the very highly specialized nature of its products and their essentiality in wartime it is one of the key strategic industries.

Most of the companies in the industry are small, but their continued success is of the greatest importance to the strength of the industry and to its ability to serve in both peacetime and wartime.

There are, according to the best information available to us, about 150 companies in the United States engaged wholly or importantly in the manufacture of photographic products, or which, though not principally so engaged nevertheless produce in some significant volume one or more photographic products. The 1947 Census of Manufactures records 366 establishments with a then total of 50,911 employees and a total value of products shipped of $440,134,000.

Photographic manufacturing plants are principally located in these States: California, Connecticut, Delaware, Illinois, Indiana, Iowa, Massachusetts, Michigan, Minnesota, Missouri, New Jersey, New York, Ohio, Pennsylvania, Wisconsin, with scattered plants in some other States.

There are thousands of establishments in other branches of the photographic industry, namely, photographic distributors, photographic retailers, photo-finishers, commercial, industrial, and professional photographers, and such related industries as photoengraving, photolithography, and others. These other branches of the photographic industry and related customer industries provide gainful employment to thousands of persons in every State in the Union.

2. Nature of products and applications

This industry is principally engaged in the manufacture of photographic products which, in dollar volume and in application, are preponderantly (nearly two-thirds) for commercial, industrial, educational, scientific, professional, governmental and similar uses.

It should not be overlooked, however, that sales to amateur photographers are also very important to this industry and its continued success. In fact, certain plants which are key precision plants in wartime depend substantially upon this market for their peacetime operation and therefore for their availability to serve in wartime. In this connection it should be emphasized that these precision photographic manufacturers with their highly skilled and specialized personnel and machinery are a major national asset which cannot be expanded rapidly to meet a national emergency.

3. Industry of key strategic importance

It cannot be too strongly emphasized that the photographic manufacturing industry is one of the Nation's most essential key strategic industries. Its photographic products in tremendous volume are absolutely essential to successful military operations in modern warfare before, during, and after combat, for essential industrial uses in the production of other war matériel and for many essential noncombat military needs. During World War II, no major military action—by land, sea, or air—was undertaken without thorough photographic reconnaissance of the enemy.

The Munitions Board (Allocations Manual, March 1950) lists photographic lenses and still and motion picture sensitized materials in its limited list of "basic and potential bottleneck items", the production of which is vital in time of war.

In fact, photographic products are as essential to national security as tanks and planes. These specialized materials can be made only by the photographic manufacturing industry with its highly specialized facilities and personnel.

Please allow us to emphasize again the important fact that this industry's specialized plants, machines and personnel cannot be rapidly expanded to meet a national emergency. Yet despite its key strategic importance, the industry's vigor is being steadily sapped by an unjustifiable harsh excise tax.

In addition to the foregoing, because of the peacetime-developed skills of its employees, the photographic industry was also called upon during World War II to produce large quantities of high-precision, complex war equipment of a nonphotographic nature.

A War Munitions Board report (March 1948) stated that during World War II, 72 percent of the products of the photographic industry went to essential military claimants. Half of these products for military uses were regular photographic products. The remaining 28 percent of the industry's wartime production went to nonmilitary claimants. This included materials for use by war industries in military production, by scientific laboratories, by local government units, and by civilians.

4. Wartime uses of photographic products

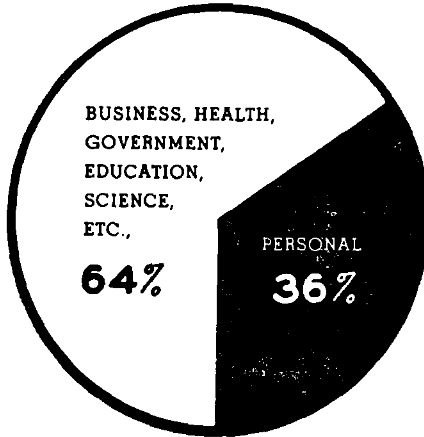
Perhaps a brief outline of the manner in which the products of the photographic industry were used by the military and war industries during World War II may help to illustrate the importance of the photographic industry to national security.

A. *Photographic products for tactical military purposes.*—(i) Aerial photography—used in connection with almost every military operation, photographs taken from any height—day or night.

(*a*) Mapping—aerial photographs to provide up-to-the-minute maps of absolute accuracy for all ground and air operations and for naval operations against shore installations. Photographic processes are used to produce these maps in large volume for use by every member of combat teams.

U. S. PHOTOGRAPHIC INDUSTRY DISTRIBUTION BY USE OF PRODUCTS

PEACETIME
(1949 ESTIMATE)



WORLD WAR II
(SOURCE - WAR MUNITIONS BOARD)

NATIONAL ASSOCIATION of PHOTOGRAPHIC MANUFACTURERS, INC.

(*b*) Reconnaissance of enemy positions on land or sea—location and movement of enemy troops, artillery and supplies; location and identification of enemy factories and other points for bombing, irrespective of the extent to which such points have been camouflaged.

(*c*) Assessment of damage to enemy targets by aerial bombing or by gunnery attacks. Photographs are practically the only source of accurate assessment of damage inflicted to enemy installations.

(ii) Gun-sight cameras and film—the peacetime 16-millimeter motion-picture camera using magazine film, with rather simple conversion becomes the highly important gun-sight camera. The gun-sight camera is synchronized with the guns and rockets on all combat aircraft, and accurately records the damage to enemy planes and surface objectives resulting from combat and strafing activities. The gun-sight camera is also used extensively in place of live bullets for training combat pilots.

(iii) Submarine periscope cameras—simple adaptations of peacetime cameras are used to record damage from the submarines' torpedos or guns and to make photographs of enemy shore installations while the submarine remains under water.

(iv) General—photographic units attached to almost every combat unit record engagements with the enemy for many tactical purposes.

B. *Other uses of photographic products by the military.*—(i) Medical—X-ray, electrocardiograph and comparable products for medical purposes.

(ii) Training of combat troops—still or motion picture photographs of actual or simulated combat operations used extensively to speed up time required to train troops for combat.

(iii) Morale.

(*a*) V-mail for rapid transportation of letters from home.

(*b*) Motion pictures for entertainment of troops.

(*c*) Photographs of the folks at home.

C. *Uses of photographic products by war industries.*—(i) Production of engineering drawings.

(ii) Pattern making—photographic methods of templet making were credited with getting the B–29 into production months earlier than otherwise possible.

(iii) High-speed photographs for study of equipment performance and flight phenomena.

(iv) Other—metallography, X-ray inspection of metal parts, stress analysis, ballistics, location of oil deposits, etc.

D. *High precision nonphotographic war equipment.*—The photographic industry also supplied a large volume of many types of high precision optical and mechanical products of a nonphotographic nature to the military during World War II.

For example, the industry was the primary source of the proximity fuse which was second in importance to the atomic bomb. This fuse, which explodes a shell when it is just close enough to its target for the burst to be most effective, helped knock down the V bomb over Britain; was a major factor in beating back the von Rundstedt bulge; and enabled the American Fleet to approach Japanese-held islands in spite of attacking planes.

Some of the other important high-precision products were height finders ("described by Ordnance officials as the most intricate and complicated optical instrument in the entire field of Ordnance fire control"); range finders; telescopes; drift meters; mechanical time fuses; naval gun directers; binoculars; aircraft fire control equipment; radar chart projectors; rocket launchers; periscopes; high-frequency aircraft radio condensers; and many other items.

5. Especially serious effect of 25 percent tax

The losses already experienced in the area of equipment and apparatus—the 25 percent taxed goods—have clearly endangered the ability of this industry to serve with full effectiveness in any sudden emergency. It cannot be stated too strongly that it is a relatively small number of establishments and employees which constitute the key strategic industry for the production of precision photographic equipment and also such other urgently needed items as height finders, range finders, proximity fuses and other highly specialized and unique precision-made products without which modern warfare could not be effectively carried on.

As for the photographic manufacturing industry as a whole, it seems self-evident that it cannot retain or expand its normal peacetime markets so long as the present highly repressive rates of excise tax are imposed on the sale of photographic products. The very real danger to national security resulting from the effects of this tax is too high a price to pay for the small net revenue produced by the tax.

6. Normal uses of photographic products

It is in very substantial measure that photographic products presently taxed at 15 percent are in the nature of operating supplies and many of those taxed at 25 percent are livelihood tools, machinery, and equipment comparable in usefulness to hand tools, machine tools, linotype machines, and printing presses, none of which are subject to any excise tax. The following is a brief list of some of the industrial, business, scientific, and other activities in which photographic products and applications play an important part. These are but a few of the many which might be cited:

Reproduction of documents, records, drawings, etc.; photocopying and microfilming to preserve records and conserve space;
Preparation of manuals, sales, production, training manuals·
Publishing illustrations (produced or reproduced by photographic methods) are a "must" in magazines, textbooks, trade journals, newspapers, etc.
Study of performance to eliminate "bugs" and develop improved products and processes, e. g.: discovery of erratic motion; time study and work analysis; airplane take-off and flight study; mechanical vibration and wear; gun firing and projectile phenomena;
Metallography: metallurgical laboratory control tests; Ingot photography (spectography);
Photomicrography, the electron-microscope and the large observatory telescope cannot function without photography;
Engineering analysis and inspection;
Production of dials and scales for instruments and other purposes;
Pattern making, photographic methods of pattern making were credited, during the war, with getting new types of aircraft into the air 4 months earlier than would have been possible otherwise;
Plant protection, identification badges, etc.;
Personnel training, sales, production, safety, and other;
Education: visual education through use of films and slides;
Mapping aerial surveys (contour mapping, city and highway planning, soil erosion control, etc.);
Geophysical survey: location of oil deposits, etc.

Competent market research indicates the greatest probable sales expansion for this industry to be in the fields of industrial and business use, but it is very evident that this expansion is being seriously impeded by the present excise tax law and high tax rates.

III. INEQUITY AND DISCRIMINATION

The photographic manufacturing industry is in the unenviable position of having its products subject to rates of excise which are one-and-a-half times and two-and-a-half times the highest generally prevailing rate of manufacturers excise and, in addition, to a special inequity which is, as far as we know, absolutely unique in the entire excise tax structure.

1. Phraseology of law makes inequity and discriminatory application unavoidable

The phraseology of the present law (sec. 3406 (a) (4) I. R. C.) which taxes "photographic apparatus and equipment and any apparatus or equipment designed especially for use in the taking of photographs or motion pictures, or in developing, printing, or enlarging photographs or motion pictures" does not provide any definite or adequate basis for determining which articles may be classified as photographic. In fact, the factors which the law offers for determining which products fall within its scope are so intangible that it is impossible, even at this late date, for the industry or the Government to determine a clear line between taxable and exempt products.

Hundreds of rulings have been issued by the Bureau of Internal Revenue with respect to the application of the photographic excise tax to specific products. However, numerous articles remain in a doubtful position with respect to the tax.

In many product areas application of the tax has placed the manufacturer in a most inequitable competitive position. Except for a few products that are basically photographic, such as cameras and sensitized materials, the items taxed under the photographic excise tax law are not unique to the photographic field but are used extensively in other occupations and trades

For example, products such as tripods, trays, rollers, timers, squeegees and lighting equipment are widely marketed for non-photographic purposes. When such items are sold by the nonphotographic manufacturers they are free from tax, even though they may be sold for photographic use, but when sold by the

acknowledged manufacturer of photographic products they are subject to excise tax even though sold for a nonphotographic use.

The acknowledged manufacturer of photographic products is, therefore, placed at a tremendous, if not impossible, competitive disadvantage when he must try to sell his products, taxed at 25 percent, in photographic or non-photographic fields against the competition of untaxed products of a like nature marketed by the non-photographic manufacturer in these same fields of use.

2. Impact of high rates

It is evident that the high rates of photographic excises are effectively discouraging expansion in new applications for photographic products, in the replacement of equipment and modernization of establishments employing photographic processes, in basic sales of photographic products, and we believe to a more serious degree is more and more permitting non-photographic manufacturers to take away certain markets previously available to the photographic industry by reason of the conditions set forth above.

The extremely high level of tax on equipment materially and artificially accelerates the process of pricing goods out of the market. For example, if a manufacturer's selling price of an article was once $100 and, because of increased labor and material costs, it becomes necessary to increase the selling price to $130 without tax, it becomes necessary to increase the selling price with tax from $125 to $162.50. This represents an increase of $37.50 to cover a real increase of $30 in the manufacturer's selling price of the article.

It is also very important to note that the tax spreads by 25 percent (to the disadvantage of the American manufacturer) any price advantage enjoyed by photographic importations and this type of competition is becoming increasingly serious. In this connection, it should be pointed out that wages are a major element of cost in the production of photographic equipment and the skilled labor wage rate in the production of foreign cameras and other photographic equipment is reported to be well below our minimum hourly wage for unskilled labor as established by legislation. Further, the photographic industry in most foreign countries is granted special concessions by their governments (or occupying forces) to encourage development and exportation of their products. In some instances the industry has been given an outright subsidy.

Because most of the manufacturers within the photographic industry are relatively small and have no large reserves of capital, they are unable readily to divert their production facilities and abilities into non-photographic fields where the tax is not a factor. Further, it is highly undesirable that they do so. For the same reason they are not able to withstand a protracted period during which their goods do not move in fair volume at reasonable prices.

The over-all repressive effect of the tax on photographic products is to render this industry and other industries substantially dependent on photographic products or processes less attractive to new capital. In a number of specific instances it has been the decision of manufacturers already within the industry that new plants or replacement of old equipment cannot be justified while the present excise taxes exercise the generally repressive effect now very evident.

The scientific progress and general advancement of the industry is being retarded also because the Internal Revenue Code and regulations require the payment of 25 percent excise tax on many items of equipment specially designed and constructed by a manufacturer for use in his own plant even though such equipment is never intended or offered for sale. The tax on a single unit of such equipment often exceeds $5,000, certainly a factor for the serious consideration of management facing an unstable and, in many product areas, a declining parket.

Ties up working capital

These taxes, being at the manufacturer's level, impose a special burden on retailers and distributors of photographic products in that they have appreciable sums of their working capital tied up in the payment of tax on goods in stock. This works a particular hardship because of the high rates and because of the high dollar amounts which are involved. They result in a heavy loss in connection with any goods which must be disposed of at sale prices, since the full amount of the excise still applies.

As to the photofinishers and professional and industrial photographers, the 15 percent tax on sensitized goods and the 25 percent tax on their essential processing equipment again makes inroads upon working capital and operating funds. The 25 percent rate of tax on capital outlay for essential processing equipment and machinery required by photofinishers, photoengravers, lithographers and by

the photographic departments of newspapers and periodicals and of business in general, is similarly restrictive and undesirable. These taxes serve to d'scourage plant expansion and modernization and new establishments.

4. Tax hits public

Approximately 36,000,000 of the 50,000,000 family units in the United States own a total of 56,000,000 cameras. Five-sixths of this ownership is in families with income of $5,000 or less per year.

These millions of users feel the repeated impact of the photographic excises which tax and tax and tax. In fact, it is a further inequitable and burdensome feature of these excises, not common to other manufacturers excises, that both equipment and supplies are taxed.

With most excise-taxed products, once the product is purchased and the excise is paid, its use can then be enjoyed without payment of further excises.

Not so with the photographic excises. First, the camera and other equipment and accessories involved in taking the picture is taxed. Then the camera must be supplied with film or plates which are taxed. Then the film or plates must be processed in equipment that is taxed, then, if prints are involved, they must be made on paper or film which is taxed, in equipment which is taxed. Then, in turn, these must be processed in equipment which is taxed.

This necessity of providing other taxed equipment and constantly providing taxed supplies in order to make use of the original taxed product thus places a further inequitable and discriminatory burden of this industry and its millions of customers. This, plus the high rates, serves to emphasize and explain the special sales-deterrent characteristics of the photographic excises.

IV. INDICATIONS OF INJURY

In the following material we have endeavored to develop and present for the committee data which would serve to indicate the degree of injury being experienced by the industry:

Although the 15 percent rate has caused injury, as might be expected it is in the product area taxed at 25 percent that the greatest losses are recorded. We have therefore provided data not otherwise available on this phase of the problem.

We do not contend that these excises are responsible for the entire loss of employment, sales, and reduction of profitableness of operation on the part of photographic manufacturers and, in varying degrees, of the thousands of establishments for whom these taxes are a business expense. We do believe, however, that this evidence clearly indicates that these excises have caused very substantial and continuing injury. In particular, it is evident:

(1) That this industry has suffered losses in sales, employment and profits very much greater than those experienced by manufacturing industries in general.

(2) That the losses suffered by this industry as a whole are many times greater than would be expected in contrast to the experience of this industry in previous periods of recession, according to informed industry opinion.

(3) That the product area subject to the 25 percent rate of tax has suffered the most severe losses of all.

(4) That in these times for the manufacturers in an industry to increase their prices by 15 and 25 percent would be considered most hazardous lest thereby goods be substantially priced out of the market. Yet, this is exactly what these taxes do to photographic products.

It is inevitable under such distressing conditions that a number of small and medium size concerns largely or wholy dependent upon photographic markets have either failed or are in severe financial difficulties with the ultimate outcome in serious doubt.

In examining the adverse effects as set forth herein, we believe that no other conclusion can be reached but that these taxes are acting very effectively in the manner originally intended, namely, to discourage consumption. To continue them, therefore, is manifestly undesirable (1) as a matter of simple justice and (2) in the interests of security.

1. Employment losses

The photographic manufacturing industry has suffered very heavy, month-after-month losses in employment, almost without interruption, since the summer of 1947.

The severe losses reported below are in sharp contrast to the drop of 11 percent in employment by all United States manufacturers, as reported by the Bureau of Labor Statistics.

(1) Photographic manufacturing industry as a whole, as reported by the United States Bureau of Labor Statistics; production and related workers:

EXCESSIVE PHOTOGRAPHIC EXCISE TAX IS AGGRAVATING UNEMPLOYMENT

This is what is happening to workers who make equipment subject to the 25% photographic excise tax.

●

Of all full-time workers in October 1947

4 out of every 10 . . .

. . . were laid off by October 1949 because of reduced sales — and many of the remaining 6 are working sharply reduced hours.

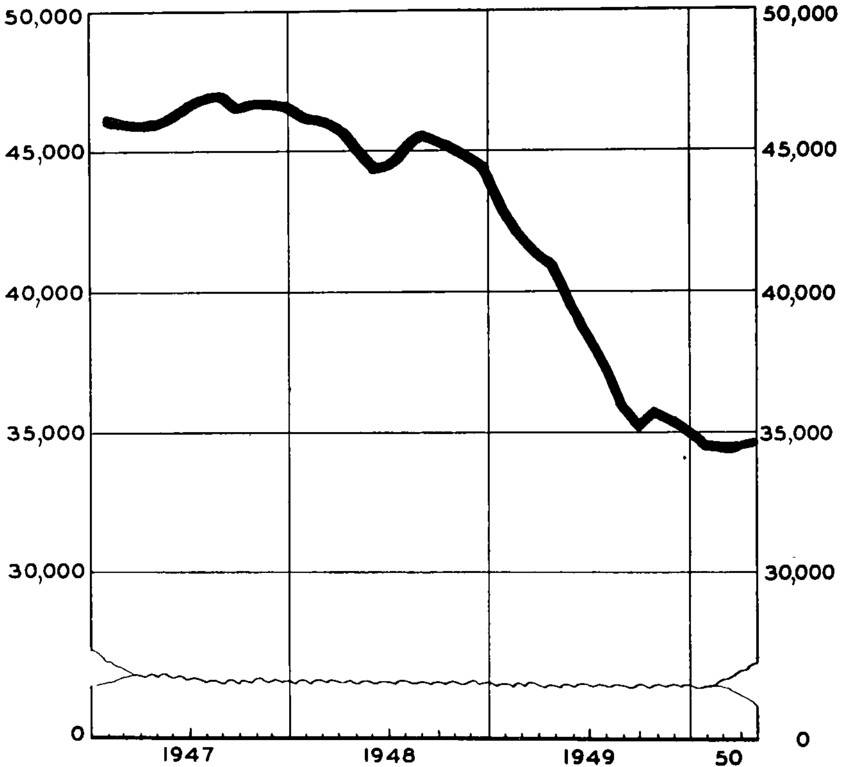
NATIONAL ASSOCIATION OF PHOTOGRAPHIC MANUFACTURERS'
JAN. 1950

Employment losses, photographic manufacturing industry [1]

Period	Thousand workers	Thousand jobs lost	Percent loss in jobs from October 1947
October 1947	46.8		
October 1948	45.3	1.5	3.2
October 1949	35.3	11.5	24.6
April 1950	34.9	11.9	25.4

[1] Note especially that the photographic manufacturing industry, which includes sensitized goods as well as equipment, is referred to in excise-tax matters as the "photographic equipment" industry.

Source: Bureau of Labor Statistics.



As might be expected, the most serious employment losses have been experienced in those product areas subject to the destructive 25 percent rate of tax. Here, according to our estimates for May 1950, the loss has reached almost 50 percent. The following table shows employment losses in this area over the same periods reported above:

Employment losses, equipment manufacturers (at 25 percent tax)

	Percent loss in jobs from October 1947
October 1948	8.3
October 1949	37.8
January 1950	[1] 40.1
May 1950 (estimated)	48

[1] January partly estimated, based on about 85 percent returns.

Source: National Association of Photographic Manufacturers.

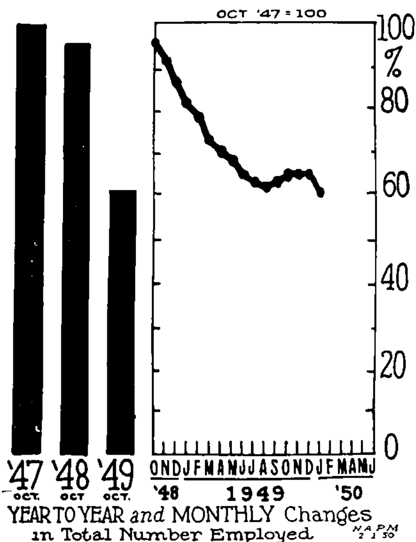
There is a further important loss in employment which neither the BLS nor our data show. These further losses are due to (1) shorter work-weeks and (2) the necessity of going to a skip-week basis from time to time in an effort to spread the work. These further losses are not reflected in the above data which only reflects number of workers employed.

We understand that coincident with the falling off of photographic retail sales (later reported herein) there have been considerable losses in employment by photographic retailers. There are a number of other areas in which these excises may have contributed to reduced employment.

2. Decreased sales volume

Major declines in the sales volume of the photographic industry have taken place over the past 2 years.

(1) *Sales losses—manufacturers.*—Our data indicate that the American photographic manufacturing industry as a whole experienced 20.3 percent loss of sales in 1949 as compared in 1948 as to products subject to photographic excises. It is clearly evident that the most serious losses of all were experienced in goods subject to the 25 percent rate of tax as might be expected.



Sales losses, 1949 versus 1948—Losses in photographic manufacturers sales as contrasted with all United States manufacturers, 1949. Dollar volume compared with 1948

	Percen
1. All United States manufacturers	−6
2. All photographic manufacturers	−20. 7
3. Photographic equipment manufacturers	−40. 1

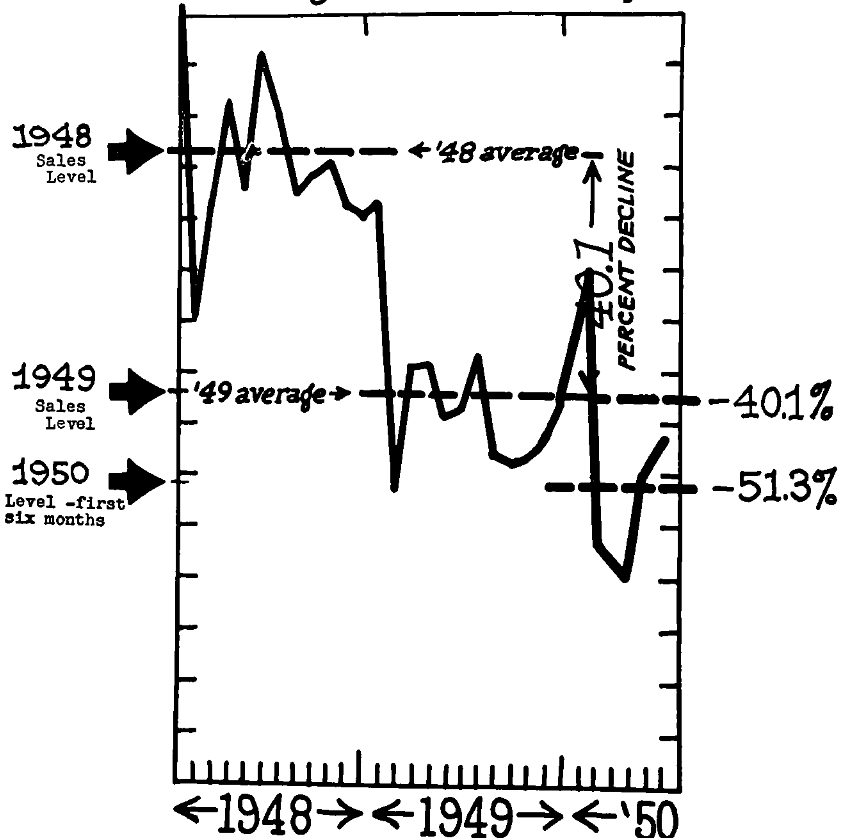
Source: (1) U. S. Department of Commerce; (2) Tax payments on photographic products, NAPM, (3) Tax payments on photographic products at 25 percent: NAPM.

An 8-percent loss, namely, a loss equivalent to about 1 month's business in a year would be serious, and would be a loss greater than that experienced by United States manufacturers in general, according to Government data. In particular, the Department of Commerce reports that sales of United States manufacturers in 1949 amounted to 213.4 billion dollars, down only 6 percent from 1948.

In contrast with this note that the photographic manufacturing industry as a whole suffered more than a 20-percent loss and the equipment manufacturers over a 40-percent loss.

(2) *Heavy decline in equipment sales.*—Especial attention is called to the drastic loss of sales which has occurred during the 2½-year period in photographic equipment, apparatus and machinery taxed at the 25-percent rate, as shown in the tax chart. This chart depicts the monthly payment of excises at the 25-percent rate on the part of manufacturers which we believe are responsible for the payment of about 80 percent of the receipts by the Government at this rate. Note the drastic decline in the 1949 average level of sales as compared with 1948. Now, for the first six tax-collection months of 1950 this loss of sales has reached the very alarming level of 51.3 percent.

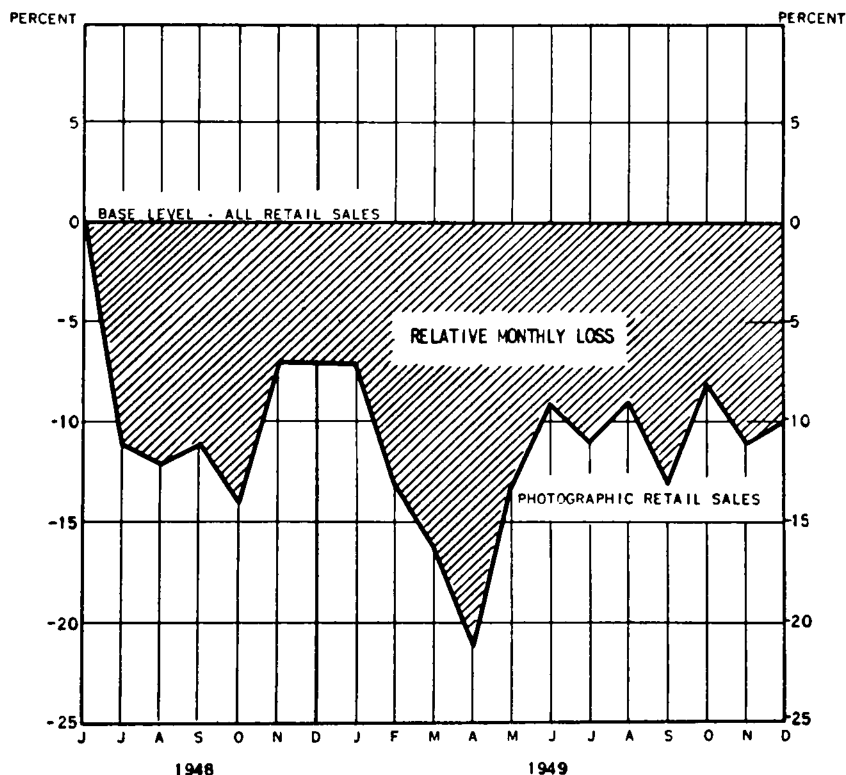
As has been stated this is a crushing, deep depression. For these manufacturers, it is the equivalent of losing 5 months of sales out of 12, and then being subject to even further losses.



This indicates that this industry has not yet shown any clear signs of recovering from the deep depression into which it has been plunged. We believe it supports our contention that the high rates of tax with the large dollar amounts which result are in some substantial measure pricing photographic equipment out of the market.

(3) *Sales losses—retail.*—Sales of photographic products at retail, as reported by the Department of Commerce, have for four consecutive 6-month periods failed to keep pace with all retail sales.

The Department reports photographic retail sales down 14 percent for the year 1949 as compared with photographic sales at retail for the year 1948 which were at that time also down below the level of all United States retail sales. The net loss of photographic retail sales as compared with all United States retail sales on the basis of these data is probably more than 20 percent. Unfortunately, these data are not presented except in terms of percentage of change from the same period a year ago. However, it is necessary to go back to the last 6 months of 1947 in order to find photographic retail sales occupying a level as satisfactory as all United States retail sales.



Shaded area represents percentage loss experienced by photographic retail sales as compared to the rate of sales which would have been experienced if they had kept pace with all United States retail sales.

This is computed by comparing the relationship of current monthly sales with sales in the same month of the preceding year for (1) all retail sales and for (2) photographic retail sales, respectively. The shaded area shows the difference between these two relationships. All source data are from "Monthly Trade Report—United States Summary" prepared by Bureau of the Census, United States Department of Commerce.

National Association of Photographic Manufacturers, Inc.

For example, for the second 6 months of 1948, all United States retail sales were 5 percent above the same period in 1947 but photographic retail sales were 5 percent below the same period in 1947.

For the first 6 months of 1949 all United States retail sales were 1 percent below the same period in 1948, but photographic retail sales were 14 percent below the already reduced levels of the same period in 1948.

For the second half of 1949, all United States retail sales were 4 percent below the same period for 1948 but, again, photographic retail sales were 14 percent below the level which they had achieved in the same period in 1948 and this level was 10 points below the level of all United States retailing.

The Department data clearly show that photographic retail sales have for four consecutive 6-month periods been in a much less favorable position than all United States retail sales.

If it is reasonably correct to relate these percentage figures in this manner, it would appear that for the second 6 months of 1949 photographic sales may be as much as 20 points or more below the level of all United States retail sales for the second half of 1948 as contrasted with a loss of 4 points on the part of all United States retail sales.

3. Decreased profits and Federal taxes

Information has been obtained from those manufacturers of photographic equipment, machinery, and apparatus, who could supply the data, whose products are principally subject to the 25-percent rate of tax (make no 15-percent-taxed goods). The purpose was to further study the effect of the high rate of tax by isolating the sample to such companies. Since these companies, according to our data, pay about 30 percent of the Government's collections, at the 25 percent rate, we consider the sample very representative and the results highly informative. A composite tax and profit-and-loss statement developed from these data has been presented to the committee for its confidential information. These data show that this group as a whole, 1949 versus 1948, has gone from a satisfactory profit to a loss position, will pay no Federal (corporate) income tax, but instead will have a refund claim. Federal payroll tax deductions (old-age benefit and withholding) are off 30.8 percent; photographic excise tax payments, off 41.6 percent; total Federal taxes, off 54.4 percent.

As stated, this group of manufacturers pays approximately 30 percent of the total collections by the Government at the 25-percent rate of excise. Note that they have experienced almost identically the same loss of sales (41.6 percent) as is true in the data previously presented which we believe represent 80 percent or more of collections at the 25-percent rate and which show a decrease of 40.1 percent.

Utilizing the figures it should be possible to arrive at the estimated adverse effects upon the entire group of companies subject to the 25-percent tax. If this is a reasonable basis, it would mean that there is a possible decrease in the above-listed Federal taxes of more than $16,000,000 for the entire group. Our data indicate that this sum will materially exceed the total revenue to the Government at the 25-percent rate for the year 1949.

In any event, we believe that these data can only raise serious doubts as to the wisdom and worthwhileness of these taxes.

They further serve as one more striking example of the destructive effects of the photographic excise. There is a note of warning in the fact that about 70 percent of the companies in the group surveyed are key producers of some specialized wartime photographic product, upon whom, in the last war, not only our own Armed Forces but those of our allies placed principal reliance.

V. NATURE AND EFFECT OF REQUESTED RELIEF

The revenue to the Government from the photographic excises is slight, but these taxes impose a tremendous and disproportionate burden on manufacturers, wholesalers, retailers, and users of photographic equipment and materials.

1. Actual revenue materially less than collections

The actual revenue to the Government is appreciably less than gross revenue (collections) would indicate. As a basis for computation, take the Treasury Department estimate of $40,000,000 revenue from these taxes for fiscal 1950.

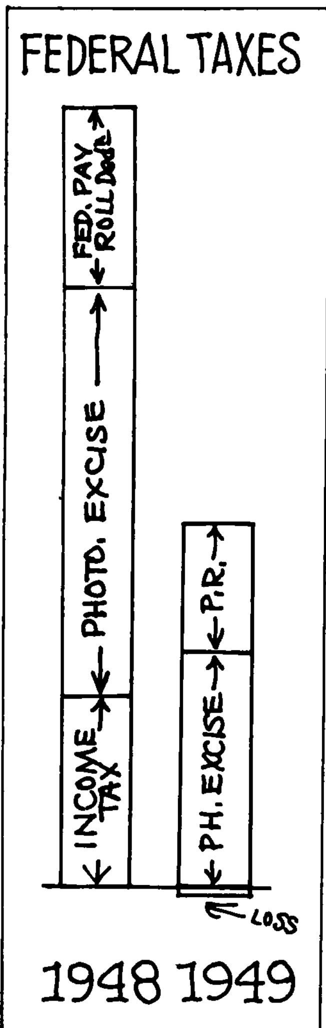
(NOTE.—Original Treasury estimate was $50,000,000. This estimate (since scaled down) and not the $40,000,000 estimate represents in our opinion more nearly the level of business the industry should be enjoying.)

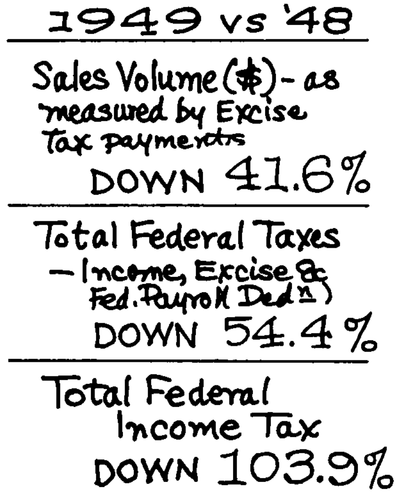
The gross amount, $40,000,000, should be reduced as follows:

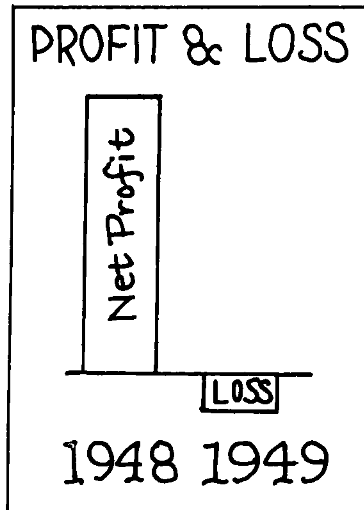
(a) Deduct an estimated $2,000,000 (our estimate is slightly higher) which represents payments of photographic excises by the Federal Government on its own extensive purchases of photographic equipment and supplies. For the Government, this sum appears first as an addition to budgets and then, when paid, as collections.

Destructive Effects of the 25% Tax on Photographic Equipment, Machinery & Apparatus

Composite Tax and Profit & Loss Statement of Group of Mfrs. Subject to 25% Rate Only







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National Association of Photographic Manufacturers, Inc.

(*b*) Slightly more than 60 percent of these taxes are a cost of doing business to the purchaser and as has been brought out are so reflected in income-tax returns of thousands of businesses throughout the country. Tax experts whose services are at your command can no doubt determine what is a reasonable allowance for this item. However, on the basis that $24,000,000 is involved and that an average income-tax rate is 38 percent, it would appear that $9,000,000 is a reasonable deduction on this account. These two items leave the sum of $29,000,000 to be accounted for as the apparent net revenue from these excises. We believe that in further developing the estimate of net revenue to the Government, the following items represent important further deductions:

(*a*) The greatly reduced profit position of photographic manufacturers due, we believe, largely to substantial decline in volume of business.

(*b*) Decline in Federal payroll taxes (withholding and old-age benefits) as a result of the substantial decline in employment. On the basis of a loss of more than 22 percent in employment, it seems reasonable to estimate this decline in taxes as being well in excess of $6,000,000. We believe the repressive effects of the photographic excises to be responsible for a very substantial portion of this loss.

(*c*) Such allowances as should be made for the cost of unemployment payments in a situation involving a decrease in employment amounting to 12,000 jobs.

(*d*) The not inconsiderable cost to the manufacturer of accounting, record keeping, etc., incident to determining, collecting, reporting, and paying taxes on many thousands of transactions monthly.

You will understand from the above why the industry seriously questions whether the Government is actually obtaining any worth-while true revenue from the photographic excises.

2. Special taxing of photographic industry fundamentally undesirable

We respectfully submit that it is basically and fundamentally undesirable for this Nation to place any special tax burden on its key strategic precision industries of which the photographic industry is a major one.

These industries are relatively small and few in number. Their full facilities would be urgently needed and greatly overtaxed in the event of an emergency. In peacetime they should be encouraged to thrive. They should not be prevented from enjoying their normal markets by being required to bear discriminatory, repressive, regulatory tax burdens, as is now the case with respect to the photographic manufacturing industry.

In the event of war, one of the early steps which would need to be taken would be to channel these facilities into the war effort. This, however, should not be done by special taxation but by direct controls of the War Production Board type, so devised as to avoid the serious mistakes made as to this industry at the outset of the last war.

National security would be jeopardized if this industry is allowed to deteriorate further. Losses already experienced have clearly endangered the ability of this industry to serve with full effectiveness in the event of an emergency.

3. The inventory problem

You are aware that one effect of the photographic excises (like other manufacturers' excises) is to tie up appreciable sums of the working capital of dealers and supply houses in the payment of tax on goods in stock. We understand that the Ways and Means Committee gave very sympathetic consideration to proposals directed to providing refunds of such tax on goods in stock on the effective date of any reduction, but concluded it could not adopt any such proposals.

Realizing that your committee may also give consideration to this matter, please note our strong feeling that if any such tax refunds or their equivalents are to be provided as a part of the relief accorded under any manufacturers' excise tax, we again call attention to the excessive rates applicable to photographic products and respectfully submit that no lesser degree of relief should be afforded to the photographic industry.

4. Provisions of H. R. 8920

Section 158 of H. R. 8920 as passed by the House provides for relief as to the photographic excises, this being a combination of rate reduction to 10 percent on some products and elimination of tax on others. This section provides for very important and urgently needed relief which would correct the most serious of the inequities, hardship, discrimination, and administrative difficulties inherent in the present law, as explained in some detail herein.

We are very conscious of the grave revenue-raising problems which face the committee. This industry is perfectly willing to pay its fair share of revenues to the Federal Government. Our concept of a fair share is where the burden of taxes falls equally on all industries and not on a selected few—or as is now the case of the photographic—not on one industry at substantially higher rates than others. What we ask is equity, believing that the only sound tax measure is one that is equitable.

If, in the judgment of the committee, it is impossible to grant at this time the complete repeal of the photographic excises, we respectfully urge and request both in terms of equity and of our urgent needs, that no lesser relief be granted than is provided in section 158 of H. R. 8920.

5. Relief needed

For reasons set forth above, and because this industry, its customer industries, and other users of photographic products have, we submit, already carried more than their fair share of the excise-tax load, and particularly because of the inequity, discrimination, and substantial injury suffered, we respectfully request that the photographic excise law (sec. 3406 (a) (4) I. R. C.) be repealed at this time, and with the utmost possible speed.

We are gravely concerned that any lesser step may be insufficient in helping to restore the sales and employment of this industry to the levels which we believe they should reasonably be expected to occupy. Any compromise short of complete repeal would continue, even though in a lesser degree, at least some of the many inequities of which we have complained. In particular, any failure to revise the faulty language of the existing law would leave the industry and the Internal Revenue Bureau still plagued with the administrative and interpretative difficulties which persist even at this late date.

It would still leave important segments of this industry exposed to the unfair competitive situation wherein their taxed products must compete with the same or similar products which nonphotographic manufacturers can sell without tax. It would still continue to act as a drain on the working capital and add to the cost of doing business of the many thousands for whom photographic products are livelihood tools, production machinery, and equipment or operating supplies. It would still adversely affect sales and thus employment opportunities throughout the entire photographic industry.

The probable net loss of revenue to the Government either from the relief provided for in section 158 of H. R. 8920 or from the complete repeal of this excise would be small, as we believe must be evident both from data presented herein and otherwise at your disposal.

Injury and hardship already experienced is substantial. The need for relief is urgent.

Respectfully submitted.

William C. Babbitt, *Managing Director,*
(For the National Association of Photographic Manufacturers, Inc.)

Mr. Schumacher. And now, permit me to summarize quickly but four vital points which are more fully developed in that brief.

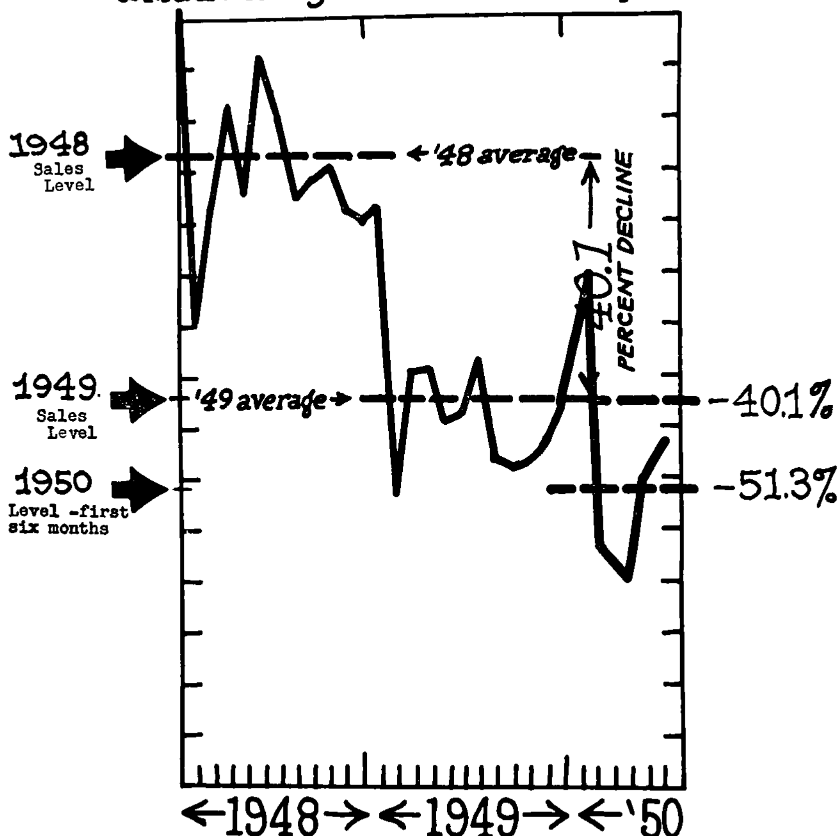
The photographic excise taxes are principally a burden on industry, science, education, and government—nearly two-thirds of these taxes becoming a business or operations cost to thousands of establishments throughout the country, by far the greatest number being little businesses which urgently need relief.

This chart, which I believe each of you has, shows the distribution of photographic products, the industry distribution, during World War II and peacetime, to which I refer.

Photographic products in tremendous volume are absolutely essential to successful military operations in modern warfare—in combat, intelligence, war production, science, research, medicine. The picture supplement before you tells that story better than any speech I might make.

Photography has been rightly called the eyes and the memory of military intelligence.

In this Munitions Board Allocations Manual dated March 1950, there is a limited list of basic and potential bottleneck items, the



production of which is vital in time of war. This limited list of vital bottleneck items includes photographic lenses and still- and motion-picture sensitized photographic materials.

Most photographic products can be made during wartime only by the photographic industry, because of the highly specialized skills and facilities required for their manufacture. As you know, most wartime photographic products are the same as or are modifications of regular peacetime photographic products.

An example of the conversion of a regular peacetime product to an essential wartime product is this gunsight-aiming-point camera required in every combat aircraft. This gunsight camera was produced in volume during the war by a photographic manufacturer as a

simple modification of his regular civilian 16-millimeter motion-picture camera which I have here. It uses the same film as the civilian camera. Obviously, only peacetime production of this civilian camera assures wartime availability of this military camera.

As another example, here is a 500-foot roll of film for aerial photography. This film was made by the same employees and on the same basic equipment as these rolls of regular civilian film. You can visualize why the military uses so much film since this single aerial roll contains enough film to make up to 5,000 rolls of these civilian types, yet it would be used up in a few minutes in photo-reconnaissance work.

A vigorous peacetime photographic industry is essential to national security. There is no substitute for its military products.

The photographic manufacturing industry has suffered disastrous losses in employment and in sales—far more than industry in general.

These charts which you have again before you show both the sales decline and the employment decline. The most serious losses relate to products burdened by the 25-percent rate of tax, where sales and employment were down 40 percent for the year 1949 as compared with 1948. This alarming decline in sales is continuing—sales by the industry of equipment and machinery subject to the 25-percent tax having further dropped during the first six tax-collection months of 1950 to a level, as you will see, in the chart, 5.3 percent below the 1948 level.

For these manufacturers this is the equivalent of losing 6 months of sales out of 12. This is a deep depression.

The present photographic excise-tax law creates inequities and injustices which, in application, plague and penalize the industry.

Specifically, it taxes many general-use products at 25 percent when sold by a photographic manufacturer, even for nonphotographic uses. Identical or comparable products sold in the same market for the same uses by nonphotographic manufacturers are tax-free even when sold for photographic use.

Here are specific examples. I hold before you two focusing cloths. This one is tax-free. This one is taxed at 25 percent. And how do they differ? The edges of this one have been hemmed.

And again, there are two print rollers, alike as two peas in a pod. This one is made by a company not engaged in manufacturing photographic equipment, and is thus tax-free. This one, made by a photographic manufacturer, is taxed at 25 percent. That company sought to bolster sagging sales by bidding on a large order for these print rollers to be used not in photography but in linoleum block printing. With a 25 percent tax disadvantage he naturally lost the order. The wording of existing law has created scores of such inequities and has caused widespread confusion, discrimination, inequity, and hardship.

The wording of section 158 of the House-passed H. R. 8920 now before your committee is the result of more than 3 years of effort to achieve a practical and workable law. The problems of application have been discussed many times with the technical staff of the Treasury and the Joint Congressional Committee on Taxation. The wording is most carefully considered, it is explicit, and its administration is simple. It eliminates the grossest inequities, discriminations, hardship, and confusion of the present law under which, even after nearly 8 years, there are scores of unsettled questions of application

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Short of complete repeal, the committee is urged to adopt the provisions of section 158 of the proposed bill.

We urgently need relief. We respectfully request your help—now—before further irreparable damage is done to America's vital photographic industry.

Senator MILLIKIN. I notice on the back of this booklet which accompanies your statement you have a picture of the proximity fuse, a cross section of it. Is that classified information?

Mr. SCHUMACHER. It is not classified now.

Senator MILLIKIN. Would not your industry be particularly concerned with a rebate of taxes on inventory?

Mr. SCHUMACHER. We consider it a very grave problem. Obviously, any tax at 15 percent or, more particularly, at 25 percent represents a great burden to those who carry those taxes in their inventory.

Senator BUTLER. Is it more than what your normal profit would be?

Mr. SCHUMACHER. Yes. Although I do not speak for the photographic dealers, from the reports which I have had they would be very happy if they could come out at the end of a year with a 5 or 6 percent profit net. The tax, of course, in our industry is passed along through channels to the photographic dealer and he carries it in his inventory. It is a very serious problem, obviously.

The CHAIRMAN. The effect of the House bill is to cut the total of your excises as applied to your industry about three-quarters.

Mr. SCHUMACHER. About two-thirds, according to the estimate which I noticed in the House report.

The CHAIRMAN. You like that better, of course, than what you have now.

Mr. SCHUMACHER. Well, as this report shows, which you gentlemen also have before you, a composite record of a large group of regular reporting member companies of our association shows that for 1949 the whole group as an aggregate consolidating their profit and loss statements is going back to the Government for a carry-back refund. They have a net loss for the year 1949. We indeed like the new wording and believe we can live with it.

Senator MILLIKIN. In terms of dollars how much excise tax do you have represented in your inventory?

Mr. SCHUMACHER. I cannot try to answer that, sir. The tax dollars in the inventory lie at the dealer level. The gentleman who will follow me is the executive manager of the Dealers Association. I think he might better answer that.

The CHAIRMAN. According to the House report, I think they estimate the revenue to the Treasury is about $40,000,000 under the existing law and with the treatment given by the House that will be cut by $30,000,000.

Mr. SCHUMACHER. Yes, sir; I saw those figures in the report.

I might say this, sir, that the Treasury Department's estimate of income from the photographic excise tax for fiscal 1950, as originally reported, was $50,000,000. Our industry felt that was not realistic when we saw the figures and actually the collections will be about $39,000,000. Now we also are of the belief that the yield from the revised wording will be higher than $10,000,000. That is why my first answer indicated a possible two-thirds reduction.

The CHAIRMAN. Two-thirds rather than three-fourths.

If there are no further questions, we thank you for your appearance before the committee, Mr. Schumacher.

Mr. SCHUMACHER. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. R. J. Wilkinson.

STATEMENT OF R. J. WILKINSON, EXECUTIVE MANAGER, MASTER PHOTO DEALERS' AND FINISHERS' ASSOCIATION

Mr. WILKINSON. Mr. Chairman and members of the committee, my name is R. J. Wilkinson. I am executive manager of the Master Photo Dealers' and Finishers' Association, the only national organization in the photographic business representing the people at the retailing and service ends of the business.

I fully appreciate the pressure for time, so I shall go directly to my points and let the briefs previously filed on the subject of photographic excise taxes fill in the detail of our situation. I wish to formally reintroduce the brief originally submitted to your committee at a previous session and with it a short, supplemental brief bringing it up to the present time.

The CHAIRMAN. You may do so.

(The statements referred to follow:)

STATEMENT BY R. J. WILKINSON, EXECUTIVE MANAGER OF THE MASTER PHOTO DEALERS' & FINISHERS' ASSOCIATION—EMERGENCY RELIEF FROM WARTIME EXCISE TAXES ON PHOTOGRAPHIC EQUIPMENT AND MATERIALS

Gentlemen, my name is R. J. Wilkinson. I am the executive manager of the Master Photo Dealers' & Finishers' Association, a national nonprofit trade association composed of a little over 2,000 member firms of retail photographic dealers and photo finishers doing business throughout all of the United States. This is the only national association in the industry directly concerned with the retail sale of photographic goods and photo equipment and the processing of the public's rolls of camera films. Its members are conservatively estimated to be handling about 65 to 75 percent of the total of all such business done. The association's meetings and conventions are "open" industry affairs rendering service and inviting participation by all members of the industry without regard for membership. Throughout the war and for 25 years this organization has represented and served the photographic business. These small business firms are about evenly distributed throughout the entire country in nearly direct ratio to the population totals of the various States.

In addition to the conclusions and observations made as executive manager of this national association, I am also the owner-operator of a typical member establishment composed of a retail photographic store and a photo-finishing laboratory operated in combination. The statements therefore come not only from experiences of the industry as a whole, but from close observation of the situation in my own business.

Our statement is made upon behalf of two related, but distinct groups of the photographic business as follows:

(*a*) Firms operating retail photographic stores or major photographic departments, engaged in the retail sale of cameras, lenses, enlargers, 8-millimeter and 16-millimeter moving-picture cameras and projectors, accessories, films of all kinds and photographic paper and chemicals.

(*b*) Firms operating photo-finishing laboratories engaged in the processing or developing, printing and enlarging of roll films exposed by the users of cameras. While a few of these users are hobbyists, the substantial part of them are using photographic goods and equipment in a commercial or business application.

(*c*) To these two distinct groups may be added the small business firms who are engaged in business operations that combine both of these departments of the photographic business.

Our statement does not directly attempt to represent the parallel interests of other business firms who are proportionately engaged in the photographic business

and who are now seriously affected in proportion because they operate photographic departments or counters, such as the 58,700 retail drug stores who operate photographic counters or departments and who sell developing and printing services, or the 22,000 professional photographic studios which are directly affected, but represented by other national associations.

Likewise our statement does not intend to concern itself directly with the problems and viewpoints of the photographic manufacturer, although it is our opinion that in many respects what is true of the retail photo dealer and photo finishers' interest is just as serious to the manufacturer.

PHOTOGRAPHIC INDUSTRY ENTITLED TO EMERGENCY RELIEF

May I briefly call to the committee's attention the critical situation which now confronts the photographic dealers and photo finishers. The cameras, lenses, enlargers, and equipment the photo dealer sells to stay in business, are carrying a 25-percent Federal excise tax—collected at the source and carried on his shelf as a nonprofit investment which has the effect of reducing his sales or "mark-up" percentage almost to the disappearing point and this on the basis of normal sales volume. Today, as a result of the high prices which have been further increased by these pyramided Federal excise taxes, sales have dropped alarmingly, many stores cannot continue in business, and unemployment is already resulting to a serious extent.

The photo finisher, and indeed all other photographic establishments which develop, print, or enlarge films or pictures are forced to pay excise taxes to the extent of 25 percent on all photographic laboratory equipment and a tax of 15 percent on the photographic film and paper they use. As a necessary tax in time of war, there was no complaint, but for a punitive tax continuing 5 years after the war has ended there can be little excuse. With today's declining sales volume these taxes are far in excess of the ability of the business to absorb and already the change in volume of business is resulting in failures and unemployment. In the name of all that is sensible, why should these business people be singled out and made to pay a punishing rate of excise tax on the tools with which they do their daily work?

As you know, the photographic industry already had a tax of 10 percent imposed in 1941. In 1942 a new revenue act raised these taxes to the ridiculous level of 25 percent on equipment and 15 percent on sensitized films and papers, a higher rate of taxes than that imposed on any other business. They have been forced to not only pay an absurd rate of tax but they have paid it now for nearly five long years after the war is over and they have paid it for a year and one-half longer than any other similar business. This rate of tax should never have been imposed at all on photographic laboratory equipment, and was not imposed on any other similar businessman for the tools with which to do his work. (See attached exhibit diagram of taxes.)

We are not concerned under today's conditions with the Government's policy decisions to generally remove or maintain excise taxes in principle, but rather we demand that adjustment and relief of a gross inequity and the rank discrimination be brought to an end by suitable, specific legislation. It is unthinkable that our Government can complacently let these thousands of small business firms and their employees be deliberately squeezed out of business for lack of legislation to adjust their tax sufficiently to bring it in line with what other competing businesses have been assessed throughout the entire war and postwar period. This business cannot stand to wait for another term of the Congress to secure relief, and if compelled to do so, we predict that hundreds of long established photographic firms will be forced out of business.

During the Eightieth Congress, first session, the House passed and sent to the Senate a bill which clearly recognized the critical need of relief for the photographic business. Members of the committees of both bodies clearly admitted the justification for "hardship" relief. The House in its letter of committal of the bill emphasized this need, yet no action of modification was accomplished by the end of the Eightieth Congress. That was approximately 2 years ago. Today, the fears which we expressed in our brief, and in interviews with committee members are now stark realities—firms are going out of businesss one right after another, and unemployment is mounting daily. It is a sad commentary but nonetheless true that hundreds of ex-GI's who have invested all their available capital are inevitably among the first victims of this failure to properly adjust photographic excise taxes.

Immediate cancellation of the photographic excise tax as it applies to photographic laboratory equipment and many photographic items, and a reduction of tax on that portion of photographic items which are largely used for noncommercial photographic business, would serve to save the critical situation. If properly selected, as has been done in certain bills before your committee, we believe that this tax adjustment would have little or no effect on the total revenue to the Federal Government. If such action is not taken promptly, it seems inevitable to us, that the reduction in income taxes which will result from the decline in sales and the business failures in this industry will far exceed the total possible excise-tax revenue which might be realized if the present high, discriminating photographic excise taxes are not reduced or abandoned.

PHOTOGRAPHIC EXCISE TAXES ARE PARALYZING CAPITAL

The photographic dealer today is in a precarious position. The photographic taxes are a substantial amount of every purchase of stock he makes. These taxes are collected at the source (the manufacturer) and therefore must be paid in advance by the dealer and placed on his shelves alongside of and as a part of the photographic goods and equipment he offers for sale. His hope of recovering this cash invested in excise taxes already imposed and collected from him, and upon which he makes no sales profit whatever, lies in his ability to sell the goods and pass on the tax to the consumer. Today sales have been severely reduced in this business. The excessive high prices which result from a combination of current conditions, when expanded to include a 25 percent excise tax become prohibitive. The result is that the use of photographic equipment and materials is severely curtailed by all who can possibly get along without them.

In the meantime a very substantial part of every photographic stock investment is tied up in "dead stock" tax dollars. This tying up of a substantial part of his liquid assets in excise tax dollars is a very real hardship to small business firms, and is becoming increasingly disturbing as their business slows down. Not only is his capital investment highly inflated, but he inevitably stands to lose the amount of the tax on his shelves, on all goods which may become spoiled or unsalable, or which remains on his shelves when the tax is reduced or removed. Serious as these burdens and losses are, they are now less serious than the impact these excessive and discriminating excise taxes are having on his sales.

EFFECT OF EXCESSIVE EXCISE TAXES ON RETAIL SALES

Whether we like it or not—whether it is justified or not, the public is now on strike against excessively high prices. They have in large numbers quit buying photographic goods and services as a result of excessive prices. Wholesale prices have reflected only nominal increases due to labor and increased overhead, but the pyramiding of a 25 percent excise tax on top of these costs has inflated the retail selling prices of every camera, every accessory and the materials used—without offering any additional value—to the point where public resistance has slowed sales to an alarming extent. The retail photo dealer is "in the middle" and holding the bag. He cannot make the goods himself, he cannot lower the price he pays, he cannot avoid the excise tax which is collected at the source and he is powerless to change public opinion. If he lowers his already decreased mark-up percentages to offer a lower retail price he is certainly going out of business. If the public stops buying to any greater extent than has already taken place—he is going out of business. The Office of Price Administration made an extensive survey which established that the average annual net profit of the photographic dealer's business is only 5.8 percent on sales. In other words, the most he can cut prices or take tax losses is an average of 5 or 6 cents on the dollar—from there on he is going broke.

EFFECT OF EXCISE TAXES ON PHOTO FINISHERS

We know of no other businessman or workman who has had a more severely raw deal from his Government than has the photo finisher or businessman who must install or maintain a processing laboratory for developing, printing or enlarging films and prints. The very necessary tools and equipment with which he does his daily work are taxed—nay, not just taxed—they are almost prohibited by a Federal excise levy of 25 percent. This is rank, unjustified discrimination—tolerated in wartime in silence, but without even the most fantastic justification in normal times.

This discrimination is literally flaunted in his face by the fact that, in addition, the same identical items of equipment upon which he must pay a 25 percent excise tax, may be purchased by other workmen for any nonphotographic use without any excise tax at all.

To make the situation more tangible I have in my hands an example. My own business is a typical establishment of a retail photographic store and a photofinishing laboratory operated in combination. Two years ago last spring the print dryer used in our photofinishing laboratory started a series of breakdowns caused from excessive strain of wartime business, plus old age. By mid-summer we had several serious breakdowns in service that cost us a lot of business. Finally by late July we received a new dryer to take its place. The price of the dryer as a capital investment is $968.33. We had to pay another $242.08 for Federal excise taxes which represents a capital loss from which there is no possible recovery (both are higher now). I have the invoice here in my hands and you gentlemen have copies of it in connection with your duplicate of my statement. Other small businesses all around me have no such tax on the equipment installations which they are making. This discrimination against the photofinisher and professional photographer should be brought to a prompt end. All of us must plan to pay our just share of the expenses of war, but that expense must be paid on a basis that gives all persons of a like class the same break. Other similar small businesses do not have to hand out chunks of their capital in order to replace their worn-out working equipment.

Again, just to give your committee a more intimate knowledge of what this equipment for a photofinishing laboratory amounts to, I wish to present at this time some photographs and some of the prices and taxes involved. (These are identified as "Photofinishing equipment exhibits, and have been placed in the committee files.

The losses incurred in these discriminatory excise taxes on the equipment used in this business are not deductible from income tax. Unconditionally, the excise taxes on professionally used photographic laboratory equipment of all kinds should be canceled in their entirety and at once.

EXCISE TAXES AFFECTING EMPLOYMENT

Our association is still too small to employ the services of an economist and conduct the national survey that would provide detailed employment statistics for your record. No economist is needed, however, to make the simple, natural deductions which the current situation indicates.

The implications are clear—the photographic dealer knows he is competing with every other line of similar type goods on the market—most of the rest of them are not taxed. He knows that the public has already quit buying everything in sight, and is refusing to buy many things because they think the items are "too high priced" or because they have decided to "wait until the excise taxes are removed." He knows his sales have already slowed down. When his sales start slipping, he not only is forced to reduce the number of his staff, but he must stop buying from the manufacturer as well. Manufacturers in turn can't pay people to make things that their dealers can't sell. This cycle or chain of recession in this business has already started. To say that it affects and will affect employment in the months ahead needs little proof. You gentlemen know what happens. The retail photographic dealers know what is already happening at their counters. Simple economics are at work.

It is the opinion of our leaders as well as myself, that the excessive wartime excise taxes which are still on the books after nearly 4 years of peace, are not only a serious detriment to this business, but from here on will, in fact, not produce any important net income to the Federal Treasury. Their hidden effect on Federal income taxes tends to nullify the advantages—if any—from retaining the current rates of excise taxes or of retaining this type of tax at all. This statement ignores the common justice of eliminating the discriminations which the photographic excise taxes impose.

MANY DEALERS HAVE DEMANDED BOTH TAX RELIEF AND A REFUND ON SHELF STOCK

Our business leaders in conferences and committees have insisted ever since the subject of excise tax removal became critical that some kind of a provision for limiting the loss through refunding or recovering all or a portion of the uncollected prepaid excise taxes which remain on their shelves at the termination or lowering of excise taxes, should be second only to securing relief from the high rates imposed.

We believe the Government can and should help relieve the loss that will be incurred through these uncollected excise tax dollars which will be in the dealers shelf stock inventory when modification or removal of the tax is effected. This can be accomplished mechanically and simply, on a compromise basis which both the dealers and the Government should accept, by simply permitting the photographic manufacturers who have collected this tax for the Government, to make refunds to all their dealers for amounts of excise taxes actually billed and collected from the dealers and finishers during the last 60-day period preceding the effective date of tax revision legislation.

The manufacturers would then present a single certified voucher to recover from the Government the excise taxes so refunded. Such a program would be simple, would not permit of illegal or unpredictable raids on the Treasury and would temper the loss to all efficient dealers—those who can and do turn over their stock at a normal turn-over rate.

Serious as these shelf tax losses may be, the continuance of the present high excise taxes is more serious in its impact on his business future. The photographic dealer and the photo finisher needs immediate tax relief. Any program which will afford him a reasonable measure of prompt relief is more to be desired and will accomplish more for him than a more liberal treatment at some hazy future date, when his business may have deteriorated and his assets have been eaten up in overhead.

WHAT SHOULD BE DONE ABOUT THE PHOTOGRAPHIC EXCISE TAXES?

While responsibility for much of the Nation's economic welfare and the Government's operations must continue to rest with you gentlemen who are among those who constitute the Congress, we believe that you will welcome our viewpoints with respect to what should be done to relieve the photographic dealers and photofinishers whom we represent. The subject is close to us and the need for congressional action at the earliest possible moment is of utmost importance.

Our recommendations, in the order of their importance or desirability are as follows:

1. Discontinue all Federal excise taxes on photographic equipment, accessories, and supplies, and make the effective date the earliest possible date that may be set, or

2. Reduce to 10 percent, or substantially lower the present rate of excise tax on those items which it is deemed necessary to retain under tax and eliminate the tax entirely from all but a very few well-defined photographic items.

In this connection it would be our recommendation that the tax be removed entirely from those items or lines which affect business the most and which will affect Government income the least. We feel that this would be accomplished if the tax were removed from all items with the exception of possibly amateur cameras and amateur roll films, and these to be reduced to not more than 10 percent on the manufacturers' wholesale selling price of cameras and 5 percent on amateur roll films.

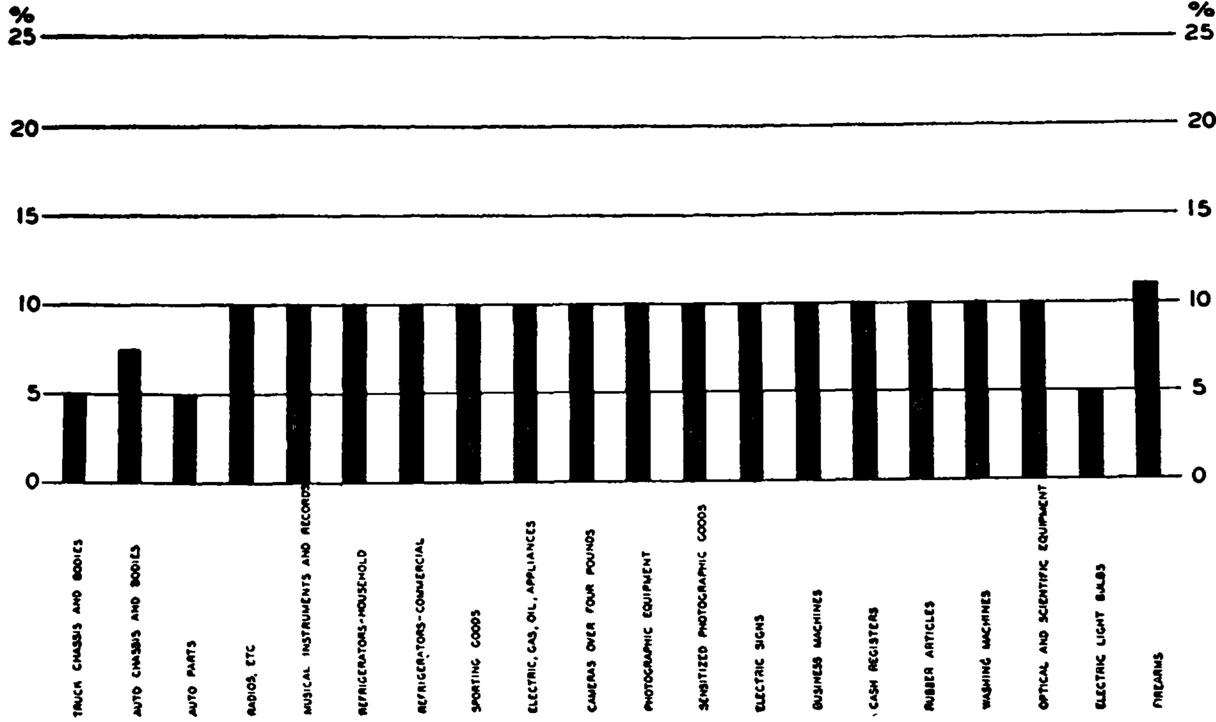
3. Write in a provision for tempering the dealers' excise-tax losses along lines recommended previously on pages 9 and 10 of this statement.

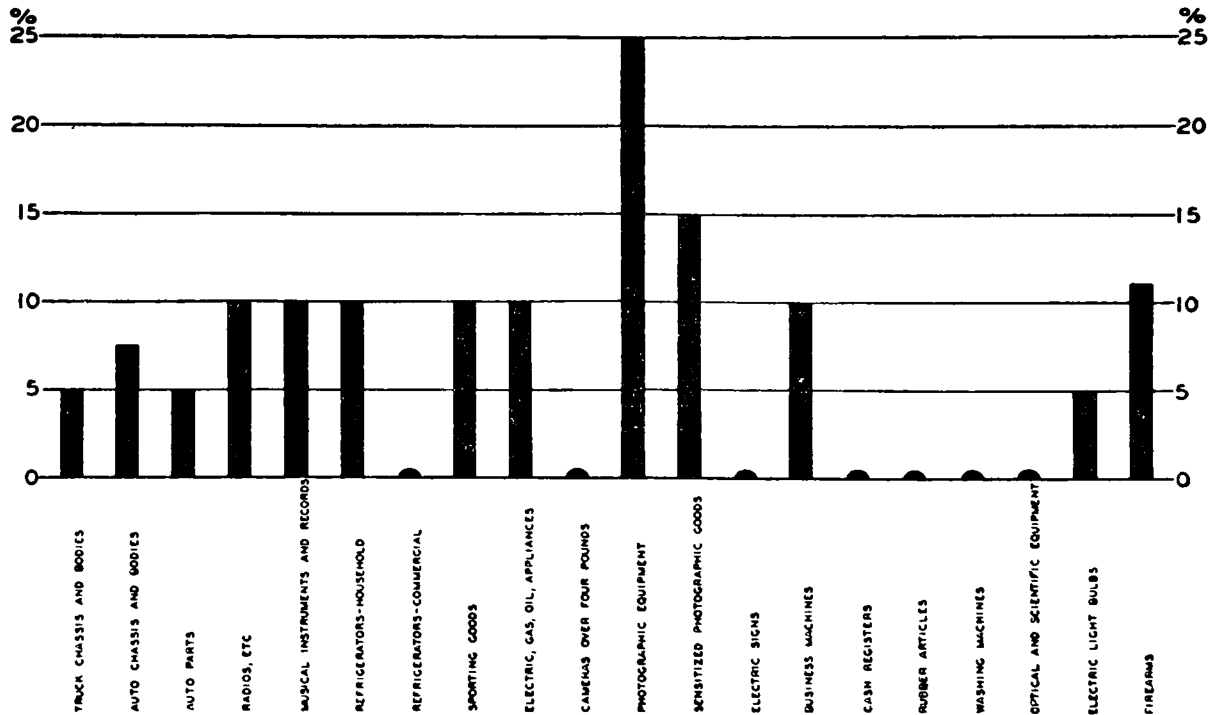
Again may we emphasize the importance of prompt action to relieve the plight of the small business firms engaged in retailing of photographic goods and the processing of pictures for the public. This action must come, if possible, at this session of Congress.

The full cooperation and facilities of this association and the industry are available to your committee if there is any further specific information which you would like to have. I thank you gentlemen for your courtesy and consideration.

REVENUE ACT OF 1941

PERCENTUM MANUFACTURERS' EXCISE TAXES





—National Association of Photographic Manufacturers, Inc.

EASTMAN KODAK COMPANY

INVOICE NO E 102542 — ROCHESTER 4, N. Y. — INVOICE NO E 102542

YOUR ORDER NO — SHIPPED TO — INVOICE DATE 8 1 46

ROYAL FILM SERVICE
103 W MICHIGAN AVE
JACKSON MICHIGAN

ENTERED BY	ORDER DATES	CLASS	ZONE	VIA	EXT BY
30	4-1-45-7-29-46	EKA F3	4-15	NYC	13

QUANTITY	BRANCH	EXCISE TAX	UNIT PRICE	TOTAL	TOTAL
	This is capital investment				
1	862 EASTMAN COMMERCIAL PRINT DRYER 60 CYCLE 110 V AC				968 33
	25% SEP-4-46	242 08 242 08			242 08 / 1 210 41X
	SEP-4-46 SEP-4-46				210.42 999.99
	SEP-4-46				210.42

This amount is total loss of working capital

Total Paid

(copy of an INVOICE for print dryer referred to on page 7 of statement of R. J. Wilkinson.)

NOTE: PAY ONLY THE TOTAL MARKED X

IN CASE OF LOSS OR DAMAGE, MAKE CLAIM ON CARRIER, WHO HAS RECEIPTED FOR GOODS IN FIRST-CLASS ORDER

STATEMENT BY R. J. WILKINSON, EXECUTIVE MANAGER OF THE MASTER PHOTO DEALERS' AND FINISHERS' ASSOCIATION—RELIEF FROM EXCISE TAXES ON PHOTOGRAPHIC EQUIPMENT AND MATERIALS

My name is R. J. Wilkinson. I am executive manager of the national trade organization in this field, the Master Photo Dealers' and Finishers' Association. This national association is composed of the retail photo dealers and the photofinishers who operate the commercial processing laboratories. This is my second appearance before your committee during the last 3 years on the photographic excise tax. Knowing the pressure for time under which you gentlemen are working, and that our previous comprehensive statement is in your files, I shall in this supplemental brief, eliminate the complete industry statistical facts about our business and our association. I am making this appearance to get down to immediate points and current conditions, not included in our previous complete statement. Therefore, I refer you to the previous statement (a copy of which

is attached and presented herewith), which still accurately reflects in all respects the facts of our present situation, and which I desire to herewith re-present to your committee for the record.

First, I think you gentlemen know that the photographic business is taxed at the rate of 25 percent on cameras, lenses, equipment and processing machinery, and at the rate of 15 percent on films and sensitized paper. This is no ordinary burden we have been carrying and we can't carry it much farther without going out of business—in fact many have already done just that.

I'd like to take the few moments available for this verbal presentation of our supplemental statement, to bring to focus a few points which seem to us to be of vital importance in your deliberations on photographic excise tax relief. I'm not going to talk about the unfair discrimination, the disastrous effect on sales, the fact of steadily increasing widespread unemployment, or the numerous bankruptcies in the trade. With these broad impacts of the excise tax problem, you have many competent witnesses.

The vital points which we feel should be brought forcibly to attention are these:

1. Despite a common opinion, photography is not a luxury by any measure. Industry statistics show conclusively that well over two-thirds of all equipment and materials produced and sold are for commercial, industrial, medical, reproduction, illustrative publishing and other business uses. All of these business uses are curtailed or burdened by this 25 percent tax. Even in the so-called amateur end of the business a great portion of sales are made for semicommercial or illustrative photography.

2. Legislation aimed to remove so-called retail excises would not include relief for the photographic business, nor would be complete removal of the 1942 and 1943 wartime excise taxes. The removal of both of these revenue acts would still leave us with a greater burden of excise taxes than the rates now being paid by most of the business groups who are now seeking readjustment or elimination of their excise taxes. Further, and most significant, elimination of the 1942 and 1943 wartime excise taxes would still leave our business people paying a 10 percent excise tax imposed in 1941 on their working equipment—the tools with which they earn a living. You know that this kind of tax on work creating tools deserves complete elimination, regardless of any general approach to excise taxation adjustment.

3. Contrary to general opinion, while the photographic excise taxes are manufacturers excise taxes—the retail photo dealer and photofinishers are the ones who are directly hurt. They are forced to prepay these excise taxes and put on their shelves thousands of dollars in a dead investment in no profit tax dollars upon which they can make no profit whatever. This results in a reduction of the normal prewar profit mark-ups which this business requires to make a decent return on investment. This situation stems from wartime decrees of OPA which prohibited making a mark-up profit in the handling of manufacturers' excise taxes. The result now is that with reduced sales volume coupled with the reduced mark-up which these wartime taxes thus imposed, many are operating near the break-even point or with a red ink loss. Some considerable number have already discharged their employees and gone out of business.

4. We want to emphasize that if any action by Congress should result in approaching the general excise-tax problem through a flat rate reduction on all manufacturers' excise taxes, that such a reduction, even if carried to a point which eliminated entirely the other manufacturers' excise taxes, would still leave the photographic business paying as high a tax percentage as the others are now paying, before such relief.

5. Without dwelling on it in great length, we must again point out that the photographic excise tax leaves this business at a real disadvantage through the discrimination that results. Many of our products, when purchased through nonphotographic channels or for nonphotographic business are untaxed despite their identical nature. To the best of our information few, if any, other workmen are required to pay an excise tax on the processing equipment and tools with which they make their living. All photographic equipment for laboratory and business use should be exempted from such taxes or else similar taxes should be imposed on all other lines of business.

6. The photographic excise taxes are at an excessive rate and impose a burden not similarly imposed on other lines of business. Carrying this excessive tax as a nonprofit investment has so severely reduced the profit margins in this business that already hundreds of smaller firms have been forced out of business.

7. This statement has not attempted to concern itself with all branches of the photographic business. Our business of processing exposed films and the sales

of all kinds of photographic equipment and supplies feels the burden of these excessive taxes more severely than some others, but the other branches of the photographic industry are suffering severe adverse effects. This brief does not attempt to discuss the situation for the industrial, scientific, educational, and medical branches of the industry—all of whom are taxed at these same high rates and experiencing some or all of the same adverse effects.

In conclusion of this supplemental statement, I would be remiss if I did not emphatically state that we, like many others, feel that there is no moral fairness in this business, or any other like it, being singled out to pay an excise tax. We believe that these taxes should now be removed in their entirety as a matter of public policy and good fiscal policy. We believe that today they represent a millstone around the neck of the small-business man which, if it is not now removed, will eliminate thousands of them from the field. Then we have the inevitable unemployment both in our business and that of the manufacturers, and with the inevitable result of emphasis on bigness in business. I'm sure you know the important part played by small business under our economy.

Make no mistake about it, the public are on strike against products which are disproportionately priced. The photographic excise taxes now imposed are diverting and destroying our business. The rate of destruction is now increasing. We believe that this is clearly evident in the records of the Internal Revenue Bureau, which through their Accounts and Collections Unit show that photographic excise taxes collected in December of 1949 had dropped 31.9 percent in a single year. We cannot and do not pay income taxes on red ink. I think the present retention of excise taxes on most businesses is not only killing the goose to get at the egg but is overlooking the fact that there won't be any more eggs. Business people, even the small-business man—recognize that the Government requires vast amounts of income to meet the challenges of these difficult days. We expect to pay taxes, heavy taxes, but business taxes should be imposed on a basis that will encourage employment and consumption and not on a basis that diverts or destroys the means for paying them.

On behalf of the photo dealers and photo finishers, I thank you, gentlemen.

Mr. WILKINSON. For the moment, I wish to get it into the record that the heavily taxed photographic business is continuing to decline in dollar volume again this year, and continuing a trend which showed a drop in sales volume for 1949 which was accurately reflected by the records of the Internal Revenue Bureau as 31.9 percent. Reports we have received from our member firms throughout the country indicate an average drop of 8 percent more during the first quarter of 1950. Some untaxed businesses, like television, for instance, which compete for the same dollars of the public's spending money have lunged ahead. I do not mean by that that I think the excise tax is solely responsible for that. There seems to be no question that most products which are disproportionately priced are falling behind the general level of the Nation's business. The 25-percent excise tax which is assessed against photographic business equipment is a serious drag. This decline in dollar volume when coupled with the advance prepayment of a 25-percent excise tax on most of their stock of cameras and equipment and 15 percent on films and sensitized photo papers has the effect of seriously lowering the margin of safety in this business, and already many of the smaller photographic dealers have discontinued business or failed. Others are running distress sales in an attempt to boost their own volume of pay bills, which sales have the effect of still further demoralizing the trade. I present herewith some typical advertisements which I picked up in yesterday's mail and which illustrate this point. You gentlemen are businessmen and know that such advertising is a real distress signal.

The excessive photographic excise tax on machinery, equipment, and the tools to work with is having a peculiarly distressing result on the smaller photo finishers at the moment. Taxing photographic

processing equipment that these photo finishers work with is just the same as taxing the lathe that goes into a small machine shop or the cooking grill that goes into a restaurant. It's the tools they work with. In the last year there has been a rather radical new development in the business which calls for completely reequipping these photo finishing laboratories with rather elaborate expensive continuous-processing machines not previously used in this business. Some of these installations run into $15,000 or $20,000 for new photographic processing equipment which carries a 25 percent excise tax. The machine creates quite a problem in competition, and hundreds of smaller plants are losing their volume to these large, highly mechanized establishments because they can't raise the money necessary to buy such equipment. A larger factor in this inability to modernize lies in the necessity of paying the high excise tax on such equipment. The end result is that the big firms are getting bigger and the little fellows are crowded out. This is not good for anybody.

We feel that the results of the deliberations and collaboration of the House Ways and Means Committee has resulted in the placing before your committee in H. R. 8920 revisions which, if enacted into law, will go far towards revitalizing the photographic business and putting it back where it has an even chance in the market place. The end result, I predict, will be industry-wide prosperity and bigger income-tax checks for the Treasury of our Government.

I have heard this morning repeatedly the question of shelf tax refunds. Our previous brief mentions the situation. I have made no appeal here. The fact that we are making no plea at this time for inclusion of such a revision in the law is not because we do not need it, not because it is not serious. We feel that we do not dare to jeopardize the possibility of our getting the revisions that are so badly needed by asking for a refund at this time. Many of our people are very insistent on this point.

I merely want to place it in the record that, if any general arrangement is made in other excise-tax departments for refunding of shelf tax refunds, then certainly we feel we are entitled to equal consideration. I believe our case would stand the closest investigation.

On behalf of the photo dealers and photo finishers, I thank you, gentlemen.

The CHAIRMAN. Thank you for your appearance.

At this time I will offer for the record a statement made Mr. Jacob Reck, counsel for the National Beauty and Barber Manufacturers' Association. It is a brief relating to the 20-percent excise tax on toiler preparations used in beauty and barber shops. Mr. Reck will not make a personal appearance.

(The statement referred to follows:)

STATEMENT OF JACOB RECK, COUNSEL, NATIONAL BEAUTY AND BARBER MANUFACTURERS' ASSOCIATION

My name is Jacob Reck.

I make this statement on behalf of the beauty and barber industry in support of section 103 (d) of H. R. 8920, the Revenue Act of 1950, repealing the burdensome 20-percent wartime tax on toilet preparations used by beauty and barber shops in the rendition of their services.

The beauty and barber industry is hopeful that the Senate Finance Committee and the Senate will affirm the recent action of the House of Representatives by approving legislation repealing the wartime excise tax on cosmetics used in beauty and barber shops.

The entire beauty and barber shop industry is united in a campaign to make the Congress aware of the harmfulness of the retailers' tax on toilet preparations used in beauty and barber shops and the need for relief from this burdensome wartime tax by its repeal. All segments of the industry—shop owners and employees, supply wholesalers and manufacturers—are joined together, through the leaders representing their associations, in an informal group called the Beauty, and Barber All-Industry Legislative Council, the main purpose of which is to advise the Congress of the need for the repeal of the tax on toilet preparations used in beauty and barber shops. I have been chosen to make this statement on behalf of all segments of the beauty and barber industry.

Many Members of Congress, having received thousands of letters and petitions from beauty- and barber-shop owners and employees and their local, county, and State associations asking for excise-tax relief, realize that the repeal of the wartime tax on cosmetics used in beauty and barber shops is the most important matter on which Congress can legislate directly affecting the 240,000 beauty and barber shops in the Nation and their 750,000 employees. That many Members of Congress feel that this industry's request for excise tax relief is meritorious is attested to by the 20 bills which have been introduced in the Eighty-first Congress, all containing provisions repealing the wartime tax on cosmetics used in beauty and barber shops, and the action of the House in providing for such repeal in the proposed Revenue Act of 1950.

In its report accompanying the Revenue Act of 1950 (H. R. 2319), the Ways and Means Committee recognized the hardship imposed upon beauty- and barber-shop owners by the tax on toilet preparations used in such establishments in the rendition of professional services. In recommending the exemption from tax those toilet preparations purchased by beauty and barber shops for professional use, the report of the Ways and Means Committee states as follows:

"The third change exempts from tax toilet preparations purchased by barber shops and beauty parlors for use in these establishments. At the present time these items are subject to tax at the time purchased by the barber shop or beauty parlor. Toilet preparations purchased for resale to customers are not taxable until sold, and the retail establishment is required to file a certificate that such items will not be used in the establishment. This has resulted in considerable confusion among the barber shop and beauty parlor operators. Your committee's bill eliminates this problem by repealing the tax on toilet preparations purchased by barber shops, beauty parlors, and similar establishments if intended to be used in such establishments. Not only will this remove confusion in the present application of the tax, but it will also take out of the tax base items which represent part of the barber shop or beauty parlor's cost of doing business."

From discussions I have had with Members of Congress, I realize that the provisions of the Internal Revenue Code and the regulations of the Bureau of Internal Revenue as they relate to the wartime excise tax on sales of cosmetics to beauty and barber shops are very confusing and difficult to understand. In order that Members of the Senate may have a full understanding of the harmful and discriminatory effects on the beauty-and barber-shop industry of the existing tax on cosmetics used in shops and the Bureau regulations administering it, I will analyze the law and regulations, point out the hardship and discrimination suffered by beauty- and barber-shop owners, and develop the need for legislation repealing the tax on cosmetics used in beauty and barber shops.

Beauty and barber shops are treated differently from other retailers of cosmetics under existing law and regulations due to the fact that such shops are normally both consumers and retailers of cosmetics. This discriminatory, different treatment has caused many beauty shops to refrain from retailing cosmetics, thereby causing them to lose income they would normally derive from retail sales of cosmetics. Section 2402 (a) of the Internal Revenue Code imposes a 20-percent tax on retail sales of cosmetics to consumers. Under Bureau regulations,[1] department stores, drug stores, etc., selling cosmetics to the public are required to collect the tax, keep records, report and pay the taxes collected to the Government monthly, and nothing more. All this is also required of a beauty or barber shop selling cosmetics to the public plus something else which is not required of other retailers of cosmetics. When a beauty shop sells cosmetics to the public, the regulations of the Bureau of Internal Revenue require the beauty-shop owner to sign and deliver a certificate of purchase for resale to each wholesale supplier from whom she buys cosmetics intended for resale or else pay the 20-percent cosmetic tax. No other retailer of cosmetics is required to furnish the wholesale supplier

[1] Regulations 51, Bureau of Internal Revenue, relating to retailers' excise taxes, sec. 320-50.

with a certificate of purchase for resale, and no other retailer of cosmetics is required to pay to the wholesale supplier the 20-percent tax if such certificate is not furnished.

The Bureau's reason for requiring the beauty- or barber-shop owner to either furnish a certificate to the wholesaler or pay the 20-percent tax when buying cosmetics for resale arises from the fact that the 1942 Revenue Act makes a distinction between sales of cosmetics to beauty or barber shops for use in their operation and sales of cosmetics to such shops for resale.[2] A sale of cosmetics for use in a beauty or barber shop is considered in section 2402 (b), as amended, as a retail sale, and the beauty-shop owner when making purchases of cosmetics for use must pay the wholesaler the 20-percent tax. On the other hand, the 1942 Revenue Act considers a sale by the wholesaler to the beauty shop of cosmetics purchased for resale as a wholesale transaction and not as a taxable retail sale unless the shop subsequently uses the cosmetics, and then what was originally a wholesale transaction becomes a taxable retail sale Although a shop pays no tax when purchasing cosmetics for resale, it does collect and pay a tax when it sells the goods.

The Internal Revenue Bureau, in amending Regulation 51, ruled that the 1942 Revenue Act amended section 2402 (b) of the code so as to continue to tax those sales of cosmetics to beauty or barber shops which are for use in the operation thereof but to exempt from the tax cosmetics sold to such shops for resale by wholesalers. The Bureau held that the question of whether a cosmetic is sold to a shop for use or resale is dependent upon the intent of the beauty-shop owner making the purchase. Thus the Bureau ruled that Congress, through the 1942 amendment to section 2402 (b), created a tax exemption on cosmetics sold to beauty or barber shops for resale but held that the shop owner buying the cosmetics for resale must express, in a certificate of purchase for resale, that the cosmetics are purchased for resale in order to be exempt from the payment of the tax to the wholesale supplier and that she will be liable for the 20-percent tax if resold or used.

I have tried to emphasize the important provisions of the law and regulations dealing with the tax on cosmetics as they affect beauty and barber shops. The regulation contains further provisions requiring wholesaler suppliers and beauty or barber shop owners who resell cosmetics to keep and maintain complicated records. I would only confuse efforts to understand this complicated situation by now endeavoring to explain such requirements, so in order to conserve time, I will merely set them forth. The Bureau regulations dealing with sales of cosmetics to beauty and barber shops provides, in part, as follows:

"(b) *Sales made on and after November 1, 1942.*—Any person who, on and after November 1, 1942, (see Section 320.2), sells toilet preparations taxable under section 2402 (a) to another person operating a barber shop, beauty parlor, or similar establishment for use in the operation thereof, and not for resale, shall be deemed to have sold such articles at retail and must make a return and pay tax on all such sales as provided in section 320.60. No tax attaches to the sale of such articles on and after November 1, 1942, to any person operating a barber shop, beauty parlor, or similar establishment for the express purpose of resale.

"The sale of any article described in section 2402 (a) to any person operating a barber shop, beauty parlor, or similar establishment shall be presumed to be made for use in the operation thereof, unless (1) at the time of sale, the vendor is furnished by the vendee with a 'certificate of purchase for resale' substantially in the form as outlined herein, or (2) (if such certificate is not furnished at that time) the vendor has written evidence at the time of sale showing that the sale is made for resale and the vendor is subsequently furnished with a 'certificate of purchase for resale'. Where the 'certificate of purchase for resale' is not furnished at the time of sale, the evidence required to be had by the vendor is not restricted to any particular form of document, so long as such evidence is in writing and shows that the sale is made for resale and not for use in the operation of the barber shop, beauty parlor, or similar establishment.

"Where a sale is made for resale purposes and the 'certificate of purchase for resale' is obtained prior to the time the retailer makes his return for the month in which the sale is made, no tax on such sale should be included in his return. If the 'certificate of purchase for resale' is not so obtained, the retailer must include the tax on such sale in his return for the month in which the sale is made. However, if the 'certificate of purchase for resale' is later obtained, a claim for refund of the tax paid may be filed on Form 843, or a credit taken upon a subsequent

[2] Sec. 623, Revenue Act of 1942, title VI, sec. 2402 (b), as amended.

return, but such action must be taken without the four-year period of limitation prescribed by section 3313 of the Internal Revenue Code.

"The articles covered by the 'certificate of purchase for resale' must be fully identified as to nature, quantity and date of sale.

"Following is the form of 'certificate of purchase for resale' which shall be adhered to in substance:

'CERTIFICATE OF PURCHASE FOR RESALE'

(For use by operators of barber shops, beauty parlors, or similar establishments in purchasing for resale purposes articles described in section 2402 (a) of the Internal Revenue Code.)

------------------------19----
(Date)

The undersigned purchaser hereby certifies that he is an operator of---------- ------------------------ (State business in which engaged) and that the -------------------- (State article purchased) in the order covered by this certicate or on the reverse side hereon will be resold by him and not used in the operation of his business.

The undersigned understands that if the articles are used by him in the operation of his barber shop, beauty parlor, or similar establishment, or resold by him at retail, he will be liable for tax on such use or resale. It is understood that the fraudulent use of this certificate to secure exemption will subject the undersigned and all guilty parties to a fine of not more than $10,000 or to imprisonment for not more than five years or both, together with costs of prosecution. The undersigned also understands that he must be prepared to establish by competent evidence that the article was actually purchased for the purpose for which stated in this certificate.

(Name)

(Address)

"If it is impracticable to furnish a separate certificate for each order or contract, a certificate covering all orders between given dates (such period not to exceed a month) will be acceptable. Such certificate and proper records of invoices, orders, etc., relative to tax-free sales must be retained as provided in section 320.62. Where, upon inspection, it is discovered that the records of a retailer with respect to any sale claimed to be tax-free do not contain a proper certificate, as outlined above, with supporting invoices and such other evidence as may be necessary to establish the exempt character of the sale, the tax shall be payable by the retailer on such sale.

"In any case where the operator of a barber shop, beauty parlor, or similar establishment uses in the operation of his business any article which was purchased by him on or after November 1, 1942, for resale purposes, such use shall be considered as a sale at retail by such operator at the time the article is first set apart for such use. The tax shall be computed at a price equivalent to the amount paid by such person for the article. Where the operator of a barber shop, beauty parlor, or similar establishment resells at retail on or after November 1, 1942, any article previously purchased by him, such operator will be liable for the tax imposed under section 2402 (a) on such resale irrespective of the purpose for which such article was purchased. In determining the amount of tax to be paid by the operator on such resale on or after November 1, 1942, no credit or refund will be allowable for any amount which might previously have been paid as tax to the United States with respect to any prior sale of such article."

Consider the plight of the small beauty- or barber-shop owner trying to comply with the record-keeping provisions of the above-mentioned regulation or confronted with the necessity of signing the frightening Certificate of Purchase for Resale set forth above. There have been differences of opinion among qualified attorneys as to their requirements and Congressmen have confessed to me that they were able to master their meaning only after patient hours of study. Referring to the frightening Certificate of Purchase for Resale, Representative Daniel A. Reed, a member of the Committee on Ways and Means, stated "I can see where it would be terrifying to the ordinary person."[3] Decrying the complicated method of record-keeping imposed on small beauty and barber shops and castigating the

[3] Report of Hearings before Committee on Ways and Means on Proposed Revisions of the Internal Revenue Code—Part 1, Excise Taxes, p. 446. June 10, 1947.

fearsome Certificate of Purchase for Resale, Representative Carl T. Curtis, a member of the Committee on Ways and Means, stated on the floor of the House of Representatives:[4]

"Barbers and beauticians are saddled with an additional hardship. If they want to sell a bottle of hair tonic now and then, they must have a double set of books to keep track of the tax. The tax for preparations used in the shop is paid by the owner or agent when he buys the material. If he sells the preparations to a customer, the barber does not pay the tax when he buys from the wholesaler, but he collects the tax from his customer and remits that. This is not all the story. The barber or beautician is required to sign a vicious statement declaring that if the merchandise used in the shop is mixed up with that which he sells, he will be fined $10,000 and jailed for 5 years."

At the time the House of Representatives, in the Eightieth Congress, enacted legislation repealing the tax on cosmetics used in beauty and barber shops, the Honorable Robert L. Doughton, now chairman of the Ways and Means Committee, stated:

"This bill was carefully considered and unanimously reported out by the Committee on Ways and Means. After full consideration, it was decided that it is a meritorious bill."

We must remember that the beauty and barber industry, while large in number, is composed of many small, for the most part individually owned beauty and barber shops and, in many cases, manned by only one person. Not possessing legal talents, is it any wonder that many beauty- and barber-shop owners threw up their hands when they were confronted with the necessity of signing the frightening certificates and maintaining the records required by the Bureau's regulation and decided not to sell cosmetics to the public if it meant signing the certificate?

The result has been that since the enactment of section 2402 (b), as amended, in 1942 and the promulgation of the Bureau's regulation many beauty- and barber-shop owners, particularly the smaller ones, refrained from selling cosmetics to the public in order to avoid the above-mentioned requirements imposed on those purchasing cosmetics for resale. Shop owners recognized that if they only purchased cosmetics for use in rendering services and paid the wholesaler the excise tax they would not have to sign the certificate or be bothered with the complicated record-keeping required by those who retail cosmetics. So, many shops have gone out of the business of selling cosmetics to the public and have lost vitally needed income they would normally derive from retail sales of cosmetics.

Now, in order to get a picture of the economic unit we are dealing with I would like to point out that the average beauty or barber shop is a one- two- or three-operator establishment depending mostly on revenue from services rendered. Bureau of Census figures [5] show that the average gross income for beauty shops amounts to $2,789, which includes retail sales. During a period of recession there is a considerable falling off in the revenue the shops receive from rendering services and during the last depression there were considerable shop failures. It became apparent to industry leaders that shops needed revenue from some other source to supplement their income from services if they are to survive a recession. The logical source of such additional revenue is the retail sale of cosmetics to customers who patronize the shops for services. Because of the expert knowledge of the sciences of cosmetology and barbering and care of the hair and skin possessed by beauty and barber shop owners and operators they are better equipped than the usual retail clerk in guiding customers in the use of toilet preparations and beauty and barber shops should be the normal and natural outlets for sales of toilet preparations.

Accordingly, the industry encouraged shops to sell cosmetics and up until 1942, and the advent of the Certificates of Purchase for Resale, the sales of cosmetics by shops were steadily on the increase. However, the resistance of shop owners to the certificates has brought a decline in the retail sales of cosmetics by beauty shops. This industry with its many employees is an important factor in our Nation's economy and we must heed the decline in beauty and barber shop receipts which occurred following the termination of World War II. The number of beauty shops rose from 83,071 in 1939 [6] to 113,490 in 1942 [7] as a result of the

[4] Congressional Record, July 14, 1949, p. 9711.

[5] Statistical abstract of the United States; 1946 Bureau of the Census, Department of Commerce, table No. 1056, p. 964.

[6] See Note No. 5, supra.

[7] "Tabulation of Beauty Shop Distribution in 1942," compiled by Beauty and Barber All-Industry Council, 1023 National Press Bldg., Washington 4, D. C.

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demand for shop services occasioned by the increase in consumer spendable income. However, following the end of the war, beauty and barber-shop services had to compete with many items, not available during the war, for the consumer's dollar and there has been a significant decline from the peak incomes beauty and barber shops received during the war years. To make up for the decline in revenue from services beauty and barber shop owners must sell toilet preparations to the public.

The future economic health of beauty and barber shops depends upon their ability to supplement their income from services with revenue from retail sales of toilet preparations. The existing excise tax on toilet preparations used in beauty and barber shops with its harsh and discriminatory procedural requirements which deter shops from retailing toilet preparations should be repealed now that the war emergency is over.

Industry leaders have made tireless but futile efforts to have the Treasury Department eliminate the harsh Certificate of Purchase for Resale through administrative action. They were told, in effect, that only the repeal by Congress of the excise tax on toilet preparations used in beauty and barber shops would eliminate the necessity for Certificates of Purchase for Resale. Treasury officials stated that the proper protection of the revenue and effective enforcement of section 2402 (b) of the Revenue Act of 1942, made it necessary for the Bureau of Internal Revenue to require beauty and barber shops to furnish Certificates of Purchase for Resale to their wholesale suppliers with respect to any preparations purchased by them which they represented they intended to resell, rather than use in the operation of their shops, as an administrative precaution against abuses.

Industry representatives pointed out that beauty and barber shops buy toilet preparations for shop use and for resale to the public in packages and containers which could not possibly be confused with each other. The packaging of toilet preparations for resale to the public is in small-size containers, ranging from 2 to 8 ounces. In addition, such packages are designed for consumer appeal. The prices generally, per ounce, for retail packages range anywhere from 3½ to 10 times greater than the price, per ounce, of the same item packaged for use in the shop. Moreover, the latter type goods, referred to as professional merchandise, is invariably packaged in large-size containers, lacking in consumer appeal, ranging from 1 quart to 5 gallons. In an effort to allay the fears of Treasury officials that shop owners might purchase retail package items, without paying the tax thereon, and use the same in rendering services, it was pointed out that, except in the utmost emergency, no shop could profitably use any item packaged for resale in rendering services or remain in business very long if this practice was followed with any degree of regularity. Despite these representations, Treasury officials advised that precedents made necessary the requirements for Certificates of Purchase for Resale in sales of toilet preparations to shops where intended for resale. Our industry then realized that only Congress possessed the power to remove the deterrent to retail selling by beauty and barber shops through the elimination of the Certificate of Purchase for Resale by repealing the tax on toilet preparations used in beauty and barber shops.

Recently, the Secretary of the Treasury, Mr. John Snyder, recommended that Congress consider for relief those excise taxes which are most harmful and burdensome to the industries affected, which create most serious competitive problems, which fall with undue weight on low-income groups, and which impose barriers to investment and consumption. The excise tax on toilet preparations used by beauty and barber shops in rendering services clearly falls within the type of tax recommended by Mr. Snyder for relief with little or no apparent loss in revenue to the Government.[8]

The beauty and barber shops of the Nation request the Finance Committee to report favorably and the Senate to enact legislation including section 103 (d) of the Revenue Act of 1950 repealing the tax on cosmetics used in beauty and barber shops for the following reasons:

1. This tax is harmful and burdensome to beauty and barber shops since it places an undue burden on shops selling cosmetics by requiring them to furnish each and every supply wholesaler with a frightening Certificate of Purchase for Resale and, by so doing, has caused many small shops to refrain from selling cosmetics to the public, thereby causing them to lose income which they normally would derive from such sales.

[8] House Report No. 1970 (80th Cong.), p. No. 3.

2. This tax adds to the operating costs of a beauty or barber shop. The greater portion of shop revenue is derived from rendering services. Toilet preparations are part of the barber's and beautician's tools. A tax on toilet preparations used in shops is a tax on the tools of persons endeavoring to earn a living with their hands. The average gross income of shops is less than $3,000 and a 20-percent tax on items making up the bulk of materials used in rendering services is an extra operating cost which falls with undue weight on small beauty and barber shop owners in the low income groups, since it must be absorbed.

3. This tax places an undue burden on small beauty and barber shops since the regulations require considerable complicated record-keeping which taxes the time and energy of the owner of a one- or two-operator shop and adds to her expense as a result of the necessity for employing accountants or attorneys.

4. This tax is difficult to administer, since some beauty and barber shops are both users and resellers of cosmetics. A realistic enforcement of the existing tax law and its regulations would cost the Government an amount of money entirely out of proportion to the small amount of revenue received from the tax on cosmetics used in shops.[9]

5. This tax and its procedural requirements for certificates of purchase for resale places beauty and barber shops at a competitive disadvantage with other retailers of cosmetics, since it requires such shops to pay the 20-percent tax to the wholesaler if the frightening certificate of purchase for resale is not furnished, whereas other retailers of cosmetics are not required to furnish their supply wholesalers with certificates of purchase for resale or pay the 20-percent tax in lieu thereof.

6. A reduction of the tax on cosmetics used in beauty and barber shops to 10 percent, or even 1 percent, will not remove the procedural hardship imposed by regulations requiring certificates of purchase for resale be furnished by shop owners to supply wholesalers when purchasing cosmetics intended for resale. The only manner in which beauty and barber shops can be relieved of the necessity of furnishing certificates of purchase for resale is through the repeal of the tax on cosmetics used in beauty and barber shops.

If legislation repealing the tax on cosmetics used in beauty and barber shops is enacted, there will be no loss of revenue to the Government.[10] It is estimated that not more than $3,300,000 is collected annually by the Government as a result of the tax on cosmetics used in beauty and barber shops.[11] Should Congress follow the recommendations of the President and reduce the toilet-preparations tax to 10 percent, the annual yield from such tax on toilet preparations used in beauty and barber shops is estimated at not more than $1,650,000. The apparent loss of either these small amounts, according to the Ways and Means Committee of the Eightieth Congress,[12] would be more than offset by the increased tax yield from retail sales by beauty and barber shops in a broadened retail market. Moreover, the committee felt that an increased income tax yield would also follow reduced business costs and enlarged volume of sales at retail by beauty and barber shops.[13]

I have endeavored to point out the hardship and discrimination suffered by beauty and barber shops as a result of the tax on cosmetics used by such shops and the need for legislation repealing the tax. There appears to be unanimous opinion in Congress that the beauty- and barber-shop industry has a just case and is entitled to the excise-tax relief it requests.

I refer to House Reports 1970 (80th Cong.) and 2319 (81st Cong.) for a further analysis of the proposed legislation requested by the beauty- and barber-shop industry.

The Finance Committee and the Senate are respectfully urged to grant the 240,000 beauty and barber shops and their 750,000 employees the relief requested from the harmful and burdensome wartime tax on toilet preparations used in beauty and barber shops in their operation by approving section 103 (d) of the Revenue Act of 1950 (H. R. 8920), which exempts such items from taxation.

The CHAIRMAN. Mr. C. W. Halligan.

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[9] H. Rept. 1970, 80th Cong., p 3.
[10] H. Rept. 1970, 80th Cong., Ways and Means Committee, p. 3.
[11] Supra.
[12] Supra.
[13] Supra.

STATEMENT OF CHARLES W. HALLIGAN, CHAIRMAN, TAX COMMITTEE, RUBBER MANUFACTURERS ASSOCIATION, INC., NEW YORK, N. Y.

Mr. HALLIGAN. Mr. Chairman and members of the committee, my name is Charles W. Halligan. I am chairman of the tax committee of the Rubber Manufacturers Association of New York City, appearing on behalf of the tire and tube industry.

Senator CONNALLY. Does that mean all the rubber people or just those in New York?

Mr. HALLIGAN. All the tire manufacturers regardless of whether they are members of the Rubber Manufacturers Association or not.

Since 1945, the manufacturers of tires and tubes have petitioned the Congress on several occasions for repeal of the burdensome and discriminatory wartime excise taxes levied against their products.

In approving the Revenue Act of 1950, which is now before you, the House gave cognizance to the plea of this industry for relief. The House action does not restore the tax to its prewar level. It goes only half way in that direction, by authorizing a downward adjustment of 25 percent in the present levy. This industry feels strongly that the tax should be carried back at least to the 1941 rate. We are here today to urge your careful consideration of the arguments which we presented before the House Ways and Means Committee on that point.

Senator TAFT. What are the rates in question?

Mr. HALLIGAN. The present rates are 9 cents a pound on tubes and 5 cents a pound on casings or tires. The House has reduced the rates 25 percent in both instances.

Senator KERR. What percentage of the retail sales price does that represent?

Mr. HALLIGAN. It will vary, depending upon the price at which it is sold.

Senator KERR. Can you average it up?

Mr. HALLIGAN. It will range from 7 percent to approximately 14 percent on passenger car, truck, and bus tires.

Senator KERR. And tubes?

Mr. HALLIGAN. Yes.

Senator KERR. It will average 10 percent?

Mr. HALLIGAN. It may average about 10 percent. On baby carriage tires, however, it runs as high as 55.7 percent but those have been eliminated in the present draft of the House bill.

Senator KERR. That is, in the present law it will be approximately 10 percent average?

Mr. HALLIGAN. On automobile, truck, and bus tires.

Senator KERR. How much did the House reduce that?

Mr. HALLIGAN. 25 percent.

Senator KERR. Thank you.

Mr. HALLIGAN. If in the judgment of the committee, recent developments in world politics and economics make it impossible to restore tire and tube excise taxes to their 1941 rate at this time, we then petition the concurrence of this committee in the judgment of the House.

Further, we wish to solicit your favorable consideration of an amplifying amendment which would permit the recovery of taxes

paid by tire dealers on floor stocks. Suitable provision for the recovery of these taxes was proposed by Hon. Walter B. Huber of Ohio in H. R. 6898, introduced on January 20, 1950, in the second session of the Eighty-first Congress. A copy of the language suggested in that bill is attached to this statement, and we wish to request that it be made a part of the record of these hearings.

Unless a provision is made for a credit on floor stocks, equivalent to the proposed tax reduction, all dealers including small dealers holding tax-paid stocks of tires and tubes, on the effective date of the new act, would be penalized and placed in an inequitable position, as against those who hold stocks of tires and tubes upon which the tax had not been paid. As a protective measure, those tire distributors who are thus discriminated against would hold off purchases and disrupt the even flow of goods from manufacturer to consumer.

We urge adoption of the Huber amendment of behalf of the tire dealers of this country to prevent stagnation of tire distribution and the competitive inequities mentioned.

We submit that in all fairness at least the tax rate adjustment on tires and tubes, and the elimination of the nuisance tax on tires for baby carriages, juvenile vehicles, toys and lawnmowers, etc., incorporated in the House bill, be adopted.

Thank you for this opportunity of appearing before your committee.

The CHAIRMAN. What was the tax under the 1941 act, before the war?

Mr. HALLIGAN. In 1932 the tax was 2¼ cents a pound on tires and 4 cents a pound on tubes. In 1940 it was raised to 2½ cents on tires and 4½ cents a pound on tubes.

Senator KERR. Was it not the same?

Mr. HALLIGAN. No, sir, a quarter-cent up, on tires, and a half cent up on tubes.

In 1941 the tax was doubled to 5 cents a pound on tires and 9 cents a pound on tubes.

The CHAIRMAN. That is your present tax?

Mr. HALLIGAN. That is right, that is the present rate.

The CHAIRMAN. Are there any further questions? If not, we thank you very much for your appearance.

Mr. HALLIGAN. Thank you, sir.

The CHAIRMAN. Mr. M. D. Harbaugh.

STATEMENT OF M. D. HARBAUGH, VICE PRESIDENT, LAKE SUPERIOR IRON ORE ASSOCIATION, CLEVELAND, OHIO

Mr. HARBAUGH. Mr. Chairman and members of the committee, my name is M. D. Harbaugh. I am vice president of the Lake Superior Iron Ore Association of Cleveland, representing most of the companies that mine and ship iron ore from the important Lake Superior district of Minnesota, Michigan, and Wisconsin.

Mr. Chairman, I have a statement which is very brief, about four and a half pages, which I shall be pleased to read to you if I have time.

The CHAIRMAN. You may proceed as you wish.

Mr. HARBAUGH. I would like to read it if I may.

The CHAIRMAN. Yes, sir.

Mr. HARBAUGH. The Lake Superior district is the principal source of iron ore for the steel industry of the United States, supplying more than 80 percent of its ore requirements.

As is generally well known, the most important reserves of easily mined open pit ores on the great Mesabi Range, which produces more than 75 percent of the Lake Superior output, have suffered severe depletion during the past decade. It was the great open pit mines which supplied the bulk of the ore to make the steel which was vital to our nation in two world wars, and which has been also the backbone of our peacetime industrial economy. Nearly 800,000,000 tons of ore were shipped from the Lake Superior district in the last decade and many of the largest open pit mines are now nearing exhaustion. The known reserves, in relation to the continued high rate of extraction, are uncomfortably low.

In order to maintain the essential self-sufficiency of the United States in iron ore—and any other position is unthinkable from the standpoint of national security—the Lake Superior iron ore industry is now faced with a tremendous task in undertaking to maintain its high productive capacity by developing new sources of supply to replace the waning open pit reserves of present commercial grades of ore.

This task involves extremely large expenditures for exploration and development of potential new ore deposits, and particularly of deposits which previously were too remote in depth or too low in grade to be commercial. The essential new productive capacity can come from three principal sources:

1. Deep open pits which will require very heavy stripping of overburden to make easily accessible certain ores which heretofore have been classed as underground reserves.
2. Exploration and development of extremely deep ores in the underground mines in Michigan and Wisconsin, to depths of 5,000 feet or more.
3. Development of large operations for concentrating taconite—the low grade, iron-bearing rock from which nature produced the ores now being mined.

Substantial productive capacity from these new sources will require vast capital expenditures, and it seems obvious that tax policy should not be such as to impair incentives to make these expenditures, which are necessary to insure that iron ore shall continue to be available within our own borders, sufficient to meet our basic needs.

We believe that the most effective encouragement that Government can create to this end is in providing fair and reasonable tax laws and regulations.

The Treasury has severely criticized the depletion allowances which are granted on a percentage basis to metal mines and other mineral deposits. I wish to point out that the iron ore industry has put back into the ground in exploratory work essentially all the tax saving for which percentage depletion has been responsible since its inception in 1932. In view of the substantially greater costs which are involved in exploring for and development of new sources of ore supply, the existing depletion allowance at 15 percent of gross income is wholly inadequate to provide funds to replace with new reserves the ores that have been exhausted. The National Minerals Advisory Council, in testimony before the Ways and Means Committee in February made this clear with respect to metal mines in general. It is particularly true with respect to iron ore.

There are certain provisions of the present bill, H. R. 8920, which, if enacted, will have highly discouraging effects upon the urgent program which I have described as essential for this industry.

Section 204 (c) of the bill, regarding percentage depletion, in revising the definition of gross income from mining, would create a deterrent that certainly will adversely affect the development of low-grade ores including the taconites, which require beneficiation. Plants cannot always be established directly at the property but must be located at the nearest practical point as determined by physical conditions and other factors. The transportation is an integral part of the whole operation of mining and beneficiation. Disallowance of transportation in computing gross income for depletion, would impose a severe handicap to the industry's program for developing these low-grade deposits.

Senator MILLIKIN. How far would you carry the transportation cost?

Mr. HARBAUGH. Well, we have plants that are located several miles from the source of the ore, centralized plants which are necessarily large in which ores from numerous small pits or small workings can be treated.

Senator MILLIKIN. How do you treat the iron ore at those smaller plants?

Mr. HARBAUGH. The ore is treated in these plants by washing to remove some of the imports and by other concentration processes such as are technically known as jigging and heavy density separation.

Senator MILLIKIN. You are simply preparing the ores for the plant?

Mr. HARBAUGH. Yes, sir. This part that is treated would not be marketable without this treatment.

Senator MILLIKIN. You would not run your cost down to Pittsburgh?

Mr. HARBAUGH. No. This involves the transportation to the processing plant where we make the first marketable product.

Senator TAFT. And a product which can be shipped on boats?

Mr. HARBAUGH. Which can be shipped on boats and which is usable in the premises.

The CHAIRMAN. Was it not intended by the House to exclude the transportation cost of the first processing plant?

Senator TAFT. These are the words:

> * * * but such terms shall in no case include transportation beyond the property,

That is what the House put in.

Mr. HARBAUGH. The whole problem is, what do you mean by "the property"? If the property is the particular place from which the crude ore is taken, then that is a very restrictive clause because the processing plant may be a few miles away or it may be a mile away.

Senator MILLIKIN. You might have four separated properties owned by the same people who have a central processing plant and this language would be ridiculous in that case.

Mr. HARBAUGH. That is right and in the future in the treatment of this taconite that will be more important than now.

The CHAIRMAN. Mr. Stam, would you be prepared to say whether the House intended by the use of this language to exclude the cost of first processing, the first step in the processing to render marketable or merchantable the minerals?

Mr. STAM. I think when the problem came up before the House committee they were particularly concerned with the new minerals that had come in, such as sand and gravel and some of those, and it was pointed out that if you computed the depletion allowance on the sand at the pit and then you carried it 3 or 4 miles away in a truck, that the cost would be much greater. I mean that is the way the thing originally came up, but in discussing it the House decided that they would make the amendment effective for the existing depletion allowances as well as the new depletion allowances that were brought in. So that I think the way the amendment was worded it was intended to put a limitation on the whole allowances but it started from the idea of sand and gravel and some of those minerals that they did not want to give a bigger allowance to than the value at the time it was taken out.

Senator TAFT. They do not propose to include transportation on ships down to Pittsburgh, of course?

Mr. STAM. That is right.

Senator MILLIKIN. What is the answer to the argument, if there was an argument, that it is practical to limit it to the property? We were just discussing, Mr. Stam, that sometimes there will be three or four properties all served by a central cleaning-up plant. In coal mines you have a washing problem, I assume, similar to your problem?

Mr. HARBAUGH. Very similar.

Senator MILLIKIN. In other words, you have no salable product until you get through that first processing business which does not change the character of the product. It merely renders the product marketable.

Mr. HARBAUGH. Section 209, regarding capital gains and losses, in its application to the iron ore industry, would very seriously interfere with the large investments of capital that are necessary if this industry is to carry out the great task which now confronts it. This section would require that capitalized exploration and development expenditures on properties abandoned be treated as capital losses, recoverable only against capital gains. Under present law, when a property is abandoned, such unrecovered investment in exploration and development or in plant and equipment, may be charged against ordinary income. Since mining companies rarely have capital gains, the effect of this provision would be to disallow practically all deductions for unproductive exploration and development, and for losses on plant and equipment. There have been large expenditures in the past by the Lake Superior iron ore industry which have proved wholly fruitless. The risks of the future will be even greater, for the problem of bringing into production new ore supplies is far different from what it was in the past. The large deposits of easily developed ores have already been discovered and to a great extent exhausted.

With respect to section 214, net operating loss, this industry protests the failure of this bill to correct the inequity of disallowing percentage depletion in the computation of net operating loss deductions. The present practice makes the tax burden much heavier for the taxpayer who has some years of profit and some of loss, than is the tax burden of one with steady income. Change should be made so that percentage depletion would not be denied in computing the net operating loss deductions.

Section 205, as to pre-1913 earnings and accruals, proposes a change which in good faith should not be made. The law has long recognized that earnings and profits accumulated prior to March 1, 1913, and appreciation in value of property, established as of that date, may be distributed tax-free to stockholders after other earnings had been distributed. That status should not now be denied. Moreover, thus lightly to change basic, long-established principles cannot fail to be considered by investors in this industry as a serious threat to any future investments of risk capital which they contemplate.

The technical know-how and organizing ability are available within this industry to successfully execute the stupendous task of developing these new and vital sources of iron-ore supply. It remains for Congress and the taxing authorities to recognize the importance and necessity of establishing the sort of tax climate that will attract the large amounts of risk capital which would be available to do this job. To this end, we urge your serious consideration of the matters herein discussed.

Senator MILLIKIN. Mr. Chairman, I would like to ask the witness whether he does not see features of capital confiscation in changing the rule of 1913 property value.

Mr. HARBAUGH. I certainly do.

Senator MILLIKIN. Because those 1913 values under all past laws have been given a corporate value or value by individual owner and you are seriously affecting that capitalized value, are you not?

Mr. HARBAUGH. It seems a wholly unwarranted thing to do at this stage.

Senator TAFT. I took it that you could not tax earnings prior to 1913 because there was no income tax.

Mr. KIRBY. I would like to say that this is merely for the computation of the dividends paid to stockholders of corporations. It is not to impose the tax on the corporation with respect to the prior earnings or with respect to the appreciation in value prior to 1913 but it is merely in the computation of the earnings that a corporation distributes to its stockholders.

Senator TAFT. For 37 years we have considered the policy of assuming that those earnings were earned before the income tax and therefore as far as the stockholder was concerned it was in effect a distribution of capital existing in 1913 when the income tax law went into effect. Why change it at this late date?

Mr. KIRBY. There is not really a lot of revenue involved. I think we figured it was something like a million dollars a year that we would obtain from this area. There is certainly no inequity in imposing upon stockholders this tax on dividends that are essentially earnings of the corporation.

Senator TAFT. They have to apply it against their cost?

Mr. KIRBY. Yes they apply it against the basis of the stock.

With respect to pre-1913 earnings, if they bring the basis of their stock down to zero as a result, then any excess will be taxed at the capital gains rate.

Senator MILLIKIN. If it involves so few dollars, why do you bother with it? Why do you have such an upsetting provision?

Mr. KIRBY. I would not say it is upsetting.

Senator MILLIKIN. My mail shows that it is upsetting and the testimony shows that it is upsetting.

Mr. KIRBY. This rule is quite an administrative problem. The taxing people who have studied this feel that it should be eliminted from our code.

Senator MILLIKIN. We do not run our tax laws to convenience the Treasury. May I make that suggestion?

Mr. KIRBY. Yes, you may.

Mr. STAM. I might say, Senator Millikin, that ever since 1928 there has been a drive on to eliminate this exemption.

Senator MILLIKIN. It has been a constant drive and it has never been done. It is one of those old "cats and dogs" that Treasury comes in with here every time it can and tries to slip in, and it slipped it in on the House side. I hope it is slipped out on the Senate side.

Mr. STAM. The tax duplication group and all the people interested in the simplification of the law have recommended that this be eliminated.

Mr. KIRBY. I think it is an area where the Congress should eliminate this tax exemption privilege which has no real reason for it. The Supreme Court some time ago indicated that it was perfectly appropriate under the Constitution to tax this.

Senator MILLIKIN. There may be a constitutional argument.

Senator TAFT. I can say that probably it does not apply to the stockholders' income but in deciding whether that kind of distribution was capital or interest, we decided it would be capital. I do not quite see how it should change now.

Mr. KIRBY. At the early stage we really wondered whether we could tax it at all and since then it has been continued really as a virtual exemption except in the reduction of the basis.

Senator TAFT. It is treated as capital distribution instead of income distribution.

The CHAIRMAN. If there are no further questions, we thank you very much, Mr. Harbaugh.

Mr. HARBAUGH. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Hugh W. Taylor.

STATEMENT OF HUGH W. TAYLOR, EXECUTIVE SECRETARY, BURLEY AND DARK LEAF TOBACCO EXPORT ASSOCIATION, INC.

Mr. TAYLOR. Mr. Chairman and gentlemen of the committee, my name is Hugh W. Taylor. I am executive secretary of the Burley and Dark Leaf Tobacco Export Association, Inc.

The CHAIRMAN. What is the difference between burley and dark leaf? Are they two separate types?

Mr. TAYLOR. Yes, sir. Dark tobacco may be either fire-cured or air-cured. Burley tobacco is air-cured tobacco but it is a light cigarette type.

Senator CONNALLY. What is that?

Mr. TAYLOR. Burley tobacco is also air-cured tobacco but it is the light type of tobacco which is used largely in cigarettes.

Senator CONNALLY. Do you not chew burley?

Mr. TAYLOR. Yes, sir, and it is also used in smoking mixtures and a small amount is used in snuff.

Our association is purely a nonprofit organization representing the growers, dealers and warehousemen of the burley and dark tobacco

areas. It has, through its subsidiary farmer marketing organizations, a membership of more than 400,000 tobacco growers who reside in the States of Kentucky, Tennessee, Virginia, West Virginia, North Carolina, Ohio, Indiana and Missouri.

We support a reduction in the excise tax on chewing tobacco, smoking tobacco, and snuff. We do so for two reasons:

1. The manufacture of chewing and smoking tobacco has declined irregularly for many years. The manufacturers of these products are therefore engaged in a declining business, and it appears that they need this assistance to stimulate their business.

2. The manufacturers of these products use leaf tobacco that is generally unsuitable for the manufacture of either cigarettes or cigars. These grades of tobacco are in surplus supply, and any action taken to increase their compensation would directly benefit the growers of flue-cured, burley, and dark tobacco through increased domestic usage of these types and grades. We would, however, oppose a graduated excise tax on these products. We regard a tax based on the retail price of tobacco products as being beneficial to certain vested interests rather than as beneficial to the tobacco industry.

A decrease in excise tax on these products may relieve a distressed situation on the part of both the manufacturers and the producers of leaf tobacco used in these products.

We oppose a change in the Internal Revenue Act to provide a differential or graduated excise tax on cigarettes according to retail price.

Senator CONNALLY. That is the so-called economy cigarette?

Mr. TAYLOR. The so-called economy cigarette or any other cigarettes on that price basis.

The CHAIRMAN. It operates against the producer; at least that has been the contention.

Mr. TAYLOR. That is our contention. We have three contentions in that connection, sir.

The first contention is that the business of manufacturing and distributing cigarettes is, as a whole, in a prosperous rather than a distressed condition. The cigarette industry, therefore, does not need relief in the form of a graduated tax.

The second contention is that the consumers of cigarettes in the United States are, so far as we know, not asking for relief in this connection.

Senator KERR. You think that if they need relief it is in some other form?

Mr. TAYLOR. Yes, sir, I do.

The rate of pay in the United States is higher than in most countries of the world and consumers are therefore well able to pay for cigarettes in present retail prices. In fact, in terms of labor required to obtain cigarettes, they are now cheaper here than in countries that are receiving aid from this country.

Senator MILLIKIN. Several times cheaper.

Mr. TAYLOR. Very much cheaper, yes, sir.

The third contention is that tobacco growers fear, from past experience, that cheap cigarettes will be made from cheaper leaf and that income will suffer in proportion to any increased sale of economy brand cigarettes.

Senator MILLIKIN. Would it work something like this? I do not come from a tobacco country, and I am trying to educate myself a little bit. If you have this graduated tax, the producers of the higher-priced cigarettes will meet the competition, and to meet the competition they will have to beat down the price of the kind of tobacco they will buy?

Mr. TAYLOR. That is right.

Senator MILLIKIN. Is that the essence of it?

Mr. TAYLOR. I will bring that out a little later, sir.

In support of our first contention we cite the record growth of cigarette manufacture and consumption in this country during the past 50 years. Since 1910 to the present, small cigarettes of all prices have paid the same excise tax per thousand, and the industry has prospered. It has prospered because the present system of excise tax has caused manufacturers to compete on a quality basis and the cigarettes made therefore have consumer demand on this basis. Cigarettes made in this country are noted for their superior quality, and we hope the quality basis of competition will be maintained, as manufacturers will use quality leaf, and this means higher prices to the tobacco growers. The prosperity of the cigarette industry, quality cigarette industry, is indicated by the high rate of production.

In support of our second reason for opposing the graduated excise tax on small cigarettes, we would point out that consumers are more than able to pay the present Federal excise tax. In terms of work hours required to buy cigarettes, United States consumers are in a favorable position.

The minimum wage in this country is 75 cents per hour. Of course, most people earn more than 75 cents an hour. At the minimum wage a laborer would work less than 7 minutes to pay for 10 cigarettes. According to data released by the United Nations Economic Commission for Europe (New York Times, June 11, 1950), the cost of 10 cigarettes, in terms of hours of work, in several countries of western Europe is as follows:

Country	Hours of work	Converted to minutes
Denmark	½	30
Norway	½	30
Britain	¾	45
Germany	¾	45
Sweden	½	30
Austria	½	30
Switzerland	¼	15
France	½	30

Senator MILLIKIN. Is it not true that in those countries they usually have government monopoly on distribution?

Mr. TAYLOR. Of the ones I have named, only in Austria and in France.

Belgium and Netherlands were not given in this.

It will be seen from the above that at the minimum wage in this country a laborer works only one-half as long as a Swiss laborer to obtain 10 cigarettes, less than one-fourth as long as laborers in France, Austria, Sweden, Norway, and Denmark. Laborers in Britain and

Germany work more than six times as long as United States laborers to pay for 10 cigarettes, and moreover the United States laborer gets quality cigarettes for his efforts.

We submit, therefore, that consumers in this country are well able to pay the price for quality cigarettes and that there is no need for a graduated excise tax to enable certain manufacturers to produce so-called economy cigarettes that are cheaper. They are already cheap enough.

Tobacco growers believe from past experience that a graduated excise rate from the so-called economy cigarettes will result in lower prices for leaf tobacco and thereby cause loss in income to hundreds of thousands of producers in order that a few manufacturing companies may be able to sell cheap cigarettes.

Under the proposed differential excise tax for economy brand cigarettes, it has been stated—Tobacco, June 8, 1950, page 4—that the wholesale and retail prices for standard brands and economy brands would be as follows:

	Standard brands	Economy brands
Manufacturer's net selling price per 1,000	$6.86	$4.807
Retailing selling price per 50 packages	8.50	6.00
Price per package	[1].17	[1].12

[1] Calculated from above data.

If the present and proposed excise taxes are deducted, there would be left to manufacturers, for cost and profit, $3.36 per 1,000 for standard brands and $2.357 for economy brands, or a difference of $1.003 in favor of standard brands. The manufacturers of economy brands must find some means of saving the difference between the net selling price of their cigarettes and the net selling price of standard brands. That is $1 per thousand. It cannot be expected that economy-brand manufacturers will absorb this difference of $1 per thousand. It would appear reasonable, therefore, to assume that manufacturers of economy brand cigarettes would be forced to cut the cost of their cigarettes below the cost of standard brands.

It would also be reasonable to expect that the largest cost item would be subjected to as large a cut as possible. The leaf tobacco used in cigarettes is the largest cost item.

A current trade estimate places the tobacco cost at about 55 percent of the manufacturers' selling price exclusive of tax (footnote 16, p. 1429, Revenue Revision of 1950).

The cost to the manufacturers of economy-brand cigarettes would be $2.357 per thousand cigarettes. If this amount is multiplied by 55 percent, the cost of tobacco in 1,000 economy-brand cigarettes would be approximately $1.30. The leaf cost to manufacturers of standard-brand cigarettes would be $3.36 multiplied by 55, or approximately $1.85 per thousand cigarettes. On the basis of leaf costs being 55 percent of total cost, manufacturers of economy brands could only afford to pay $1.30 per thousand cigarettes for their leaf, which is 55 cents per thousand less than can be paid for the leaf used in standard-brand cigarettes.

Senator CONNALLY. Do you contend that the manufacturers of the economy-brand cigarettes, in order to meet this differential that you mention, would reduce the price to the producer?

Mr. TAYLOR. They would be obliged to make the savings somewhere and, the leaf cost being the biggest cost item, they would naturally have to attack that.

Senator CONNALLY. That is what you object to?

Mr. TAYLOR. That is what we object to.

Now the usual basis of calculation in the manufacture of a thousand cigarettes is three pounds, farm-sales weight, of leaf tobacco per thousand cigarettes. So on this basis of 3 pounds the manufacturers of economy-brand cigarettes would need to buy leaf tobacco at 18 cents per pound less than the price paid for leaf used in the manufacture of standard brands. In other words, the farmer who sold the tobacco for that purpose would lose 18 cents per pound.

Senator MILLIKIN. I think you have another factor. The standard-brand man in order to compete with the economy-brand man has to beat down the price of the tobacco that he buys. Is that not correct?

Mr. TAYLOR. Even on that particular basis they would be even, Senator, at 18 cents. So that, for the economy brand to get some advantage, you would have to do better than that.

If you refer back to the records of when economy-brand cigarettes were sold in volume, in this table attached you will see that their purchases always averaged more than 18 cents below the prices paid for standard brands. Now in studying this table it is necessary to remember that the tobacco bought in 1950 will be aged for 18 to 36 months before it goes into cigarettes and that price would not show up for 18 months or 2 years thereafter in the cigarette manufacture.

Now there is just one further point to which I would like to call your further attention, and that is this. The retail price of economy-brand cigarettes under the proposed excise differential would be 12 cents as compared with 17 cents for standard brands, or a price differential of 5 cents per package of 20 cigarettes. Now the tax differential of $2.45 as compared with $3.50 would be $1.05. Now, if the manufacturers got all of it, it would be 2.1 cents per package, but since they are going to sell their cigarettes at 5 cents less, there is still that 2.9 cents that the economy-brand manufacturer has to make up from some other source, and we submit that this 2.9 cents must come largely from the principal cost, and that is the price paid for the tobacco.

It appears, therefore, that the fears of producers are well-founded and that cheap cigarettes will necessarily mean lower prices to growers of leaf tobacco.

This association consequently petitions the Finance Committee of the Senate to—

1. Approve reductions in the excise taxes of chewing tobacco, smoking tobacco, and snuff; and
2. Reject the differential or graduated excise tax on cigarettes.

(The table referred to in this presentation follows:)

Comparative prices paid to farmers for leaf tobacco used in standard and economy brand cigarettes, and difference between the prices paid, 1931–41

[Cents per pound]

Year	Burley [1]			Eastern flue-cured [2]			Western flue-cured [3]			Economy-brand cigarettes as percent of distribution of all cigarettes
	Standard brands	Economy brands	Difference	Standard brands	Economy brands	Difference	Standard brands	Economy brands	Difference	
1931	16.04	5.98	10.06	22.28	3 20	19.08	24 83	2.65	22.18	0 3
1932	(4)	(4)	--------	27 15	6.70	20 45	29 08	5.89	23.19	10 3
1933	21.71	10.35	11.36	28 36	9.10	19 26	31 27	9.61	21.66	9 1
1934	26.78	15.23	11.55	37 92	14 88	23 04	42.37	13.37	28 60	11 0
1935	35 01	15.54	19.47	31.07	9.91	21.16	31 58	7 48	24 10	11.7
1936	61.71	38.00	23.71	35.11	8 71	26 40	41.50	9 08	32.41	10.9
1937	36 71	20.33	16 38	34 94	11 43	23.51	38.42	13.13	25.29	12.1
1938	27.00	16.62	10.38	31.44	15 58	15.82	33.33	16 60	16.63	14.3
1939	25.14	15.91	9.23	24 58	11 68	12.90	26 88	11 85	15.03	14 8
1940	28 71	17.21	11 50	28 11	14 31	13 80	32 25	14 13	18 12	11.9
1941	42.71	31.33	11 38	37 77	26 54	11.23	42 75	25 35	17.40	10 2
1942	(5)	(5)	--------	(5)	(5)	--------	(5)	(5)	--------	6 3
1943	(5)	(5)	--------	(5)	(5)	--------	(5)	(5)	--------	4 1

[1] Type 31
[2] Types 12, 13, 14.
[3] Types 11a, 11b.
[4] Government figures not given.
[5] Not contained in table 9 of hearings before Ways and Means Committee on Revenue Revision of 1950

The CHAIRMAN. If there are no further questions, thank you, Mr. Taylor, for your appearance before the committee.

Mr. TAYLOR. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Thomas A. Buckley.

STATEMENT OF THOMAS A. BUCKLEY, PRESIDENT, LUGGAGE AND LEATHER GOODS MANUFACTURERS OF AMERICA, INC.

Mr. BUCKLEY. Mr. Chairman, my name is Thomas A. Buckley and I am president of Buxton, Inc., but appearing here as president of the Luggage and Leather Goods Manufacturers of America, Inc.

Permit me first to thank you for the privilege of appearing before you to present some additional facts relative to your consideration of tax bill H. R. 8920 which concerns itself with excise tax relief and other tax provisions.

As president of the trade association which represents the manufacturers of luggage and leather goods, and as president of one of the principal manufacturing units in the industry, I have come to realize now more than ever the devastating effect that an excise tax can have on an industry. Never before in the history of our Nation has competition for the consumer dollar been so keen. As the representative of an industry which must compete for this dollar, I have come to know just what it means, competitively speaking, to have the products of an industry burdened by an excise tax. To our industry it has meant unemployment, business losses, and failures.

I realize that you have limited my time to appeal to you, for good and sufficient reason. I shall not abuse the courtesy you have extended to me. In that interest, therefore, I shall rely on our case as submitted to the House Ways and Means Committee as the principal statement which I believe proves beyond a shadow of a doubt that the unemployment, business losses, and failures which I have previous-

ly mentioned can only be stemmed by the constructive action of both Houses of the Congress in voting excise-tax relief.

That brings me to the additional points which I should like to make before you. Tax bill H. R. 8920, in dealing with the retail excise tax under the heading "Luggage," recommends that the retail excise tax on some items within its classification be reduced from 20 percent to 10 percent, while other items within its scope be entirely exempt from excise tax. We have no quarrel with that portion of the bill which calls for complete exemption. In fact, we applaud this action, and urgently request that this provision be maintained.

Our concern is with that portion of the bill which retains the excise tax on certain luggage items. In urging reconsideration of this section of the bill, we present these thoughts:

1. In our analysis of the action taken by the House Ways and Means Committee in dealing with the retail excise taxes, it is obvious that the foremost thought was to continue, albeit reduced, the excise tax on so-called luxury items and to completely eliminate the tax on items not considered luxuries. It is our contention now, and has been our contention all along, that the excise tax on luggage did not have its origin in luxury but rather in necessity. Necessity created by a world at war. Necessity imposed by the absolute need to wage such a war successfully. The leather, wood, steel, brass, paper, cotton, and silks so essential in the manufacture of luggage and leather goods, became materials of war immediately upon the declaration of war.

Our record as an industry in supplying our military with the products of our manufacture indicates clearly the essential nature of our products. So that civilian usage would not hamper the military need, the excise tax was imposed. That it served that purpose well is obvious when consideration is given to the fact that upward of 90 percent of the total production of the industry during the war years went to post exchanges, ships service stores, and other military agencies.

Now, however, when the products of our manufacture must find their way only through normal civilian business channels, the excise tax is an anchor which is proving disastrous. As a necessity of war, the excise tax could be and was tolerated. As an instrumentality of revenue raising, it may have its merits, but should not be used in a manner clearly discriminatory.

In removing the tax completely from items not considered luxuries, the House Ways and Means Committee recognized the need to right a grievous wrong. However, in the case of the excise tax on luggage items, it only reduced the wrong, but did not correct it. We urge this committee, with all the power at our disposal, to make the half-wrong now recommended, a right which would bring the needed relief to an industry which has undergone a period of deep depression caused by a discriminatory tax.

The proof that luggage, trunks, brief cases, salesmen's sample cases, and other luggage items are not luxuries, is self-evident when examined in the light of modern living and modern business. I ask each member of this committee to examine into his own travel requirements and business functions and find within them even the remotest suggestion that the luggage items used are anything but essential.

Even such charitable organizatoins as the Salvation Army, Travelers Aid Society, the American Legion, and a host of others have recently appealed to the public to contribute used luggage so that it may be distributed to organizations which send underprivileged children to summer camps. Here, where charity is the principal mover, it has been found essential to use luggage and luggage items.

How can it even remotely be said that luggage is a luxury?

We appeal to this committee to revise tax bill H. R. 8920 so that the entire "luggage" classification be eliminated from excise tax. This would be in keeping with the spirit of the House bill to relieve those products from tax which are not luxuries.

II. While our principal point in analyzing tax bill H. R. 8920 stresses the apparent objection of that bill to eliminate the excise tax from nonluxury items, further study also indicates that in its recommendation, the House has penalized a part of our industry for a return which will be negligible.

With a 10 percent tax remaining on certain luggage items, the luggage industry will continue to suffer competitively. Its competitive position vis-à-vis those items which carry no tax will be bad enough to assure continued business losses and unemployment. Unemployment means less individual income tax. Business losses means no income tax. No retail sales mean no excise tax collections. Such conditions are harmful. In the final analysis, the harm outweighs the good. Does this committee wish to sanction such a condition? I believe you will not.

I most respectfully urge that this committee take its stand in the aid of a small industry by recommending the complete elimination of the excise tax on all of the products listed under the classification "luggage."

The CHAIRMAN. If there are no questions, we thank you very much for your appearance.

Mr. BUCKLEY. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Eitel?

Will you please identify yourself for the record?

STATEMENT OF OTTO K. EITEL, CHAIRMAN FOR THE 20-PERCENT CABARET TAX COMMITTEE, WILMETTE, ILL.

Mr. EITEL. Mr. Chairman and members of the committee: My name is Otto K. Eitel, my residence address is 826 Forest Avenue, Wilmette, Ill. I am the registered chairman for the 20-Percent Cabaret Tax Committee. I am also president of the Bismarck Hotel of Chicago, Ill.

This committee is made up of substantially all the major hotel men who either now operate, or formerly did operate, dine and dance rooms subject to the 20-percent cabaret tax.

Among the more prominent of the seventy-odd members are the Waldorf Astoria, Astor Hotel, and Hotel New Yorker in New York; the Bismarck, Palmer House, Stevens, Drake, Sherman, and Blackstone Hotels in Chicago; the Roosevelt Hotel in New Orleans; the Peabody Hotel in Memphis; the Mark Hopkins and St. Francis Hotels in San Francisco, and the Biltmore and Ambassador Hotels in Los Angeles. These include the Hilton and Statler chains of hotels.

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Among the other contributors to the work of our committee are operators of establishments not affiliated with hotels as well as the American Federation of Musicians on behalf of their large membership, and some allied amusement agencies. Our membership is made up of those who are most directly affected by the cabaret tax. We hope for a revision of the cabaret tax from its present rate of 20 percent to its prewar level of 5 percent will be made without delay in order to increase tax revenues and at the same time serve the best interest of the establishments affected, their employees, musicians, entertainers, as well as their suppliers and purveyors.

There is a general misunderstanding as to the character of the hotel dine and dance rooms somewhat caused by the misnomer of the tax being called a "cabaret tax." The fact is that hotels, large and small, of a prominent nature, require the additional volume of business which the dine and dance room attracts in order to make their entire catering department function at a profitable level. For that reason, certain type hotels must have dining and dance rooms so that they become a necessity to the proper operation of the establishment rather than a luxury.

As an example, in the Bismarck Hotel, we have approximately 700 employees of whom approximately 400 are engaged in the service of food and beverages alone. We have attempted repeatedly to operate our hotel without a dine and dance room in order to avoid charging this tax. However, when we do, we find that our losses increase because we do not have the volume sufficient to take care of the overhead and therefore even though the cabaret tax is the lesser of the two evils, it is causing real hardship.

I am sure the members of this committee are aware that the cabaret tax was increased 300 percent in 1944. Prior to this time the rate of taxation had been 5 percent. For a few months it was increased to 30 percent, after which it was readjusted to the present level of 20 percent.

An interesting sidelight to this tax adjustment, and the Treasury figures will bear me out in this, is when the Congress reduced the cabaret tax to 20 percent in 1944, in spite of the reduced level, the Treasury receipts from a lesser tax in 1945 were more than double those of the preceding fiscal year ending June 30, 1944. It is estimated by experienced hotel operators and hotel accountants that the combined benefits produced by a reduction of the cabaret tax to 5 percent or even 10 percent would amount to more than double the tax collections of the present 20-percent cabaret tax. This may seem a startling and extravagant statement but we have presented actual Treasury figures which indicate the sharp and accelerating decline in cabaret-tax collections which are now taking place.

It is our belief that the major question before this Senate committee in keeping with the position taken by our President is that an adjustment in these taxes should be made with several purposes in mind:

1. Does the reduction of this excise tax tend to increase revenue to the Treasury?
2. Does the reduction of this excise tax aid the manufacturer in the use of additional labor and aid him in an over-all manner his general economic picture?

3. Does the revision in the excise tax aid both the revenue returned to the Treasury and our entire economic welfare?

In making such reduction, if these things be answered in the affirmative, certainly it is to the interest of this country that an adjustment in a tax that will do all these things should definitely be considered.

We have presented to the Ways and Means Committee of the House, which is a matter of record, six different steps by which a decrease in the cabaret tax answers in the affirmative each of the above statements and have submitted proof therein as to how this will be brought about.

The Ways and Means Committee debated this tax on at least two different occassions and tentatively adjusted the tax to 10 percent and then in the last days of their consideration of H. R. 8920, they readjusted this to 15 percent, a reduction of only 5 percent, which is certainly not in conformance with the proof we presented to them and the following information which we wish to present here for your further consideration. In February 1949, the American Hotel Association sent to its many members throughout the United States a cabaret-tax questionnaire and of the 77 hotels who are members of our committee, 41 returns comparable for tabulation of the number of persons served and amount of cabaret tax paid was reported as follows:

Our figures show that in 1947, 6,600,821 persons paid $3,487,941.33 in cabaret taxes—an average of 53 cents (52.8 cents) per person, which would bring the average amount spent per person for dining and entertainment in these 41 hotels to $2.64 (exclusive of tax).

In 1948, 5,749,569 persons paid $3,139,850.58 in cabaret taxes—an average of 55 cents (54.6 cents) per person. The average bill per person amounted to $2.73 (exclusive of tax).

Our variations show that these 41 hotels served 851,252 less persons (or 12.8 percent) in 1948 than in 1947 with a loss in cabaret taxes of $348,090.75 (or 9.9 percent).

This amounts to a 10-percent loss in taxable revenue in these hotels.

To the above we attach for your closer consideration a tabulation by months of these returns identified as exhibit A.

We present, in addition to the above, as exhibit B, a complete list of the excise taxes as they were in the prewar period and as they are at present along with a notation of the proposed revision of these taxes on the six items that appear definitely in the luxury class, which are jewelry, furs, luggage, cabaret, admissions, and cosmetics.

It will be noted from exhibit C, attached hereto, a comparison of the receipts by the Internal Revenue Department of the Treasury shows that the returns from the cabaret tax for the year 1949 over 1946 is a decrease of 32 percent, while jewelry, furs, and like commodities are far below this loss bracket.

The figures mean that more labor which includes musicians, chefs, waiters, bartenders, and entertainers are being deprived of work and in turn the Government deprived of a return on their taxable income.

Interesting to note is the effect the tax is having on one segment of the employment concerned, which is the musician's union. We attach hereto as exhibit D an article taken from the International

Musician, June 1950, and written by Leo Cluesmann in which they report a survey reporting how many places of business have closed down and the drop in employment opportunities and earnings of musicians as a result of such closings.

I should like to call to the committee's attention emphatically the printed copy of Mr. Sherrard's presentation to the Ways and Means Committee, page 1978 of that report, in which he listed the hotels throughout the country that have closed their dining and dance rooms because of this levied tax and the fact that in the State of Pennsylvania in 1947 there were 26 hotels operating dining rooms with orchestras; by the end of 1948, this number had dropped to 13 and that 5 more had been forced to close between January 1, 1949, and the date of his testimony. As a result, of which there are only eight hotels in the entire State of Pennsylvania that are operating rooms in which the 20-percent tax is applicable.

Gentlemen, we are asking that you give serious consideration to our plea in behalf of our industry, bearing in mind that those people whom I represent here maintain establishments of large investments and they maintain the type of establishments the American family can use as a safe place of entertainment. These hotels are interested in reopening these establishments and rehiring the necessary personnel to operate them but the reduction of this tax to 15 percent as suggested and passed by the House in H. R. 8920 does not permit them to do so, while, on the other hand, a reduction to 10 percent which would only be in keeping with the reductions suggested for the fur, jewelry, luggage, toilet preparations, and admission industries in this bill, would permit them to do so.

Our sincerest hope is that an amendment by the Senate and agreement in conference will permit this tax to be set at 10 percent.

(The exhibits referred to are as follows:)

EXHIBIT A

American Hotel Association recapitulation of 20-percent cabaret tax questionnaire, January 1949—41 comparable returns

	1947		1948		Variation, 1947-48		Percentage variation, 1947-48	
	Number of persons served	Cabaret tax	Number of persons served	Cabaret tax	Number of persons served	Cabaret tax	Persons	tax
January	579, 256	$295, 298. 80	507, 423	$280, 663 11	−71, 833	−$14, 535 69	−12 4	−4. 9
February	545, 383	276, 509 17	479, 925	256, 929 20	−65, 458	−19, 579. 97	−12 0	−7 0
March	576, 882	289, 434 29	498, 768	252, 761 86	−78, 114	−36, 672 43	−13 5	−12. 6
April	554, 429	274, 415 46	515, 370	255, 295 51	−39, 059	−19, 119 95	−7. 0	−6 9
May	555, 078	283, 640 69	474, 193	249, 670 14	−80, 885	−33, 970. 55	−14 5	−11. 9
June	558, 043	300, 378. 50	501, 764	281, 112 85	−56, 279	−19, 265 65	−10 0	−7 6
July	536, 552	295, 436. 20	476, 578	272, 759 96	−59, 974	−22, 676 24	−11 1	−7. 6
August	567, 845	302, 453 41	453, 897	251, 132 54	−113, 948	−51, 320 87	−20 0	−16 9
September	529, 468	291, 956 04	456, 091	256, 351 54	−73, 377	−35, 604 50	−13 8	−12 1
October	556, 739	299, 005 04	476, 762	271, 863 47	−79, 977	−27, 141. 57	−14 3	−9 0
November	525, 931	289, 001 46	441, 452	251, 083 04	−84, 479	−37, 918 42	−16. 0	−13 1
December	515, 215	290, 412 27	467, 346	260, 227 36	−47, 869	−30, 184 91	−9 2	−10 3
Total	6, 600, 821	3, 487, 941 33	5, 749, 569	3, 139, 850 58	−851, 252	−348, 090 85	−12 8	−9. 9

Exhibit B

How excise taxes rose

	Prewar	Now	Proposed H. R. 8920	Percent increase
			Percent	*Percent*
Cigarettes (package)	$0.065	$0.07		7.69
Cigars (each)	.002 to .0135	.0025 to .02		25.00 to 48.15
Whisky or brandy (fifth, 80 proof)	.64	1.44		125.00
Beer (barrel)	6.00	8.00		33.33
Still wine (light, gallon)	.08	.15		87.50
Still wine (fortified, gallon)	.65	2.00		207.69
Liqueur (pint)	.07	.20		185.71
Sparkling wine (pint)	.14	.30		114.29
Lubricating oil (gallon)	.045	.06		33.33
	Percent	*Percent*		
Admissions	10	20	10	100.00
Cabaret bill	5	20	15	300.00
Ticket broker's mark-up	11	20		81.82
Club dues, initiation fees	11	20		81.82
Light bulbs, tubes	5	20		[1] 300.00
Furs	10	20	10	100.00
Jewelry	10	20	10	100.00
Luggage, handbags, etc	10	20	10	100.00
Cameras, other photo equipment	10	25		[1] 150.00
Photo film-plates	10	15		[1] 50.00
Telegrams, domestic	10	25		150.00
Leased wire	10	25		150.00
Local telephone bill	6	15		150.00
Long distance calls (over 24 cents)	10	25		150.00
Wire and equipment service	5	8		60.00
Cosmetics	10	20	10	100.00
Train, bus, ship, plane fares	5	15		200.00
Freight		3		
Bowling alleys, billiard, or pool tables (year)	$10.00	$20.00		100.00
Gambling machines (per year)	$50.00	$100.00		100.00
Average increase percentagewise excluding items [1]				111.20

[1] On manufacturer's sales price.

Exhibit C

Comparison roof garden-cabaret tax to furs, jewelry, luggage, toilet preparations and general admissions

	1946	1948	1949	Percent of increase or decrease (−) 1948 over 1946	Percent of increase or decrease (−) 1949 over 1946
Furs	$91,706,170.55	$79,539,152.40	$61,946,246.55	−13	−32
Jewelry	223,341,986.48	217,899,249.20	210,688,165.33	−2	−6
Luggage	81,423,426.46	80,632,323.81	82,607,133.49	−1	1
Toilet preparations	95,574,485.34	91,852,012.92	93,969,241.32	−4	−2
Admissions (including cabaret tax)	415,267,866.77	438,627,844.34	434,700,462.24	6	5
Cabaret tax	72,076,898.35	53,527,145.22	48,856,669.14	−26	−32

Exhibit D

[From International Musician]

Effects of 20-Percent Tax

(By Leo Cluesmann)

Any Federal tax which shuts down enterprises and curtails employment calls for careful reconsideration by Congress. Particularly is this true when the tax is a wartime imposition which—according to an unwritten covenant—was supposed to be abolished when the war was over.

Now, 5 years after the termination of hostilities, the 20-percent entertainment tax is still with us. The House Ways and Means Committee has gone so far as to recommend that the tax be reduced to 10 percent; but it will be a long, hard pull in Congress to obtain even this partial relief. Meanwhile, musicians are well aware, from their own experience, what a crippling effect this tax has had—and is still having—on musicians' job opportunities.

Just how crippling this effect has been will be apparent from the following figures, obtained by a spot check in major cities in the various areas of the country. The aim was to find out (1) how many cabarets, night clubs, ballrooms, and similar places of entertainment have shut down; (2) how many such places have stopped using live music; and (3) how big a drop has resulted in the employment opportunities and earnings of musicians.

As a result of this spot check, it is conservative to say that musicians have suffered at least a 33-percent drop in their employment and earnings in the cabaret field, and in many cities the drop is 50 percent. Here are the findings in detail:

MIDDLE WEST

Cincinnati, Ohio: Local 1—cabaret licenses dropped from 27 in 1947 to 11 in 1940, to only 4 in 1950. Ballroom licenses ran 47 in 1947; by 1950 only 35 were still doing business. Between 1947 and this year musicians lost 85.2 percent of their employment opportunities in cabarets, and 25.6 percent of their work in ballrooms.

Chicago, Ill.: Local 10—night clubs numbered 632 in 1948, 602 in 1949, but dropped to 422 in 1950. Over the 2-year period, therefore, musicians had a 33.3-percent drop in employment opportunities.

St. Louis, Mo.: Local 2—this year there were 15 fewer entertainment places licensed for dancing than in the corresponding period in 1948–49. The license bureau predicts a sharp drop June 1 in the number of license renewals for night clubs, cabarets, and dance halls.

Indianapolis, Ind.: Local 3—musicians get 28 percent less money for cabaret entertainment in 1949 than in 1948. The reason was a falling off in the number of cabarets from eight to six—a 25-percent drop. One cabaret cut the number of nights' dancing from six to two. Three cut the number of musicians from six to four, one from four to three.

Minneapolis, Minn.: Local 73 had 61 cabaret licenses in 1947–48, but only 57 in 1949–50. Many establishments have eliminated live music, while many others have sharply reduced the number of men employed. The labor-relations expert for the enterprises involved tells the secretary of local 73 that the elimination of the 20-percent tax would mean the immediate reemployment of at least 50 musicians. The secretary adds: "It is a safe assumption that since the inception of the amusement tax we have had a drop of at least 25 percent in employment of musicians."

St. Paul, Minn.: Local 30 had a drop of 14 percent in number of tavern licenses issued to establishments offering live entertainment. But the drop in employment for musicians has been much greater. A typical establishment which formerly engaged two orchestras full time plus two relief pianists now hires only one four-piece orchestra. One of the larger hotels has dispensed with the large bands which it formerly used, while another has substituted five- or six-piece combinations for the large group formerly employed. Most of the night clubs have cut in half the number of musicians employed.

Milwaukee, Wis.: Local 8—since the imposition of the 20 percent amusement tax, Milwaukee musicians have suffered a 50 percent drop in employment and earnings.

Kansas City, Mo.: Local 34—night clubs and taverns have either sharply reduced the number of players, or in some cases have eliminated live music entirely. Reduction in employment and earnings is at least 25 percent.

SOUTHWEST

Phoenix, Ariz.: Local 586—number of cabarets licensed dropped 13 percent in 1948; a further 20 percent in 1949, and a still further 10 percent so far (May 7) this year; a total drop over the 3-year period of 36.3 percent.

SOUTH

St. Petersburg, Fla.: Local 427—from October 1948, when there were 14 cabarets under license, to the present, when there are only 10, there has been a drop of around 29 percent in employment opportunities for musicians.

Dallas, Tex.: Local 147—the trend since 1948 shows a constant downward turn in employment for musicians. Of the larger clubs, one has dropped its band from 11 to 6 men; a second, from 9 to 6; another, from 8 to 4; the fourth, from 9 to 6. Smaller clubs have dropped from trios or quartets to pianos alone. Total drop in employment and earnings runs around 40 percent.

Louisville, Ky.: Local 11—out of 106 jobs formerly available in night clubs, only 62 are currently available, representing a drop in employment and earnings of over 40 percent. Of the 36 clubs originally operating, 3, employing a total of 17 men, have closed, while 11 others, which formerly used 27 men, have dispensed with live music pending the repeal of the 20 percent tax.

NORTH ATLANTIC STATES

New York City: Local 802—in 1949 the number of licenses issued to cabarets, etc., totaled 1,170. This is a decrease of 152 from 1948, when 1,322 licenses were issued, or a percentage drop of 11.5.

Newark, N. J.: Local 16—of the 40 cabarets, night clubs and ballrooms in Newark, only 5 or 6 now employ musicians full time. The other 35, as a result of the 20 percent tax, either have cut the number of musicians, or have reduced the playing days from 6 to 3. Thus employment opportunities for musicians have been reduced by roughly 50 percent.

The CHAIRMAN. Thank you very much.

Are there any questions?

If not, thank you very much for your appearance, sir.

Mr. EITEL. Thank you, gentlemen.

The CHAIRMAN. Mr. Colladay?

Will you identify yourself for the record, please?

STATEMENT OF EDWARD F. COLLADAY, APPEARING FOR THE LINCOLN ROCHESTER TRUST CO., ROCHESTER, N. Y.

Mr. COLLADAY. Mr. Chairman and members of the committee, my name is Edward F. Colladay, and I represent the Lincoln Rochester Trust Co. of Rochester, N. Y. I am a member of the District of Columbia bar. I will be very brief.

I appear to support a proposed correction of an oversight in the language of Public Law 378, Eighty-first Congress, chapter 720, first session, to amend certain provisions of the Internal Revenue Code.

Senator Ives, on July 6, introduced an amendment to accomplish this purpose, a proposed amendment to the present tax bill.

Section 7 of that law was intended to relieve certain estates from the effect of the Spiegel and Church decisions of the Supreme Court which had the effect, among other things, of taxing a "reverter" or "the possibility of a reverter" arising by operation of law, and a reversionary interest the value of which immediately before the death of the decedent was minor in amount.

The hardship imposed by the aforesaid Spiegel decision and the necessity of granting congressional relief in cases falling within its scope, were readily apparent to Congress. As one of the Justices in a dissenting opinion pointed out, given the facts in the Spiegel case, the value to the settlor just prior to death, of a reverter on a $1,000,000 trust fund would be about $70, but that $70 reverter gave rise to a tax liability of over $450,000. Congressional relief was accordingly granted but said relief, as it now develops, was not extended to cases involving the transfer of life insurance. It covered all other kinds of property.

The purpose of my presentation is to have that extended to cover transfers of life insurance which alone were left out.

The amendment was related to the subject of transfers taking effect at death. It provided that an interest in property of which the decedent made a transfer, on or before October 7, 1949, intended to take effect in possession or enjoyment at or after his death shall not be included in his gross estate—

under paragraph (1) (C) of this subsection unless the decedent has retained a reversionary interest in the property, arising by the express terms of the instrument of transfer and not by operation of law, and the value of such reversionary interest immediately before the death of the decedent exceeds five per centum of the value of such property * * *.

In the conference report which accompanied H. R. 5268, which became Public Law 378, it was stated that:

Where the reversionary interest has a value of not more than 5 percent of the value of the transferred property, or where it arises by operation of law (regardless of its value), it will not cause the property to be included in the decedent's gross estate to any extent.

Obviously Congress in making this enactment intended it to apply to estates coming within the language used regardless of what kind of property composed the estates. However, the Bureau of Internal Revenue has construed this language as being limited to section 811 (c) of the Internal Revenue Code and as not extending to estates insofar as they consist of life insurance. In doing so, the Bureau has pointed out that transfers of life insurance are treated under a separate subsection of section 811, namely subsection (g), and the Bureau says that subsection (g) was not specifically mentioned and transfers of life insurance are not relieved from the effect of the Spiegel decision, as other property is.

The present amendment is addressed directly to this position taken by the Bureau and extends the amendment to paragraph 2 of subsection (g) of section 811 which deals with transfers of life insurance.

It is desired that the amendment now proposed should be made retroactive with the same effect as if it had been included in Public Law 378. We consider it merely an oversight. This will call for the technical skill of the legislative draftsman to whom we suggest that the matter be referred to be placed in final form.

The purpose of Congress to give relief from the effect of the Spiegel decision and to make the relief retroactive clearly appears in the debate at pages 13235–13236 of the Congressional Record of September 16, 1949. That intention was carried into effect in the language of the act as passed, except only as to transfers of life insurance.

I think Senator Millikin will recall that debate.

Thank you very much.

The CHAIRMAN. Any questions?

The Treasury has taken the position that section 811 (g) is not within the reasoning of the rule that we tried to lay down.

Mr. KIRBY. Mr. Chairman, I would like to say that there is no question about it, that it does not apply to Section 811 (g) which is a special section for life insurance. There are two rules written into section 811 (g), I think it was back in 1942. This amendment that we made back last year does not apply to that situation at all, and the Supreme Court cases did not affect that area.

The CHAIRMAN. But all the reasoning that controlled the committee would apply, would it not?

Mr. KIRBY. No, I do not think so, or at least our view was that it does not.

There was no uncertainty back in 1942 when we put in these rules, there was not the comparable uncertainty that arose with the Church and Spiegel cases.

The CHAIRMAN. I just wanted to see what the issue was.

Mr. COLLADAY. The matter was definitely ruled on by the Treasury Department in a case in which I represent the Lincoln Rochester Trust Co. and they said that the language passed by Congress last year did not extend to the transfers of life insurance. It extended all other kinds of property but not to that.

Senator MILLIKIN. I would like to have the staff go into this, Mr. Chairman.

The CHAIRMAN. Oh, yes. After seeing that it is in issue. I was in hopes that it was not in issue.

Mr. KIRBY. There is an issue, Mr. Chairman.

The CHAIRMAN. We will have to go into that.

Thank you very much, Mr. Colladay.

Mr. COLLADAY. Thank you, gentlemen.

The CHAIRMAN. Mr. Jerome Kaufman?

Mr. Kaufman, will you identify yourself?

STATEMENT OF JEROME KAUFMAN, ASSOCIATE MANAGING DIRECTOR, NATIONAL ASSOCIATION OF TOBACCO DISTRIBUTORS, WASHINGTON, D. C.

Mr. KAUFMAN. My name is Jerome Kaufman. I am associate managing director of the National Association of Tobacco Distributors, representing the Nation's wholesale tobacco distributors who serve more than a million and a quarter retail outlets which in turn purvey cigars, tobaccos, matches, confectionery, and related products to consumers throughout the country.

This association was greatly dismayed to learn that the House Ways and Means Committee decided not to allow floor stock refunds in connection with the proposed reductions in manufacturers' excise taxes, as provided in H. R. 8920, the Revenue Act of 1950.

In the words of the committee minority—This is an unfortunate mistake and as a result a substantial loss to some wholesalers and retailers, with respect to their tax-paid inventories on hand at the time relief becomes effective will result.

That is the opinion of the minority members of the committee.

Our members and their retailer customers are particularly concerned with the possible disastrous effect of this omission as it applies to the proposed reduction of taxes on matches, snuff, plug and twist tobaccos, and the revision of the tax rate on cigars. It is, therefore, their desire that this committee consider the unfortunate effect and the inequity of any failure on the part of Congress to permit floor stock refunds in the pending bill.

There is ample precedent in Federal tax legislation to indicate that when a tax on a commodity is increased, the increase also applies to floor stocks. We have that, too, in the case of the cigar tax which was most recently increased in 1942 and in the case of the tax on matches which was increased in 1941, over the rate originally established in 1932.

These rate increases were required to be paid on floor stocks of both these products.

Senator MILLIKIN. How much money is involved in your situation?

Mr. KAUFMAN. Well, I can only give you roughly that we maintain inventories on these items of 30 to 60 days. I could not offhand give you the amount of the refunds involved.

Senator MILLIKIN. Would it be administratively practicable to make the refund?

Mr. KAUFMAN. Yes, Senator; we feel that it would be. As a matter of fact, we propose to submit to this committee in a supplementary brief a suggested plan for paying these refunds which we think will be feasible.

Now that it is proposed to reduce the Federal excise tax on matches, plug and twist tobaccos, and to revise the tax rate on cigars, it would logically follow that there should be provision for a refund on floor stocks of these products on which the higher tax rates were paid As Senator Taft remarked earlier today, it ought to work the other way also.

Senator MILLIKIN. How much write-up is there on a box of cigars at the retail level?

Mr. KAUFMAN. The mark-up?

Senator MILLIKIN. Yes.

Mr. KAUFMAN. Well, cigars normally are sold by the manufacturer at 10 percent and 2 percent off.

They are resold by the wholesaler on approximately 5 percent mark-up. The retailer enjoys about——

Senator MILLIKIN. Take, for example, a 25-cent cigar.

Mr. KAUFMAN. On a quarter cigar he enjoys about a 10 to 15 percent mark-up on that.

We feel that failure to do so would serve as a deterrent to business in these lines of merchandise and a hindrance to the normal processes of distribution of these items from the manufacturer to the ultimate consumer.

It is obvious that wholesalers, retailers, and the public will invariably seek to benefit by awaiting the effective date of a tax reduction. Thus, the flow of the goods involved, from the factory to the wholesaler, to the retailer, and then to the ultimate consumer, would be in a virtual state of paralysis during the "twilight period" between the enactment date and effective date of the new tax rates. In other words, they would not be buying.

The cigar industry, to a greater extent than any other, cannot afford to be the victim of this disruption in the normal processes of distribution of its product. This industry has been static for a quarter of a century and any depletion of floor stocks in the warehouses of wholesalers and in the stores of retailers—even though temporary—would subject the industry to a further loss of business which it can ill afford to lose and could never recoup.

Similarly, the branches of the tobacco industry, also static for many years, producing snuff, plug and twist tobaccos, on which tax reductions are proposed, would also suffer irreparable injury were stocks permitted to become depleted due to a failure to provide for floor stock refunds.

With respect to the proposed reduction in the tax on matches, it should be noted that this tax is almost always absorbed by retailers of tobacco products, since it has been a long standing practice in the trade to give, gratis, one or more packages of book matches to every

purchaser of cigarettes, cigars, and smoking tobaccos at the time of each purchase. It would, therefore, not be equitable to these retailers to impose a heavier burden on them by requiring them to absorb the higher tax rate.

Refunding the amount of the tax reduction on floor stocks would have the additional advantage of preventing an unhealthy competitive situation which would arise if some sellers had large floor stocks on which the higher tax rates were paid, and others, such as new businesses, enjoyed a lower inventory cost because they had paid the lower tax rate on their merchandise.

Again I would like to refer to the minority report of the Ways and Means Committee, in which it is recommended "that floor stock refunds be provided where necessary, in order to prevent any serious competitive disadvantage." That was the opinion of the group of men on the Ways and Means Committee.

The members of this association and their more than a million and a quarter retailer customers are hopeful that your committee, after thorough consideration, will provide for floor stock refunds on cigars, snuff, plug and twist tobaccos, and matches, which

(1) would restore these merchants to the same position they were in when taxes were increased on these products and they were required to pay floor stock taxes on them;

(2) would maintain healthy competitive relations among sellers of these products during the transition period; and

(3) would permit normal distribution processes to operate during the period between the enactment of H. R. 8920 and the effective date of the proposed tax reductions.

Thank you, gentlemen.

The CHAIRMAN. Thank you, sir, for your appearance.

That concludes the hearing until 10 o'clock Monday.

(The following statements were submitted for the record:)

UNITED STATES SENATE,
COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE,
July 11, 1950.

Hon. WALTER F. GEORGE,
Chairman, Senate Committee on Finance,
United States Senate, Washington, D. C.

DEAR SENATOR GEORGE: I am writing you to call to the attention of the Senate Committee on Finance the pressing problems of excise taxes as they affect our domestic record communications carrier. I have not personally testified before your committee since Senator Ed C. Johnson, a member of your committee, as chairman of our committee and a member of our communications subcommittee is as fully informed of the facts as am I and will be able to answer any questions which may be asked by members of the Finance Committee.

It is my judgment, and I believe that of the members of our subcommittee, that public policy makes advisable the repeal in its entirety of the excise tax on telegrams as a move to help prevent bankruptcy of this carrier. An interim report of our committee, dealing with our continuing study of communications matters, summarizes the situation. That report, although approved by our committee in confidential committee print form, has not yet been released. I quote the following from it:

"8. Taxes. While the telegraph company pays income, social security, and other taxes, as do all private enterprises, it is peculiarly handicapped by the 25-percent excise tax which works an unusual hardship on this taxpayer. This tax was imposed during the war primarily to curb private citizen use of urgently needed communication services which were at that time heavily overloaded by the Government and those engaged directly in the war effort. While the tax on telegraph messages has yielded the Government from $30,000,000 to more than $40,000,000 annually during the last 5 years, it seems to the committee most

unwise to continue a tax which has the effect of reducing business at a time when the enterprise is desperately seeking additional business. Here is a Nation-wide operation, heavily invested with the national defense and the public interest, which has made application to the Government for loans to meet bond maturities and which faces bankruptcy. Yet, the Government imposes a tax which can have no other effect than restricting its business simply because it increases the cost of each telegraph message by 25 percent. While it is generally recognized that most, if not all, of the wartime-imposed excise taxes should be reduced to prewar levels, the committee believes that for the time being the entire excise tax on telegraph messages should be eliminated. Such an action would not only have the effect of reducing telegraph-message rates by one-fifth, but also would place the telegraph industry in a much better competitive position with both the air mail and the long-distance telephone."

That conclusion is based on the following facts:

(1) The telegraph company showed an operating deficit of $4,171,000 in 1948 and $4,971,000 for the first 11 months of 1949. Testimony of the management clearly established this was due primarily to the volume-depressing effect of the excise tax.

(2) The telephone company has reduced its long-distance rates in the last 4 years, while the telegraph company because of increased operating costs has been required to increase its rates some 27 percent. It should be noted that more than 80 percent of the revenues of the telephone company are obtained from local and intrastate sources. These rates have been doubled and in some instances tripled since the war. The telegraph company conversely relies upon interstate traffic for 85 percent of its domestic revenues.

(3) The House bill reduces the tax on domestic telegrams from 25 to 10 percent. The elimination of the tax would involve a further loss of revenue of only $15,000,-000. At the 25 percent rate, the yield from a tax on domestic telegrams for 1949 was $33,750,000, or less than 6 percent of the total communications-tax collections and less than one-half of 1 percent of all excise-tax collections. Failure to extend complete relief to Western Union would involve future Federal expenditures in the millions of dollars if the industry is taxed into the hands of the Government.

(4) Although there has been a temporary improvement in operating results during March, April, and May of 1950, revenues for the first 5 months ended May 31, 1950, were $2,331,813 less than in the same period of 1949 in spite of the extraordinarily high level of general business activity. Improvement in operating results has been achieved by rigid expense control and restriction of expenditures on plant and maintenance to a dangerously low level.

(5) Complete elimination of the tax should arrest the present decline in volume and based upon past experience result in an increase in volume of domestic telegraph traffic of around 10 percent. This estimate is based upon analyses involving declines in traffic when rates have been increased. The elimination of the tax would be the equivalent of a 20 percent decrease in rates.

I am taking the liberty of sending copies of this letter to all members of the Committee on Finance in the hope that this information will be helpful to you and your colleagues during committee consideration of the excise-tax question.

With sincere expressions of my highest regard, I am

Very sincerely yours,

ERNEST W. MCFARLAND.

STATEMENT BEFORE THE FINANCE COMMITTEE, UNITED STATES SENATE

JULY 11, 1950.

GENTLEMEN: We appreciate this opportunity of presenting a brief statement on how one omission in H. R. 8920, the general revenue bill, works a distinct hardship on many persons in the districts of Wisconsin which we represent in the House.

It is not our purpose to come here to espouse passage of the entire bill, but rather to inform your committee of the imminent discrimination against the producers of tobacco used for scrap chewing. Apparently, through an oversight in the House committee, when provisions were written to reduce the tax on plug and twist chewing tobacco, a similar tax reduction on scrap chewing tobacco was not included in the bill.

This would vitally affect our districts in Wisconsin. In 1948, our State produced 29,000,000 pounds of tobacco, and of that total, 21,000,000 pounds was of comparatively low grade and used for scrap chewing tobacco. Thus of Wisconsin's 1948 crop, over 70 percent went into scrap chewing tobacco, and Wis-

consin furnished over one-half of all the tobacco that went into scrap chewing that year.

If this tax is retained for scrap chewing tobacco, while the corresponding tax on plug and twist chewing tobacco is reduced it will mean a discrimination of about 1.3 million dollars per year against Wisconsin tobacco growers. In fairness to the producers in our State, we believe that scrap chewing tobacco should receive the same consideration as plug and twist.

LAWRENCE H. SMITH, M. C.,
First District, Wisconsin.
GLENN R. DAVIS, M. C.,
Second District, Wisconsin.

THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA, INC.,
Washington 4, D. C., July 10, 1950.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington 25, D. C.

DEAR SIR: The Associated General Contractors of America, Inc., on behalf of its affected members, recommends to your committee that section 3475 of the Internal Revenue Code, with reference to the transportation of property tax, be amended as follows: "The tax imposed under this section shall not apply to the use of motor vehicles by contractors in the movement of earth, rock, or other excavated material within the boundaries of or incidental to a construction project."

The purpose of this amendment is to bring to an end the confusion that now exists throughout the highway and heavy divisions of the general contracting industry. It likewise would permit uniformity with reference to administrative rulings and would eliminate conflicting court decisions.

The focal point of this confusion centers around individuals or corporations that own one or more trucks that are used by general contractors on a particular project. For many years it has been the practice of contractors to engage these owner-truckers for the most part on projects requiring the movement of excavated material. In 1942, when section 3475 was enacted by Congress and incorporated in the Internal Revenue Code, the Bureau of Internal Revenue promulgated a ruling that if the general contractor rented a truck and placed his own employee on it the contractor was not subject to the 3 percent transportation of property tax. The contractors, pursuant to this ruling, made it their practice to lease a truck from an owner, place the owner on the truck as a driver and carry him on the payroll as an employee, paying the social security and unemployment taxes to the Federal Government and carrying workmen's compensation insurance. The same practice was followed by the contractors when several trucks were rented from coal dealers and others during their slack season, the drivers of the trucks becoming employees of the contractor. This practice has resulted in a conflict of rulings in individual cases, as well as a conflict with reference to court decisions. In many instances, notwithstanding the contractor has paid social security, unemployment taxes, and workmen's compensation insurance, etc., it has been held that the owner-truckers were independent contractors and vice versa. This has created an intolerable situation for the contractors, due to the fact that a great deal of their labor is transient and hence social security and unemployment taxes are practically impossible of refund.

One example of how confused this situation is is summed up in an administrative ruling with reference to the movement of excavated material. Under this ruling the contractor building an airport is permitted to use a bulldozer to push the excavated material to the desired location without being subject to the transportation of property tax. However, if a power shovel is used to pick up the excavated material and deposit it in an owner-trucker's truck, and the truck then dumps the material in the same location where it was pushed by the bulldozer, it is ruled to be transportation of property and subject to tax.

For the past few years contractors have been using a combination bulldozer and truck or scraper vehicle, the material being fed from the blade into the body of the equipment. The blade is then raised and the material conveyed to a desired location and then dumped. Following the rule of consistency, the Bureau would be required to rule that if this piece of equipment was owned in the same manner as the trucks already referred to, then the transportation of property tax would apply.

The courts have found this situation confusing and in some instances these owner-truckers are held to be independent contractors, while in other instances they have been held to the employees. Then again, it has been held that these

owner-truckers are employees because they were merely performing work that was incidental to the completion of the project.

The tax on owner-truckers engaged by contractors on a project for the movement of excavated material raises little revenue, as it involves mostly the construction of highways and airfields for Federal and State authorities, resulting in an added cost to these agencies.

Sincerely yours,

H. E. FOREMAN,
Managing Director.

NEW YORK, N. Y., *July 12, 1950.*

Re H. R. 8920, an act to reduce excise taxes.

To the Senate Finance Committee:

SIRS: This memorandum is submitted on behalf of Pitney-Bowes, Inc., of Stamford, Conn., which is engaged in the business of manufacturing, selling, and leasing mailing equipment. In the course of its business it has on rental approximately 80,000 postage meters throughout the United States. These postage meters are leased under yearly contracts which are automatically renewed at the end of each contract year and which are taxable upon renewal under the provisions of section 3440 of the Internal Revenue Code. The present tax is the 10-percent excise tax on business and store machines, which is payable on each item of rent, pursuant to the provisions of section 3441 (c) of the code.

Under the proposed amendment contained in H. R. 8920 this tax would be reduced to 5 percent. However, in view of the fact that under section 3440 a lease is regarded as a sale, the tax would remain at 10 percent on rents from all leases entered into prior to the effective date of the Revenue Act. This is recognized at pages 69 and 78 of the report of the Committee on Ways and Means accompanying the Revenue Act.

Pitney-Bowes, Inc., bills its 80,000 lessees quarterly in advance for the postage meter rental, and at the same time bills them for the 10-percent excise tax, which, under the provisions of the lease, is payable by the lessee and amounts to 2 or 3 dollars.

Assuming that the new Revenue Act became effective September 1, 1950, reducing the tax on business machines from 10 percent to 5 percent, it will nevertheless be necessary to bill about 25,000 lessees in September at the rate of 10 percent, since their leases all antedate the effective date of the act. We desire to say that, in our opinion, the effect of billing such a large group of lessees at 10 percent after the excise tax on business machines has been reduced by an act of Congress to 5 percent would be appalling; that there would be an avalanche of protests and, in many instances, there would be an absolute refusal to pay. Of course, subsequent billings at the 10-percent rate would diminish as contracts were automatically renewed in the ensuing months, but thousands of lessees would be billed quarterly at 10 percent until the whole series of 80,000 leases had been automatically renewed during the course of the year.

The only alternative suggested is for Pitney-Bowes and its 80,000 lessees to agree upon a cancellation of all old leases and the execution of 80,000 new leases, but it is respectfully submitted that such a procedure is an impossibility. It would require a staff of 100 or more clerks with adequate supervision to handle such a vast operation, and the result would be a chaotic situation with several thousand leases not rewritten, and the building situation would be in utter confusion.

We respectfully submit that, if it is the intention of the Congress to reduce the excise tax on business machines from 10 percent to 5 percent, such a reduction should be made across the board for every form of sale or lease, without discrimination, and that it is inequitable to encumber a group of 80,000 leases with a 10-percent hang-over tax for the best part of a year, awaiting the renewal date of their contract.

We suggest, therefore, that section 163 of H. R. 8920, now before your honorable committee, be amended by adding at the end thereof the following language:

"*And provided further*, That such amendments shall be effective with respect to rentals payable under existing leases on or after the first day of the first month which begins more than 10 days after the date of the enactment of this act."

Respectfully submitted.

SHATTUCK, BANGS & DAVIS,
Attorneys for Pitney-Bowes, Inc.

GEORGE B. FRANCIS,
of Counsel.

STATEMENT ON BEHALF OF CLOCK MANUFACTURERS ASSOCIATION OF AMERCA, INC.

The membership of Clock Manufacturers Association of America, Inc., includes the following companies:

The Herschede Hall Clock Co., Cincinnati, Ohio.
The E. Ingraham Co., Bristol, Conn.
General Time Instruments Corp., New York, N. Y.
Seth Thomas Clocks Division, Thomaston, Conn.
Westclox Division, La Salle, Ill.
The Lux Clock Manufacturing Co., Waterbury, Conn.
The New Haven Clock & Watch Co., New Haven, Conn.
The Sessions Clock Co., Forestville, Conn.
U. S. Time Corp., Waterbury, Conn.
The William L. Gilbert Clock Corp., Winsted, Conn.

In January 1949 the association filed with the Ways and Means Committee of the House of Representatives a printed brief in support of the then proposed revision of excise taxes on clocks and watches. Since this statement must necessarily be limited, we urge that reference be made to our former brief, copies of which are attached, for the detailed information which it contains.

The clock manufacturers comprising this association produce a variety of timing devices. They fall into the following classes:

Household, including alarm, kitchen occasional, mantel, chime, and miscellaneous clocks found in every home and farm.

Personal, including inexpensive clock-type watches, i. e., watches with pin-lever escapements.

Commercial, including wall clocks, clock systems, master clocks, advertising clocks, and the like.

Industrial, including time switches and process timers used in many industrial processes and operations.

Maritime, including naval clocks and other devices such as recording barometers used on ships and in shipping.

Miscellaneous, including automobile clocks, special-purpose clocks, and timing devices for myriad applications such as toaster switches, range timers, washing-machine cycling devices, photographic timers, and recording timers.

While the American clock industry manufactures all of the above items, the great bulk of its production consists of inexpensive clocks and clock-type watches for household and personal use.

Clock-type watches contain nonjeweled movements. They are sometimes called pin-lever watches because they have pin-lever escapements. Jeweled watches, having jeweled lever escapements, are manufactured only by the jeweled-watch industry. The jeweled-watch industry has its own distinct problems and is separately represented in these hearings. This association of clock manufacturers is concerned exclusively with excise taxes as they affect clocks and inexpensive clock-type watches.

Clocks and inexpensive clock-type watches are distributed in the United States through retail merchants estimated to exceed 140,000 in number. The following breakdown shows the types of retail outlets and approximate numbers and percentage of each type:

Type of store	Percentage	Number of retailers selling clocks
Jewelry	9	13,000
Drug	39	55,000
Hardware	21	30,000
Department and chain	2	2,500
Electrical appliance	2	30,000
Miscellaneous	7½	10,500

Under existing rates the purchaser of a clock or inexpensive clock-type watch is obliged to pay, in addition to the retail price, an excise tax which applies as follows:

> If he purchases a clock at any price or an alarm clock priced above $5, the Federal excise tax is 20 percent.
>
> If his purchase is an alarm clock which sells at retail for not more than $5 the Federal excise tax is 10 percent.
>
> If he purchases an inexpensive clock-type watch, the Federal excise tax is 10 percent.

It is our contention that excise taxes on clocks and inexpensive clock-type watches should not be merely revised or reduced but repealed outright. There is no justification for imposing a discriminatory excise tax on ordinary alarm clocks when other commonplace utilitarian items are not subject to a similar tax.

Clocks and inexpensive clock-type watches are improperly classified with jewelry for excise-tax purposes. Section 2400 of the Internal Revenue Code has the descriptive heading "Tax on Jewelry, etc." under the heading "Description of Tax." Section 1650 refers to the articles taxed under section 2400 as jewelry and increases the excise tax rate to 20 percent on all clocks except alarm clocks selling for $5 or less.

In drafting its regulations on excise taxes with respect to section 2400, the Treasury Department made a clear distinction between jewelry on the one hand and other articles, such as clocks, which are subjected to the same tax. Internal Revenue Regulations 51, section 320.30, refers to the scope of the tax as follows:

"*Scope of tax.*—The tax attaches to the sale by the retailer of articles:

"(1) All articles commonly or commercially known as jewelry, whether real or imitation, regardless of the substance of which made, including articles to be carried in the hand, or hung on the arm, or carried or worn on the person, which are made of, ornamented, mounted, or fitted with pearls, precious or semiprecious stones, or imitations thereof;

"(2) Pearls, precious and semiprecious stones, and imitations thereof;

"(3) All other articles made of, ornamented, mounted, or fitted with precious metals or imitations thereof;

"(4) Articles specifically mentioned in section 2400 such as *watches, clocks, cases and movements therefor*, gold, gold-plated, silver, or sterling flatware or hollow ware, and silver-plated hollow ware; opera glasses; lorgnettes; marine glasses; field glasses; and binoculars." [Emphasis supplied.]

Regulations 51, sec. 320.31, explains the meaning of "jewelry" in these terms:

"*Jewelry.*—Jewelry in general includes articles designed to be worn on the person or apparel for the purpose of adornment and which in accordance with custom of ordinary usage are worn so as to be displayed, such as rings, chains, brooches, bracelets, cuff buttons, necklaces, earrings, beads, etc. The tax is imposed on the sale of any of such articles at retail, regardless of the substance of which made and without references to their utilitarian value or purpose, unless for a purpose specifically exempted by law.

"Jewelry also includes articles to be carried in the hand, or hung on the arm, or carried or worn on the person, whether in pocket or bag or under the outer garment, such as cigarette cases, eyeglass cases, pencils, powder boxes, garter buckles, canes, purses, or handbags, if made of, or ornamented, mounted, or fitted with pearls, precious or semiprecious stones, or imitations thereof. Such articles are likewise subject to tax without regard to their utilitarian value or purpose. * * *

"For purposes of the tax, it is immaterial whether jewelry is real or imitation."

Regulations 51, section 320.34, defines "watches and clocks" as follows:

"*Watches and clocks.*—The tax is imposed on the sale at retail of watches and clocks or cases and movements therefor. The term 'watches and clocks' includes all time-measuring devices whether actuated by weights, springs, or electrical energy, except watches sold on and after November 1, 1942, which are designed specially for use by the blind."

It is readily apparent that neither clocks nor inexpensive, clock-type watches come within the official definition of "jewelry." Clocks are not "designed to be worn on the person or apparel for the purpose of adornment" and are not "carried in the hand, or hung on the arm, or carried or worn on the person." As to clock-type watches, it should be particularly noted in the definition that while an article may be "carried or worn on the person," it is not "jewelry" unless it is worn "for the purpose of adornment" or is "made of, or ornamented, mounted or fitted with pearls, precious or semiprecious stones, or imitations thereof." The inexpensive, clock-type watch is strictly utilitarian and not ornamental; it is never mounted or fitted with pearls or stones of any kind.

While it is clear that section 2400 makes a distinction between jewelry and timepieces, the distinction is purely formal. The statute treats both types of articles in the same class and taxes them exactly alike, apparently on the theory that they have the same general characteristics. Section 1650 does not bother to refer to "clocks and watches" by even so much as an "etc."; it simply lumps them into the "jewelry" class and describes them solely and exactly as "jewelry." It is submitted that the functional distinctions between jewelry and timepieces, as shown by the Internal Revenue Regulation 51 itself, are sufficient to establish

that there is no logical or functional basis for placing those two different kinds of articles in the same class for excise-tax purposes.

The classification of clocks and watches either as jewelry or in the same category as jewelry is a carry-over from more than 50 years ago when timepieces were made more or less by hand, were highly embellished and required considerable servicing after sale to the consumer. In that early period the natural outlet for that sort of merchandise was through jewelers, who sold ornamental and heirloom merchandise and, in the case of clocks and watches, could keep them in repair. The clock industry does not manufacture that type of merchandise, and the sales of products of the clock industry through jewelry stores has never been more than a very small fraction of the total. The real volume of sales is made through drug, hardware, department, chain, electrical, appliance, and miscellaneous stores.

Aside from a few specialty items above indicated, clocks and clock-type watches have no feature or characteristic to classify them as or with jewelry. They are utilitarian and not for the purpose of adornment. Most clocks are more properly in the category of household or business furniture which is not taxed. It is ridiculous even to consider whether the alarm clock or kitchen clock should be classified with jewelry for excise tax purposes. The same is true as to clock-type pocket and wrist watches, which not so many years ago were known to the public as "dollar watches."

Clocks and inexpensive, clock-type watches are not luxuries, but necessities.

Excises in the United States have usually been levied upon the legislative assumption that they tax luxuries or discourage consumption of unnecessary commodities. Familiar examples of such excises are taxes on amusements, liquor and tobacco. Regardless of whether this theory of exicse taxation is sound it obviously does not support taxation of commodities that are essential to the daily needs of all persons in the country. On the contrary, the theory that luxuries and harmful products should be taxed as such inferentially presupposes that products properly classified as necessities should not be taxed on the same basis. The fact that the "necessity" argument is frequently urged against excise taxation of particular products should not condemn it as shopworn or ineffective. It seems appropriate for Congress to reconsider whether any product subject to an excise is or is not a necessity. Should it be found that the product is a necessity, the clock industry contends that Congress ought to remedy the situation by repealing the tax. To impose any tax on products of the clock industry seems utterly inconsistent with the policy of Congress not to levy excises upon the necessities of life.

Extensive explanation is not required to emphasize the important part timepieces play in the daily lives of all people. However, examples of the necessary uses of timepieces hereinafter stated—as well as many other examples which will readily occur to every person who reads this brief—demonstrate beyond shadow of doubt that clocks and watches are utilitarian items in our national economy.

Nearly every employed person has an alarm clock at his bedside to awaken him in the morning. The housewife could not operate her kitchen and run her household without a clock, any more than without pots and pans. Offices and shops are run on clock time. The use of pocket and wrist watches is no less important than the use of clocks in enabling all persons to regulate manifold details of their daily business.

Numerous industries require time-controlled machinery. Many clocks, therefore, no longer tell time but accurately measure time. At predetermined times they close switches, turn off furnaces and stoves, change the flow of water and perform many other time precision assignments. Every weather bureau has several clocks that record and display continued graphs of temperatures, humidity and pressure all day long. Clocks have advanced beyond their original function of time-telling; they have become regulators and as such are highly important in today's high-speed business world.

In World War II clock products became integral and essential parts of the deadliest weapons evern known and likewise parts of the mechanisms of defense which counteracted those self-same weapons. During the war, the importance of timepieces to our national economy was emphasized when, after the domestic clock and watch industries were completely converted to the producing of timing devices for military purposes, the War Production Board found it necessary, despite the military need of critical materials, to order the resumption of the production of alarm clocks because without them the war effort was being seriously injured through lateness of workers.

The low average unit prices paid by the consumer for a clock or a clock-type watch offers the most compelling argument that products of the clock industry are not in the luxury class.

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That clocks and clock-type watches are necessities and not luxuries, and are improperly classified with jewelry for excise-tax purposes, was clearly implied in the Treasury Department's special study on Federal Retail Excise Taxes (October, 1947), where it is said (p. 32):

"Some of the items subject to the jewelry tax are considered essential. For example, most adults need some sort of clock or watch. The demand for most of the items in the tax base, however, is for the purpose of adornment."

Excise taxes on clocks and clock products are discriminatory. It is an axiom of taxation law that a tax should not be discriminatory. Even though a particular discriminatory tax may not violate the United States Constitution, it is contrary to sound economic principles and natural justice to penalize one industry and favor other industries through the taxation of some products and the exemption of other products less or no more esential than the products taxed. It is submitted that excise taxation of timepieces under sections 2400 and 1650 is violation of the concept that a tax should not be discriminatory.

Many other articles less essential or necessary for every day use than clocks and watches are not subject to an excise tax under the revenue laws of the United States. A few of such articles include: household vacuum cleaners, silver-plated flatware, fountain pens (unless four parts of the pen contain a precious metal), boats, orange juice squeezers, cigarette lighters, ash trays, cigarette cases, compacts without powder, candy, chewing gum, soft drinks, glassware, china, oriental rugs, furniture, statuary and pictures—and even yachts, for that matter. While such articles go untaxed, so should clocks and clock-type watches.

Existing excise tax rates result in discrimination among producers, retailers and consumers of clocks and watches. The basic tax rate is 10 percent of the retail price, which is levied under section 2400 and there is an additional wartime tax of 10 percent under section 1650. However, the additional tax does not apply to alarm clocks selling for not more than $5 and watches selling for not more than $65. Failure to tax all clocks and watches at a uniform rate results in discrimination not only among producers but also among retailers and consumers. This discrimination is recognized by the Treasury Department publication, Federal Retail Excise Taxes, which states (p. 38):

"The tax may have adverse competitive effect on producers in certain price area. This is especially noticeable in the case of clocks and watches, since the tax rate for alarm clocks selling for over $5 and watches selling for over $65 is twice as high as the tax on articles selling below these prices. A larger proportion of domestic than imported watches probably sells for over $65 and the differential tax, therefore, tends to discriminate against the domestic producer."

The Treasury Department publication states further (p. 40):

"The present differential tax rate on clocks and watches illustrate the competitive problems created by a price exemption. Under present law, alarm clocks selling for not more than $5 and watches selling for not more than $65 are taxable at 10 percent, while the respective articles selling above these prices are taxable at the full rate of 20 percent. *The 20-percent rate applies to all of the non-alarm type clocks. This discriminates against both the sellers and purchasers of those types of clocks. The 20-percent rate applies to the total price and not to the excess over $5. or $65. As a result, the tax is substantially higher on the clock or watch selling slightly above these prices than on those selling at or below such prices. This presents pricing problems for producers and may discriminate against particular producers.* For example, most of the imported watches are in the lower-price range and are subject to the 10-percent rate. Since domestic producers concentrate more on higher-priced watches, a large proportion of their product is subject to the higher rate." [Italics supplied.]

It must be obvious that a tax of 20 percent on an ordinary kitchen clock, say one priced at $5 to the consumer, is discriminatory when the consumer can purchase a gold watch for as much as $65 and pay only a 10-percent tax. Also, if a watch selling for as much as $65 is entitled to a present rate of 10 so-called dollar watch and inexpensive wrist watch should be completely exempted from tax. Likewise inequitable is the payment of a $1 tax on a kitchen clock selling for $5 as against a tax of 50 cents for an alarm clock selling at the same price.

Many excise taxes have the characteristics of a general sales tax. They hit low-income groups the hardest. It has been estimated that 85 percent of the taxes covered by the Excise Tax Act of 1947, which continued indefinitely the wartime excises due to expire on June 30, 1947, come from the pocketbooks of individuals and families earning less than $4,000 a year (congressional debates, on January 29, 1947; 93 Congressional Record 678). The excise tax on clocks and clock-type watches in particular affects low-income groups the most. This is so because

these articles are low-priced necessities purchased in greatest volume by low-income groups and are not high-priced luxuries which high-income groups can best afford. Accordingly, the tax on clock products is regressive; it imposes a burden on those consumers who can least afford to pay. Instead of attempting to lessen inequalities in income by taxation, as has usually been the policy of Congress, the excise tax on clock products defeats that objective. It is an inversion of a tax based on ability to pay. For this reason alone, the tax should be repealed.

The continuance of wartime excise taxes on clocks and clock products contributed to bring about the acutely depressed condition of the clock industry in the first 9 months of 1949. While some recovery in the industry was experienced in the last quarter of 1949, conditions in the clock industry, and especially in Connecticut, where most of the industry is concentrated, were exceedingly serious during the first months of the year.

Between June 1948 and June 1949, employment in the Connecticut clock industry dropped 46.8 percent and man hours dropped 52.8 percent.

The number of persons employed fell from a peak of 10,575 in 1948 to 5,280 as of August 12, 1949.

Production plunged from 2,763,688 clocks in the fourth quarter of 1948 to 1,359,947 in the second quarter of 1949.

The maximum realizable revenue to the Federal Government from excise taxes necessarily reflected an exactly corresponding drop from $1,336,666 (based on production in fourth quarter of 1948) to $673,800 (based on second quarter of 1949). During the first half of 1949 shipments of the Connecticut clock industry actually fell below the volume in the depression periodof 1932–35, and indications were that at least two-thirds of the Connecticut clock companies were operating at a loss.

It is not contended that these conditions were brought about entirely as a result of Federal excise taxes. But unquestionably their smothering effect on clock and watch sales was a contributing cause. In the Treasury Department's study of "Federal Retail Excise Taxes" the frank admission is made that (p. 37):

"Purchases of most of the items in the tax base normally would probably be reduced substantially by the tax."

In the case of clocks and clock-type watches there is no doubt about the loss in sales attributable to excise taxes. While in the period of abnormal demand following the close of the war, clock sales were not retarded by excise taxes, in the present more nearly normal market the effect has become abruptly felt. Market tests have disclosed very substantial losses of sales of clocks because of buyers' resistance to the additional price occasioned by the amount of excise tax to be paid. There are numerous jobbers who now refuse to handle clocks because of the excise tax; they distribute to variety houses, newsstands, tobacco stores and the like which sell no other items subject to excise taxes and wish to avoid the burden of collection and monthly reports. We believe the committee will agree that this artificial obstruction to the sale of clocks and clock products should be removed.

In conclusion, it is perfectly apparent that clocks and clock-type watches are improperly included with jewelry and other luxury items for excise tax-purposes. They are not luxuries in any sense of the word, but are universally recognized as necessities for modern living. To impose excises on clock products and exempt other essential products and even some luxuries is flagrant discrimination against the clock industry. To tax the lower-priced watches and alarm clocks at 10 percent and all other clocks at 20 percent is discriminatory among producers, retailers, and purchasers.

Excises on clocks and clock-type watches have many injurious effects on the clock industry and the national economy. These taxes reduce sales and thereby lower aggregate profits. They also reduce production and as a result thereof curtail employment and increase unit and overhead costs. Higher production costs plus the taxes themselves mean inflationary prices to consumers and an increase in the cost of living. Finally, the tax is regressive, having the worst characteristic of a general sales tax in that low-income groups pay the most.

In addition to being difficult and burdensome to administer, the excise tax on clocks and clock-type watches does not produce sufficient revenue to offset its many disadvantages. Should the tax be repealed, the income taxes on increased profits from increased sales would to a very large extent replace the excise tax revenue lost through repeal.

The clock industry believes there was never any justification in singling out an item here and another there for discriminatory taxing purposes. Conceding, however, that need for revenue in wartime did perhaps offer some excuse for

emergency measures such as excises, there is no such excuse now that the war has ended and Congress is making an over-all study of wartime excises.

The Eighty-first Congress should repeal all excise taxes on clocks and clock-type watches by amending the present law in the following respects:

(a) Revise section 2400 by striking out the words "watches and clocks and cases and movements therefor."

(b) Revise section 1650 (a) by striking out in the column entitled "section" of the table set out therein the following: "(except as respects watches selling at retail for not more than $65 and alarm clocks selling at retail for not more than $5)."

STATEMENT OF THE INTERNATIONAL UNION OF UNITED BREWERY, FLOUR, CEREAL, SOFT DRINK, AND DISTILLERY WORKERS OF AMERICA, CIO

Mr. Chairman and members of the committee, the International Union of United Brewery, Flour, Cereal, Soft Drink, and Distillery Workers of America, CIO, with headquarters in Cincinnati, Ohio, is one of the oldest labor organizations in this country, representing more than 70,000 workers in the malt beverage, liquor, malt, and allied industries. That organization and its entire membership request that this committee include the alcholic-beverage industry in considering H. R. 8920 for the repeal of some excise taxes under the Revenue Act of 1943.

It is a fact that the alcoholic-beverage industry is the largest industrial taxpayer to the Federal Government. From December 31, 1933, up to and including the fiscal year of 1948, this industry has paid to the Federal Government the staggering sum of $26,823,255,944. This does not include State and local government taxes The alcoholic-beverage industry provides employment for approximately 1,100,000 workers. The annual payroll of this industry is around $2,700,-000,000. It has approximately 400,000 business units.

The Federal excise tax on this industry has increased in the little more than 16 years since repeal from $1.10 to $9 per proof gallon on distilled spirits and from $5 to $8 per barrel of 31 gallons of beer.

The high excise tax that has been placed on this industry is a contributing factor to the large number of illicit operators (moonshiners and bootleggers) who are enjoying a steadily expanding business at the expense of the Government, the industry, and the workers. In the fiscal year of 1949, Federal agents alone seized 8,008 illicit stills, or 18½ percent more than in the previous 12 months and 32 percent more than in the fiscal year of 1947. It is estimated that these 8,008 stills, if paying taxes, could have netted the Federal Government about $739,-000,000 at the present excise rate. These seizures do not, of course, include the thousands of stills confiscated by State and local enforcement agents nor the thousands of stills not discovered at all and which therefore continue to operate.

Approximately 42 percent of every dollar spent for alcoholic beverages is returned to the Federal Government as excise taxes. The excise-tax rate imposed on such services and products as furs, toilet preparations, jewelry, luggage, telephone and telegraph services, admissions, transportation, etc., range from 3 cents to 20 cents excise tax on the dollar in contract to the 42 cents excise tax on alcoholic beverages.

The repeal of all wartime excise taxes of the Revenue Act of 1943 would stimulate business in the optical, telephone, telegraph, jewelry, leather goods, fur, cosmetics, transportation, electrical, petroleum, brewing, distilling, and other industries and would greatly increase consumer buying power in all industries affected by said excise taxes as well as industry generally.

Organized labor has protested loudly and strenuously for an across-the-board repeal of all wartime excise taxes. More than 13,800,000 members of organized labor in the United States went on record during the hearings held by the House Ways and Means Committee for excise tax reductions, insisting that, if there be any reductions, such cuts be across the board without discrimination against the alcoholic-beverage industry or any other commodity or service.

The International Union of United Brewery, Flour, Cereal, Soft Drink, and Distillery Workers of America, CIO, urgently request that this committee report favorably on legislation to repeal all wartime excise taxes and that no industry be discriminated against.

STATEMENT BY ORRIN B. WERNTZ, GENERAL MANAGER AND COUNSEL, NATIONAL SCREW MACHINE PRODUCTS INDUSTRY

MEMORANDUM BRIEF IN SUPPORT OF CLARIFICATION OF EXCISE TAX ON LUBRICATING OILS, UNDER SECTION 3413 OF INTERNAL REVENUE CODE, AS APPLIED TO CUTTING FLUIDS OR CUTTING OILS

To the Ways and Means Committee of the Eighty-first Congress of the United States:

This brief is submitted on behalf of the screw machine products industry through the general manager and counsel of its trade association, Orrin B. Werntz.

The industry operated principally automatic screw machines in producing metal products machined from bar, rod, or tube stock. The screw machine products industry embraces more than 1,200 establishments (1,207 per 1947 Census of Manufacturers), of which 412 employ 1 to 4 persons; 251, 5 to 9 persons; and 243, 10 to 19 persons. (Total of 906 companies out of 1,207 employing less than 20 persons.)

An impelling reason for this action is the use by this small industry of more cutting fluids, in proportion to sales volume of products, than any other industry in the country; and therefore this tax bears unequally on these producers; however, we are also in the broader sense speaking for all industry who use cutting fluids and oils in operation of machine tools on which lubricating-oils tax is imposed.

All operators of machines that cut metals purchase a small amount of oil for actual lubrication of the machine parts such as gears and bearings. They also purchase and use a much larger quantity of so-called oil which, contaminated with water, sulfur, chlorine, or other substances, is poured on the metal being cut during cutting operations and functions as a coolant and to carry away cuttings and chips, is a carrier for the sulfur, chlorine, and other additives, and not a lubricant. These coolant and flushing mixtures are called cutting fluids or cutting oils.

The present law imposes a tax of 6 cents per gallon on lubricating oils. Lubricating oil has been construed by the Treasury Department and the courts to apply to cutting fluids and oils, a much cheaper grade of so-called oils than motor oils, and which is not used primarily as a lubricant but to carry away chips and to cool cutting-machine tools. Despite this the Treasury Department has been inconsistent in its application of lubricating-oils tax as evidenced by rulings eliminating this tax with respect to similar oils, such as grinding oils, hydraulic oils which actually lubricate pistons while transferring power, transformor oils, and other comparable types.

Considering the fact that motor oil costs more than $1 per gallon and cutting fluids and oils approximately 25 cents to 40 cents per gallon, the imposition of 6 cents per gallon tax is very disproportionate to true lubricating oils, amounting to from 15 percent to 24 percent ad valorem as against less than 6 percent on motor oils.

The average automatic multispindle screw machine required 75 gallons of cutting-fluid mixture in the flushing tanks, which is circulated at rate of 50 gallons per minute and is completely dissipated, by loss through spray and on chips, 10 or more times per year. The cost of cutting fluids used averages 5 cents per machine-hour operated for each automatic screw machine, higher than other costs such as employee insurance.

The amount of revenue derived from including cutting fluids and oils under lubricating oils is minor compared to the total revenue from lubricating oils—Section 3413 of Internal Revenue Code presently estimated at $83,000,000 annually—but it is a significant factor in the operating costs of small establishments who buy $1,000 to $2,000 or more of cutting fluids annually on which a tax equaling 15 to 24 percent of cost is imposed.

When the law was passed by the House in 1932, the tax was imposed only upon lubricating oils falling within ranges of 20 to 70 viscosity, graded in accordance with the grades of the Society of Automotive Engineers. Oils of this viscosity are motor oils. That this was understood by the House committee as excluding industry from the tax is indicated by the following quotation from the statement of the Honorable John W. McCormack, Congressman from Massachusetts:

"The Senator from Pennsylvania a moment ago asked a question about lubricating oil; and, while that is not releveant to the purpose that I had in appearing before this committee, I might call to the attention of the committee that we

never intended to impose a tax on lubricating oil used in industry; and I am also frank in saying that my impersonal opinion of this latter remark is that the same thing should apply to tractors on the farm because in a sense they are to the farm just what machinery is to the industrialist.

"If you will read the debate in the House, you will note that the acting chairman of the committee, Mr. Crisp, in response to an inquiry I made of him, stated on the floor that they never intended to have the tax on lubricating oils apply to such lubricating oil used in industry, and my impersonal opinion is that the same thing might reasonably extend to the tractor on the farm."

In the Senate an amendment was proposed to eliminate the words "of the grades designated (at the time of the enactment of this act) by the Society of Automotive Engineers viscosity Nos. 20 to 70, inclusive." As to this Senator Walsh, of Massachusetts, said: "I think attention ought to be called to the fact that this amendment makes a substantial change in the House provision. The rate in the House was 4 cents per gallon. It is reported by the committee at 4 cents per gallon, but the House bill contained an exception that was of very great importance. It excepted lubricating oils used in industry.

The elimination of viscosity ratings from the law as finally enacted came about for one reason only, as shown by the debates. It was thought that, if the oils to be taxed were to be determined by a viscosity rating, the tax could be avoided by the automobilist by buying oils of a higher and a lower viscosity respectively than those which were taxable and, by mixing them, produce for himself the taxable article without paying the tax. Probably Congress in its proper zeal to make certain that a feasible and collectible tax would be applied to motor oils did not fully appreciate the burden placed upon industry and agriculture. Certainly it did not foresee that the Treasury Department would ever attempt to apply the tax to oils because of their potential lubricating character, when such oils are used either not at all or only minutely for lubricating purposes.

The above quotations indicate two things, that Congress intended originally to tax motor oils (lubricating oils within the motor oils viscosity range) and did not intend to tax lubricating oils used in industry. Passing the larger question of whether industry generally should be relieved of the tax on lubricating oil and assuming that it may still be proper to impose the tax when the oil is in fact used to lubricate machinery, we come to the narrower question of whether the tax was ever intended to be applied where the oil is used as a cutting fluid or a processing oil.

It is a matter of record that after the Government had, in our opinion, unlawfully collected the tax on cutting fluids, a suit was instituted in the Court of Claims in 1939 taking 1½ years to try, in an endeavor to get our money back, at which time all obtainable evidence by experts on cutting fluids and oils was heard. An impartial commissioner found that cutting fluids and oils did not lubricate in the generally accepted sense of that word and certainly not under the dictionary definition of "lubricants" when the law was passed in 1932.

Unfortunately the United States was at war when the case was argued upon the findings of commissioner before Court of Claims, and the findings of that court—namely, that cutting oils were lubricating oils—were distinctly contrary to the findings of the commissioner, as the record will show.

This left us only congressional redress, and due to the war and postwar readjustments 18 years have elapsed from the enactment of this law before we finally secured a hearing before this committee. We stress this point because the small manufacturer (using cutting fluids as there is no substitute) has not forgotten this seeming injustice and is still looking to Congress to rectify the action of Treasury Department, to clarify its original law to meet the intent, and therefore we propose change in the law to be included in excise-tax revision bill when reported as follows:

"*Lubricating oils.*—Section 3413 (relating to tax on lubricating oils) is amended by adding at the end thereof the following: 'Oils used primarily in cutting and machining operations on metals and known commercially as cutting oils shall not, for the purposes of this section, be considered as lubricating oils'."

This is the wordage used in H. R. 6563, Eighty-first Congress, second session.

ATHLETIC GOODS MANUFACTURERS ASSOCIATION,
Chicago, Ill., July 10, 1950.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR: We realize time is limited for testimony before your committee on excise taxes for, as representatives of our industry, we personally appeared before the Committee on Ways and Means on February 21, 1950. As a result, we are presenting this memorandum, which we will appreciate your having placed in the records of the hearings before your Committee.

Section 551 of 1941 Revenue Act, section 3406 (a) (1) Internal Revenue Code, calls for a 10-percent tax on certain articles of athletic equipment such as footballs, basketballs, inflated balls, track and gymnasium equipment, etc., as used by schools and colleges and children in their sports and games.

The majority of the public schools and colleges are claiming exemption of the excise tax on their purchases under section 3442 of the Internal Revenue Code because they are political subdivisions of a State. However, private and parochial schools cannot claim the exemption.

The Committee on Ways and Means considered the loss in excise taxes due to the purchasing by these public schools on the exemption certificates, as well as the unusually large amount of expense placed upon our industry, distributors and manufacturers alike, in the processing of these exemption certificates, and the resulting loss of income taxes due to this added expense. Details of this testimony are on pages 1705 to 1715 of revenue revision of 1950 hearings before the Committee on Ways and Means.

H. R. 8920 provides for the rewriting of section 551, 1941 Revenue Act, section 3406 (a) (1) Internal Revenue Code. This will eliminate the 10 percent tax on those articles purchased by schools, as detailed in scheduel A attached, but will retain the 10-percent tax on such other articles of athletic equipment as golf clubs, golf balls, golf bags, tennis rackets and balls, badminton and squash rackets, etc.

It will be greatly appreciated if the Senate Finance Committee will go along with the recommendations of the Committee on Ways and Means and the House of Representatives in the rewriting of section 551, 1941 Revenue Act, section 3406 (a) (1) Internal Revenue Code, as provided for in the present H. R. 8920.

Respectfully submitted.

ATHLETIC GOODS MANUFACTURERS ASSOCIATION,
By FRED J. BOWMAN, *President.*
By PHILIP H. GOLDSMITH, *Secretary.*
NATIONAL SPORTING GOODS DISTRIBUTORS ASSOCIATION,
By SHELBY HINES, *President.*
By MARVIN SHUTT, *Secretary.*

SECTION 551, 1941 REVENUE ACT, SECTION 3406 (A) (1) INTERNAL REVENUE CODE

To be rewritten to exclude the manufacturers excise tax of 10 percent on the following items used by schools in physical training program and which are now being purchased on exemption certificates free of excise tax. The articles to be excluded under section 3406 (a) (1) are:

Baseballs
Baseball bats
Baseball body protectors
Baseball shin guards
Baseballs gloves and mitts
Baseball masks
Footballs
Football helmets
Football harnesses
Hockey balls
Hockey pucks
Hockey sticks
Mass balls
Soccer balls
Softballs
Softball bats
Softball gloves and mitts
Indoor balls
Indoor bats
Indoor gloves and mitts
Basketballs
Boxing gloves
Boxing masks
Boxing head and ear guards
Fencing equipment
Gymnasium equipment and apparatus
Lacrosse balls
Lacrosse sticks
Pushballs
Track hurdles
Vaulting poles
Vaulting cross bars
Vaulting standards
Water-polo balls and goals
Wrestling head harness
Volleyballs
Volleyball nets
Volleyball standards

NATIONAL BOWLING COUNCIL,
Washington, D. C., July 10, 1950.

THE REQUEST OF THE NATIONAL BOWLING COUNCIL IN BEHALF OF THE BOWLERS OF AMERICA, THE BOWLING PROPRIETORS, THE MANUFACTURERS AND DEALERS, AND THE BILLARD- AND POOL-TABLE OWNERS FOR THE REPEAL OR REDUCTION OF PRESENT WARTIME EXCISE TAXES

Hon. WALTER F. GEORGE,
Chairman, Committee on Finance,
United States Senate, Washington, D. C.

Mr. Chairman and gentlemen of the committee, we herewith respectfully ask your consideration of our pleas for relief from the wartime excise taxes on the bowling and billiard industry, and attach hereto a copy of the brief filed with the Ways and Means Committee on February 21, 1950, asking that it be made a part of this brief in restating to your committee our contentions and reasoning in support of our plea, and in addition to which we wish to submit the following:

The Ways and Means Committee, in a general statement to the House, calls attention to the fact that wartime excise taxes have been borne by our citizens for a period of 9 years, five of these after the cessation of hostilities of World War II. Yet this committee failed to recommend any reduction of these taxes on bowling alleys, billiard and pool tables, nor any reduction of the manufacturers' excise taxes on bowling pins and bowling balls or on billiard and pool balls and cues, thus retaining the maximum of excise taxes on these items.

We respectfully submit that proper consideration has been denied that group of citizens comprising the 15,000,000 bowlers of the Nation; the nine-thousand-odd bowling-establishment proprietors; the manufacturers and dealers of the bowling industry; and the owners, operators, and manufacturers of billiard and pool tables.

Bowling is an essential and recognized recreational activity throughout the Nation and as such is certainly deserving of the same consideration and relief as the amusement and entertainment industries.

It is our contention that, in keeping with the stated intent of the Revenue Act of 1943, the excise tax of $10 per year per bowling alley and $10 per year per billiard and pool table—that tax which was added in 1943 to an excise tax of a similar amount imposed by the Revenue Act of 1941—should have been removed on the July 1 following the first day of the first month which began 6 months or more after the date of the termination of hostilities in World War II.

This not having been done we now repsectfully ask that your committee give to this section of the citizenry of our country that relief. Failing in this, we respectfully ask that these taxes be reduced on a percentage basis in keeping with the reductions so far recommended on behalf of other segments of the Nation's citizenry.

We believe and contend that all of the 1943 imposed excise taxes should be repealed or, in lieu thereof and in fairness to all, should be reduced on an equal percentage basis all down the line.

We graciously thank your chairman for having offered us the opportunity to appear before your committee for a 5-minute period on Thursday, July 6, but in deference to your very crowded schedule and the heavy demands on your time we submit our written plea instead, and ask that it be made a part of the record.

Respectfully submitted.

NATIONAL BOWLING COUNCIL,
A. L. EBERSOLE,
Executive Secretary.
JOHN CANELLI,
General Counsel, Toledo, Ohio.

NATIONAL BOWLING COUNCIL,
Washington, D. C., February 1, 1950.

The request of the National Bowling Council in behalf of the bowlers of America, the bowling proprietors, the manufacturers and dealers, and the billiard and pool table owners, for the repeal of all present wartime excise taxes.

Hon. ROBERT L. DOUGHTON,
Chairman, Committee on Ways and Means,
United States House of Representatives, Washington, D. C.

MY DEAR SIR AND GENTLEMEN: The National Bowling Council, representing the more than 15,000,000 bowlers of America, the 9,842 bowling establishments, the manufacturers and dealers of the bowling industry, and the owners, operators

and manufacturers of billiard and pool tables, on behalf of and for these citizens, respectfully and earnestly appeal to your honorable committee to recommend to the Congress the removal of all wartime taxes as imposed by the Revenue Act of 1943, and the excise taxes as imposed by the Revenue Act of 1941, particularly the removal of the excise taxes that were levied by these acts on bowling alleys and billiard and pool tables, as described by section 3268 of the Internal Revenue Code, and on sporting goods as described by section 3406 of the Internal Revenue Code.

We respectfully submit to your committee that the afore-mentioned excise taxes were accepted in good faith by the bowlers, proprietors, billiard- and pool-table owners, manufacturers and dealers, located in virtually every city and town in each of the 48 States, as a wartime necessity, and it was believed and expected that these taxes would be terminated upon the official declaration of the termination of hostilities of World War II, as promised and stated in the Revenue Act of 1943.

True, these taxes were technically terminated by the declaration of the President of the United States, on December 31, 1946, but the Congress immediately reinstated the same in toto, and they have remained in complete and uninterrupted effect since their imposition.

We respectfully submit that these imposed wartime excise taxes, the then stated purpose of which was to aid in the conservation of materials, travel and communication facilities, and to release manpower for the manufacture of essential war material and machinery, etc., present no justification for their continuance 5 years after the fighting war has ended, and we again respectfully ask that this committee act to repeal these taxes, and we also wish to express the full support of our representative membership of bill H. R. 2100, introduced in the House of Representatives on February 2, 1949, by Hon. Joseph W. Martin, Jr., and referred to your committee.

We wish to call attention to the fact that these wartime excise taxes, insofar as they apply to bowling and billiards, and to sporting goods, are a tax on the recreation activities, and also facilities, of our citizens.

Recreation is one of the most important and essential activities of the Nation today, being equally so recognized by government (National, State, and local), industry and labor. Every major industry has a well rounded-out employee recreational program, and a survey among industrial employees reveals that 58 percent name bowling as their first recreation choice.

A comprehensive survey of business reports, from a widely diversified number of bowling establishments of every size and type, for the year 1948, disclosed an average net income of from 3 to 5 percent, with many establishments on the border line of net loss. And this situation certainly cannot have improved for the year 1949. Just as occurred after World War I, prior to the time that the wartime excise taxes of that period were repealed, many bowling establishments are closing, due to inability to meet operating expenses aggravated by the present overburdensome tax load.

It is respectfully pointed out to your committee that the millions of bowlers in this country comprise that strata of citizenry least able to pay the heavy load of present taxation. It is an accepted fact that approximately 75 percent of the wage earners of the Nation are in the $3,000-per-year-and-less salary bracket, and a Nation-wide survey has shown that 70 percent of all persons who participate in bowling come from that $3,000-per-year-and-less salary bracket. Bowling is, in fact, the "poor man's" game. These citizens simply cannot participate in their favorite recreation to the fullest extent, nor obtain the needed and desired recreational and sports equipment, on account of the high level of existing taxes. The repeal of these wartime excise taxes on bowling alleys would accord them relief in the approximate amount of $1,600,000 annually, a comparable amount by the repeal of these same taxes on billiard and pool tables, and a further substantial relief by the repeal of the self-same taxes on sporting goods and sporting equipment.

We, therefore, respectfully urge the removal of all wartime excise taxes, believing such action to be in the best interest of the Nation's economy, and a particular need for those thousands of businessmen and firms supplying the bowling, billiard, and other recreational needs to the millions of participants.

Respectfully submitted.

NATIONAL BOWLING COUNCIL,
A. L. EBERSOLE,
Executive Secretary.
JOHN CANELLI,
General Counsel, Toledo, Ohio.

STATEMENT OF L. V. COLEMAN, DIRECTOR, AMERICAN ASSOCIATION OF MUSEUMS

Our case, in a word, is that the tax on museum admissions adds less than a drop in the bucket as revenue, whereas the collecting of its interferes with services of museums, does real harm to the institutions themselves, and contains the ingredients of a greater mischief.

1. The revenue so derived is small

Museums, like libraries, perform educational work that is mostly offered gratis to the public. Reports indicate that not 20 of the larger museums have pay days, and that very few small museums make charges yielding even $100 a year in taxes. The inside charges made at intervals by the larger art museums for temporary exhibitions rarely meet costs, and it is estimated that less than 100 museums have such features that could yield $100 or more in taxes annually. Collections for lectures and courses of instruction, mostly for children, are equally limited. The substantial amounts come almost exclusively from two or three important museums in each of several large cities—notably New York and Chicago—where tax collections for general or special admissions run from $5,000 to upward of $25,000 a year. There are five planetariums in this category.

The largest class of museums charging admission is that of about 900 historic house museums, some of them in every State. Four or five of these historical shrines have large attendance (the largest at Mount Vernon) but most museums of this kind have less than 2,000 visitors a year and collect less than $100 of taxes—much less in a typical case. These old houses need every inducement to visitors, upon whom they principally depend; no words can exaggerate the difficulty—often ending in failure—of efforts of little historical societies to preserve such places and to keep them in repair and on view.

Botanical gardens, zoological parks, and aquariums of any size are located in not more than 50 places, and less than half of them are reported to make admission charges. Attendances at a few zoos are high, but are made up largely of children, whose small fees are exempt. Last year the great zoo in New York collected only $4,300 in taxes on general admissions of adults (children exempt) and about $8,000 on a special feature.

2. The tax interferes with museum work

The task of collecting and handling the tax costs museums from 5 to 15 percent of the tax amount collected. Thus a museum that collects $27,000 (one of the few large amounts) has a recorded cost of $2,700. Small museums, incurring only trivial costs, are the ones least able to take care of any costs at all.

The business of collecting interferes with management of people under museum conditions, and it has an adverse effect on visits of school groups and enrollment in courses.

3. The tax is an imposition upon the public

It is reported that people often object to paying this tax on service which, as a rule, they are already doubly supporting—through the admission charge and through public tax support of the institution. The difficulty is further multiplied in the case of students who are given a reduced rate by the museum but must pay the tax on the full rate of admission. For example, at colonial Williamsburg, where there is a blanket charge of $2 and a tax of 40 cents for visitors to six museum houses, there is a student rate of $1 on which the tax is still 40 cents, or 40 percent, thus considerably overcoming the purpose for which the reduced rate was designed. The attendance at museum exhibits, lectures, and programs includes many groups of school children with their teachers, as well as college and university students and groups in adult educational work. The offerings of museums to such people is like school or college instruction, for which the fees are not taxed.

4. The tax works to discredit museums

Museums have worked hard over many years to establish in the public mind an understanding of the educational character of museum work. The fact that visitors must now pay the same tax to a museum that they pay to a motion-picture house tends to break down the museum's position and in turn to undermine the public support that springs from what the people think.

5. The tax is believed to threaten the basis of public service

Museums, like other nonprofit institutions, have traditionally been exempt from taxation and—equally important—from any involvement in tax procedure. There is widespread and earnest concern among museum trustees, who are wise and experienced leaders in the community, lest this tax duty be only the beginning. It is believed that the admissions tax, though to be sure it only sideswipes the institution, in effect contradicts State and city charters under which museums exist as nonprofit, educational, public establishments.

STATEMENT OF J. T. HEILIG, VICE PRESIDENT, SAVORY EQUIPMENT, INC.

INTRODUCTION

This brief is presented by and on behalf of Savory Equipment, Inc., a manufacturer of electrically operated, gas heated, toasters, located in Newark, N. J.

The Revenue Act of 1950, H. R. 8920, as passed by the House of Representatives June 29, 1950 under the heading "Manufacturers' excise taxes," subheading "Electric, gas and oil appliances" exempts "electric toasters" from excise taxes, and provides for no change as to "all others." It fails to define electric toasters. It fails to exempt toasters of similar construction and serving identical purposes and uses, but employing other heating means such as gas. (See illustrative exhibits attached demonstrating identity of two types of toasters, both electrically driven, the only difference being in the medium employed to furnish heat for toasting.)

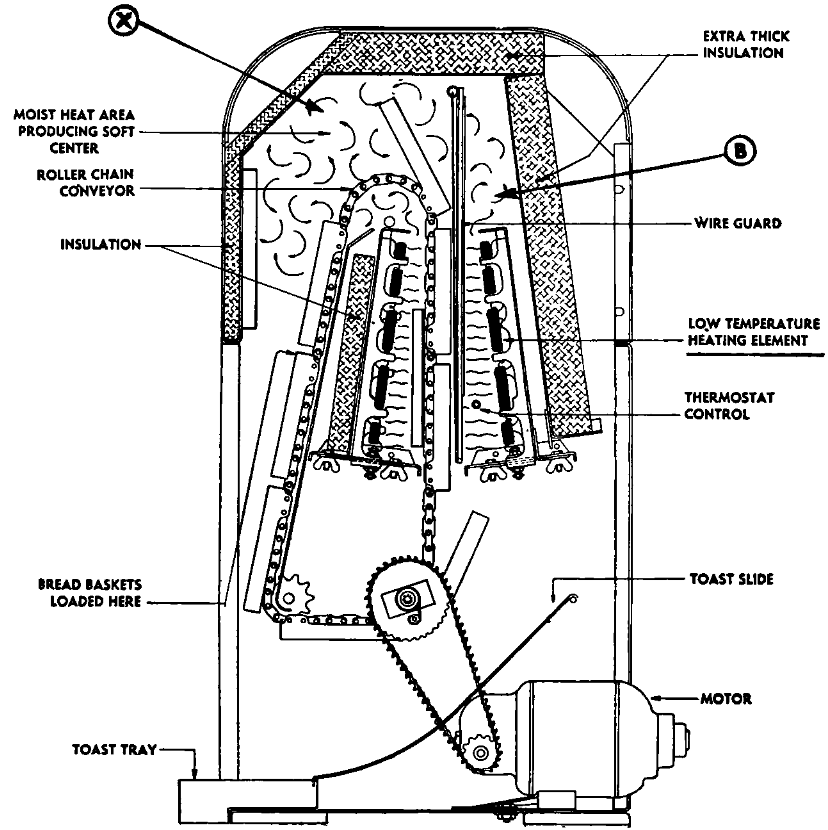
It is assumed that the framers of the bill did not intend discrimination, but the effect of the bill as written is to discriminate to a ruinous degree against manufacturers and users of gas heated toasters and against gas utilities and bottled gas suppliers. The United States Government in military establishments and hospitals, and also private hospitals and other large users of toast are adversely affected. The electrically driven gas toaster is subject to the possible ruling that although electricity is used in part in the operation of the toaster, the use of gas as a heating medium prevents its classification as an electric toaster (exempt) and compels a classification as a gas toaster which since there is no change as to "all others" in the appliance field would continue to be subject to the excise tax.

It is respectfully requested that the Senate Finance Committee give favorable consideration to eliminating the word "electric" in this classification so that the bill will provide that all toasters are exempt, for the following reasons:

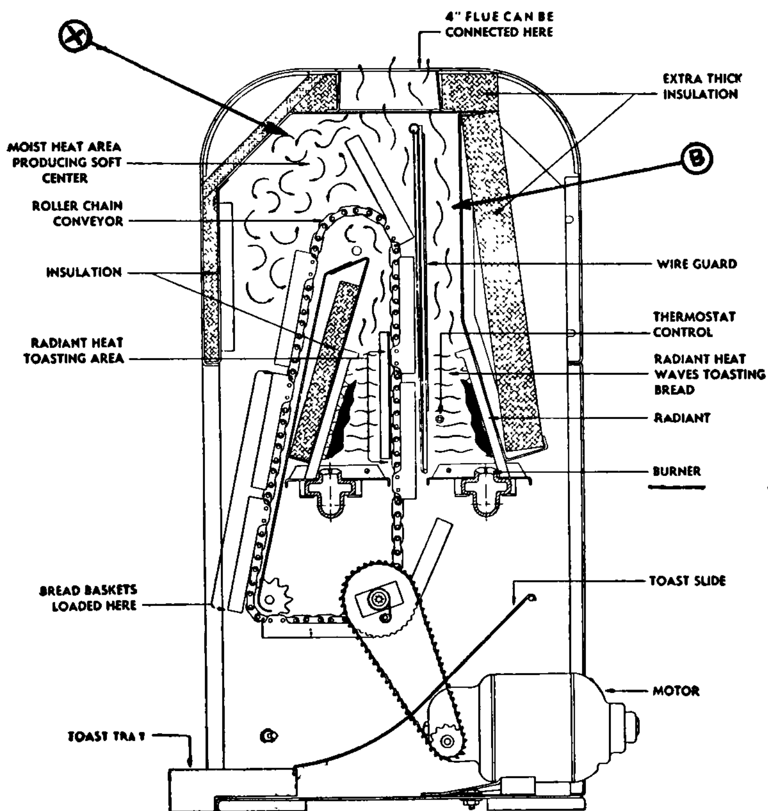
1. The toasters are of substantially the same construction and serve the same purpose. Both are electrically driven, the only difference being in the heating means employed. (See illustrative exhibits attached.)
2. The bill will discriminate against the user who has gas available as a convenient or desirable heating medium (many users have only lighting circuits on their premises which supply current sufficient to operate the electric motor but not sufficient to use for the heating medium).
3. The loss in revenue to the Government is insignificant.
4. It will be impossible with this handicap for gas toasters to continue to be manufactured competitively.
5. Unemployment will be increased if manufacturers of gas toasters are thus forced to discontinue.
6. Hospitals and the Federal Government, now large users of gas toasters will thus lose the source of supply of such toasters.
7. In cases where gas toasters are used commercially the "tools of production" will be taxed.
8. The bill discriminates against gas utilities and the bottled-gas industry.

CONCLUSION

The word "electric" in this classification should be eliminated so that all toasters will have the same exempt status.



ELECTRIC


4" FLUE CAN BE CONNECTED HERE
EXTRA THICK INSULATION
MOIST HEAT AREA PRODUCING SOFT CENTER
ROLLER CHAIN CONVEYOR
INSULATION
RADIANT HEAT TOASTING AREA
WIRE GUARD
THERMOSTAT CONTROL
RADIANT HEAT WAVES TOASTING BREAD
RADIANT
BURNER
GAS
TOAST SLIDE
BREAD BASKETS LOADED HERE
MOTOR
TOAST TRAY

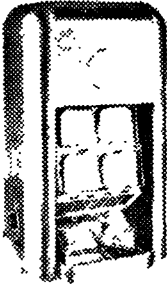
Model CT-4—BREAD TOASTER

9 to 12 slices per minute, depending upon size of bread

Maximum consumption 3,600 watts—average 2,700 watts

Dimensions Height 29⅞', Width 23⅛ Depth 16⅝"

Shipping weight 125 lbs



Model CT-2—BREAD TOASTER

6 slices per minute—360 slices per hour

Maximum consumption 2,640 watts—average 1 980 watts

Dimensions Height 29⅞ , Width 18⅝ , Depth 16⅝

Shipping weight 116 lbs

THESE WILL BE

EXEMPT

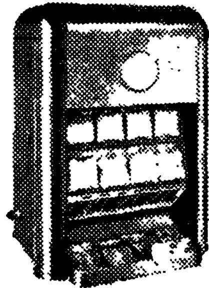
BUT

THESE WILL BE

TAXED

Model PD—BREAD TOASTER

6 slices per minute—360 slices per hour.
Operates for as little as ½¢ per hour
Max consumption: 12,000 B T U. per hour.
Dimensions Height 29⅞", Width 19⅛", Depth 16⅝"
Shipping weight 110 lbs.



Model PQ—BREAD TOASTER

9 to 12 slices per minute—540 4½" by 4½" slices to 720 3⅝" by 4½" slices per hour
Operates for as little as 1¢ per hour
Max consumption: 20,000 B T U. per hour
Dimensions: Height 29⅞", Width 23⅝", Depth 16⅝"
Shipping weight· 125 lbs.

PROPOSED AMENDMENT TO SECTION 3250 (1) (5) OF THE INTERNAL REVENUE CODE

WASHINGTON, D. C., *July 10, 1950.*

To the SENATE FINANCE COMMITTEE,
United States Senate Office Building, Washington, D. C.:

Your petitioners, the Flavoring Extract Manufacturers' Association of the United States, the National Fruit and Syrup Manufacturers Association, and the National Manufacturers of Soda Water Flavors, comprising in their membership the larger manufacturers of food products, flavors, and flavoring extracts, using ethyl alcohol for nonbeverage purposes in the production of food products, flavors, flavoring extracts intended for further manufacturing purposes by the ice cream, confectionery, bakery, dairy, soda fountain, drug, and carbonated and still beverage industries, as likewise household culinary use, respectfully urge the members of the Senate Finance Committee, in the consideration of H. R. 8920, Part IV—Occupational Taxes, section 141. Distilled spirits used in the manufacture of certain nonbeverage products, to amend aforesaid amendments passed by the House to section 3250 (5), as follows:

"(5) *Draw-back.*—A draw-back at the rate of $6 on each proof gallon shall be allowed on distilled spirits tax-paid and used as provided in this subsection and be due and payable quarterly upon filing of a proper claim with the Commissioner, except that in the case of distilled spirits used in the manufacture or production of medicines or medicinal preparations the draw-back shall be at the rate of $7. No claim under this subsection shall be allowed unless filed with the Commissioner within the 3 months next succeeding the quarter for which the draw-back is claimed."

Your petitioners recommend that Part IV—Occupational Taxes, section 141. Distilled spirits used in the manufacture of certain nonbeverage products, amending section 3250 (5), be amended as follows:

"(5) *Draw-back.*—A draw-back at the rate of $7 on each proof gallon shall be allowed on distilled spirits tax-paid and used as provided in this subsection and be due and payable quarterly upon filing of a proper claim with the Commissioner. No claim under this subsection shall be allowed unless filed with the Commissioner within the 3 months next succeeding the quarter for which the draw-back is claimed."

The members of the Flavoring Extract Association of the United States in convention on May 10, 1950, as likewise members of the National Fruit and Syrup Manufacturers Association in convention on May 11, 1950, unanimously approved the intent and purpose of an increase in draw-back claims on ethyl alcohol withdrawn and intended for use in certain nonbeverage products. Resolutions were unanimously adopted recommending that H. R. 8920, Part IV—Occupational Taxes, section 141. Distilled spirits used in the manufacture of certain nonbeverage products, be further extended to include food products, flavors and flavoring extracts as hereinabove set forth.

The groups comprising the flavoring products industry are of the opinion that a net $2 tax is fair and proper and that an increase in the draw-back claim from $6 to $7 per proof gallon, due to competitive conditions within the flavoring products industry, would be automatically passed on to the consuming public.

Your petitioners further represent that the rate of draw-back on distilled spirits used in the manufacture of certain nonbeverage products ought to be uniform regardless of the fact that said ethyl alcohol is used in medicines or medical preparations. Two separate classes and rates of draw-back would, in our opinion, be very difficult to administer, especially in such cases where the manufacturer is engaged in the production of medicines and medical preparations as likewise food products, flavors, and flavoring extracts. A differential in said rate of tax would unquestionably bring about difficulty in the keeping of books and records as likewise preparation of draw-back claims and payment thereof by the Treasury Department.

Your kind cooperation in this matter will be greatly appreciated.

FLAVORING EXTRACT MANUFACTURERS' ASSOCIATION OF THE UNITED STATES.
NATIONAL FRUIT AND SYRUP MANUFACTURERS ASSOCIATION.
NATIONAL MANUFACTURERS OF SODA WATER FLAVORS.

STATEMENT BY HAROLD B. WAHL, GENERAL ATTORNEY, THE PENINSULAR & OCCIDENTAL STEAMSHIP CO., JACKSONVILLE, FLA.

The Peninsular & Occidental Steamship Co., commonly called P. & O., is now in its fiftieth year of rendering service between Florida and Caribbean ports. We are down to our last ship, the steamship *Florida*, operating between Miami and Habana, and business each month' shows a decrease under the corresponding month of the previous yea.

One of the principal deterrents and handicaps is the 15 percent Federal transportation tax which applies to our transportation to Cuba and yet does not apply to competing tourist transportation attractions which go to South America, Europe, Africa, etc.

Our regular round-trip fare for the overnight trip between Miami and Habana is $46, including transportation, room, dinner, and breakfast each way. The 15 percent transportation tax of $6.90 added to this makes a total of $52.90. This difference (in the case of a man and his wife amounting to $13.80) keeps a good many people from making the trip. The airline round-trip fare is $30 (the airline rate does not include room and meals). The transportation tax in the case of the P. & O. applies not only to transportation but also to stateroom and meals, and further increases the differential between water and air transportation.

To show what we are up against, we resumed operations with the steamship *Florida* in January 1947, when the WSA returned her to us, after we had first put the vessel in first-class condition, freshly renovated throughout. During 1947 we handled 73,376 passengers between Miami and Habana. During 1948 the number fell to 64,028 and in 1949 it decreased still further to 61,473.

The bulk of our business comes from people who are in Florida for the winter, discover that Cuba is only a short distance away, and while here decide to take the trip. There is no particular hurry about the trip and there has been so much talk about repealing the transportation tax that many of these people decide to wait until the tax has been repealed.

In addition, when there is a family group, the transportation tax, multiplied by the number in the group, frequently causes the abandonment of the trip or the party to travel by air because of the saving in costs. This is so even though they prefer the overnight boat trip with dancing aboard ship and all of the other attractions that are included in the trip by sea. The end result is that many people who would prefer the overnight boat trip are forced to travel by air because of the differential, and many others are unable to go at all, either by air or water.

We have made a check both among passengers and the travel agencies and are convinced that there is so much resentment against this transportation tax that it is a primary deterrent in our business.

Moreover, most people are totally unable to understand why if they go all the way to South America they pay no transportation tax, whereas if they merely go to Cuba 15 percent is added to their bill.

We earnestly hope that the tax will be repealed.

The P. & O. is one of the few companies under American registry which is still operating in the coastwise or nearby Caribbean territory and we are struggling valiantly to keep our heads above water.

WASHINGTON, D. C., *July 11, 1950.*

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Washington, D. C.

DEAR MR. CHAIRMAN: Representing the Toy Manufacturers of the U. S. A., Inc., a trade association made up of a large majority of the children's toy and plaything producers in this country, we appeared before the Ways and Means Committee in support of H. R. 6723, Mr. Camp, of Georgia, see Hearings before Ways and Means Committee, 1950, volume 1, page 1513. This bill was intended to relieve the toy industry and its customers of certain burdensome excise taxes which, largely through administrative rulings, have been held applicable to children's playthings. Most of the provisions of the Camp bill have been incorporated in H. R. 8920. Our attention has been called to the inadequacy of the definition of tires found in section 151 of the House bill, page 26, in paragraph (b), Removal of tax on tires for toys, etc.:

"* * * The tax imposed by this paragraph shall not apply to (A) tires which are not more than 18 inches in diameter * * *"

We were of the opinion at the time of our appearance before the Ways and Means Committee that this definition would cover most, but not all, of the tires and tiring on juvenile vehicles, but our attention recently has been called to the fact that such definition discriminates against velocipedes used by small children. Many of these velocipedes have front wheels 20 inches in diameter, and such wheeled toys generally are used by children 4 to 6 years of age.

We quote from two letters received from manufacturers of children's wheeled goods. The first is from Junior Toy Corp., Hammond, Ind., signed by N. G. Wintermantel, vice president in charge of sales:

"So far as our particular product is concerned, namely children's velocipedes, there is one little catch to the language of the section dealing with tires on children's vehicles and that is "not more than 18 inches in diameter." As you will observe, from our catalog enclosed, the largest size velocipedes have 20-inch-diameter front wheels. These 20-inoh front wheel size velocipedes generally are used by children from 4 to 6 years of age."

The second is from the Colson Corp., of Elyria, Ohio, under the signature of Mr. J. C. Struthers, vice president:

"I note in the language of the new section that you say that: '(A) tires which are not more than 18 inches in diameter and not more than 1¾ inches in cross section, if such tires are of all-rubber construction (whether hollow center or solid) without fabric or metal reinforcement, or (B) tires of extruded tiring with internal wire-fastening agent.' Does this mean that our tires in excess of 18 inches diameter that the tax is still effective? This is the point, inasmuch as all velocipedes have a 20-inch diameter on the front wheel."

Thus, we would respectfully request that when your committee considers the bill, H. R. 8920, to reduce excise taxes and for other purposes in executive session, as we do not wish to take its time by asking for a hearing, that it strike out in line 10 on page 26 the figure "18" and substitute in liue thereof the figure "20."

Respectfully yours,

DOW W. HARTER.

STATEMENT ON BEHALF, ASSOCIATION OF MARYLAND DISTILLERS AND ALLIED INDUSTRIES, BY DONALD HAMMOND, SECRETARY OF THE ASSOCIATION

(Members: The Calvert Distilling Co., the Hunter-Wilson Distilling Co., Paul Jones & Co., Inc., National Distillers Products Corp., Schenley Industries, Ind., the Frank L. Wight Distilling Co.)

We most urgently ask you gentlemen for relief from the most recent of the two wartime increases of the excise tax on our product.

As you will recall, there was an increase from $4 to $6 in 1942 and then, in 1944, the excise tax was increased from $6 to $9. It is for prompt relief from the last increase of $3 that we respectfully seek your favorable consideration.

Our appeal is made on common-sense grounds. You gentlemen are well aware of the theory of diminishing returns. That theory unquestionably is at work and has been at work in the distilling industry.

Consumer resistance to the admittedly high Federal tax on distilled liquors has resulted in a serious drop in Federal excise receipts.

Federal excise-tax collections from distilled spirits aggregated 1.9 billions of dollars in 1946, the first full peacetime calendar year following World War II. These Federal receipts dropped to 1.5 billion dollars in 1947 and in both 1948 and 1949, Federal excise-tax receipts from distilled spirits approximated 1.4 billion dollars. The 1949 figure is about 26 percent lower than the 1946.

The lesson is clear enough. Maintenance of the present excise tax on distilled products will mean a continuing decline in Federal receipts and, from our point of view, a most serious deterioration of the legitimate distilling industry with its hundreds of thousands of employees, distributors, and retailers.

Please note that this decline will not necessarily mean a reduction in the consumption of distilled beverages. As is well known, the illicit distilling of alcoholic beverages has greatly increased during the last 4 years.

Such a situation is natural and entirely to be expected. Should prohibitive costs for our products continue to prevail as the result of the present excise taxes—of each dollar spent for distilled spirits by the consumer, 42 cents is represented by Federal excise taxes—then we may look with certainty to further inroads by illicit distillers.

69474—50——23

In plain words, bootlegging is on the increase and the Federal Treasury will suffer directly therefrom.

United States Government figures show without question that there has been a shift in the consumption pattern from tax-paid, legally produced distilled spirits to tax-avoiding moonshine.

Not only is the illicit activity causing substantial losses in tax revenues to Federal, State, and local governments, but is resurrecting most serious control and enforcement problems.

During 1949 Federal investigators seized 8,649 illegal stills, an increase of 14½ percent over the preceding years and—please mark this—a 34-percent increase over the number of such stills seized during 1946.

The daily producing capacity of the illegal stills seized in 1949, according to Government figures, was 240,809 gallons, which represented a 16.7 increase over the preceding year and, alarmingly enough, a 46.4-percent increase over the producing capacity of stills seized during 1946, demonstrating an increase in the capacity of the illegal stills as well as their numbers.

And may we call to your attention that these figures deal only with raids made by Federal investigators; they do not include seizures made by State and local enforcement authorities.

These are considerable. For example, North Carolina reported that for October, November, and December, 1949, there were 1,351 stills captured by State authorities and 561,573 gallons of mash destroyed.

It seems to us beyond question that the production and consumption of non-tax-paid distilled spirits are a direct result of some consumers' inability or unwillingness to pay the present tax-inflated prices for legally distilled spirits.

We believe that a reduction in the Federal excise tax on distilled spirits will put a stop to this trend toward illegally produced beverages with a resultant increase in the legally recorded consumption of alcoholic beverages.

We further believe that there would not be a corresponding loss in revenue to the Federal Government through a reduction in the excise tax.

Our industry is important in the economic structure of the country and our particular segment of the industry is very important to the economic well-being of the State of Maryland, which has been suffering reduced revenues as a result of the decline in consumption of legally produced distilled spirits.

In the Revenue Act of 1943 there was included a congressional intention to remove wartime excise taxes after the war. We most urgently ask now that the last such increase on distilled spirits be removed.

We do not feel that we are seeking special consideration. We think the facts warrant the reduction sought, and hope your committee will see its way clear to bring about this reduction.

REPEAL ASSOCIATES, INC.,
Washington, D. C., July 11, 1950.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

SIR: This letter is addressed to you in my capacity as president of Repeal Associates, a Nation-wide organization of citizens who are interested in furthering good control of the sale and use of alcoholic beverages, and who are opposed to prohibition.

Your committee has received representations regarding the excise taxes on alcoholic beverages from the producers and the sellers of such beverages, but probably little or nothing has come to you regarding the point of view of those who actually pay those taxes—the consumers.

Although I can speak officially for only those who are members of this organization, I feel that a very great many, perhaps even a large majority, of the 60 to 65 million citizens who drink beverages containing alcohol would concur in the representations which I shall make.

Citizens expect the Congress to keep faith with them in the commitment which was written into the Revenue Act of 1943, that the increases therein made in the excise taxes on distilled spirits, wines, and fermented malt liquors would be done away with within 6 months after the end of the war. H. R. 8920 does not do this.

The bill as written discriminates between the various products upon which excise taxes are levied, and affords no tax relief whatever to something near one-half of the people, who pay the taxes herein discussed. These citizens feel that there is no justification for continuing the wartime excise taxes on alcoholic

beverages, if other products are favored by tax reductions. Of course, if the present international situation should become an actual emergency, and high, and even higher, taxes should be found necessary, no reduction would be expected as to alcoholic beverages, and none should be made as to other products now taxed.

The citizens for whom I speak, and many others as well, are not primarily interested in this matter of excise-tax reduction as a means of saving them money. Their first thought is that in the interest of legal and orderly manufacture and sale of beverages containing alcohol, and because of the increasing amount of illicit manufacture and illegal sale of such beverages, there is need for doing all that is possible to eliminate this illegal traffic.

Records of the Alcohol Tax Unit, and of State enforcement agencies, show a constant and alarming increase in the numbers of illicit stills captured. This illegal business is a direct product of the high excise taxes, which make such operations extremely profitable.

Some informed observers have stated that the total capacity of the illicit stills captured, and the many which in all probability escape detection, is approximately as great as the liquor output of the legal distilleries. If this is even measurably true, the inescapable conclusion must be that the present high excise taxes are defeating their own purpose, and that a lowering of those taxes would not only bring the promised relief to the consumers of alcoholic beverages, but would result in tax collections possibly equal to or greater than are being realized under the present high rates. At the same time, and more important, whatever is done that results in lessening the volume of the illicit liquor business will be of inestimable value toward solving the social problems resulting from the illicit liquor traffic.

In view of the foregoing considerations, it is respectfully requested that your committee take the opportunity, when acting upon H. R. 8920, to keep the definite promise which was written into the Revenue Act of 1943, by canceling the increases made by that act, and restoring as to alcoholic beverages the tax rates which maintained prior to that enactment.

It is requested that this letter be made a part of the record of the hearings on H. R. 8920.

Respectfully submitted.

Very truly yours,

C. L. CHAPIN, *President.*

WASHINGTON, D. C., *July 5, 1950.*

MISS ELIZABETH B. SPRINGER,
Clerk, Senate Finance Committee,
Senate Office Building, Washington, D. C.

Retel hearings Finance Committee on H. R. 8920 war excise taxes respecting limited time and due to fact that any new material I would present would be cumulative, will forego appearance, but urgently request members of committee consider my testimony before House with reference communications and transportation taxes calling attention again to undisputed fact that this is a tax on doing business and reduces working capital and, therefore, business velocity. Also many largest firms, repeat, many largest American firms evade transportation tax by having their agents pay domestic American freight bills in Canada leaving small American business still paying transportation tax.

JAMES F. SOLLEY, JR.,
President, National League Distributors.

WASHINGTON, D. C., *July 5, 1950.*

HON. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

Thanks for your past interest and courtesy regarding efforts to obtain relief from communication and transportation taxes. Have agreed to forego further personal appearance to avoid repetition and cumulative testimony, but hope your committee will consider my testimony before House Ways and Means Committee on H. R. 8920. Interested in hearing your broadcast yesterday to the effect that you were disappointed in House committee action particularly on communication and transportation excise taxes. Thanks.

JAMES F. SOLLEY, JR.,
President, National League Distributors.

WENCHEL, TANNENBAUM & NUNAN,
Washington 6, D. C.

Re Wine and Spirits Wholesalers of America, Inc.

CHARLES OLIPHANT, Esq.
Chief Counsel, Bureau of Internal Revenue,
Washington 25, D. C.

DEAR MR. OLIPHANT: This memorandum is submitted on behalf of the Wine & Spirits Wholesalers of America, Inc. The question involved is whether profits realized by a State from the purchase and sale of alcoholic beverages is subject to Federal corporate income tax. For the reasons given below we believe that such profits are not exempt from tax. It is respectfully requested that the opinions expressed in G. C. M. 13745, C. B. XIII-2, p. 76 (1934), and in G. C. M. 14407, XIV-1, C. B., p. 103 (1935), be reconsidered and amended.

FOREWORD

With the repeal of the eighteenth amendment of the Constitution of the United States each State became free to adopt individual systems of control over the alcoholic-beverage trade within its jurisdiction. Seventeen States [1] enacted legislation prohibiting private citizens from engaging in the liquor business. In most cases the prohibition applies only to spirituous liquors and wines, leaving the trade in beer, or perhaps in light wines, to private business, but in some States the control covers all intoxicating beverages. In practically all of these States control of the business is placed in a commission or a board, which has not only the responsibility of regulation and taxation but also has the right and duty to engage in the liquor business. Any profits derived from the business inure to the State and either becomes a part of the general revenue of the State or is allocated to some specific purpose.

The basic purpose of the systems adopted by these States has been described by writers on the subject as a method for removing profit motive out of the liquor business and as a means of regulating and conducting it primarily for the welfare of the people.[2] While it was recognized that this system of control required the State to enter the market place and engage in the barter of goods, the control advantages were deemed to outweight the objections to this departure from the usual method of private merchandising of goods.[3]

As early as 1905, the Supreme Court held that when a State engaged in business of a proprietary nature, such as the operation of liquor stores, it is subject to a Federal excise tax on the right to engage in that business (*South Carolina* v. *United States*, 199 U. S. 437). Again in 1934, and following repeal of the Eighteenth Amendment, the Supreme Court reiterated its holding and said that whenever a State engages in a business which is of a private nature, that business is not withdrawn from the taxing power of the Nation (*Ohio* v *Helvering,* 292 U. S. 360).

In 1934 the question was presented to the Bureau of Internal Revenue whether profits realized from the operation of liquor stores and similar activities by the State of Oregon through the Oregon Liquor Control Commission were subject to Federal income tax. It was ruled that such profits were subject to the Federal income tax (I. T. 2797, C. B. XIII-2, p. 74 (1934)).

Immediately thereafter this ruling was reversed by G. C. M. 13745, C. B. XIII-2, p. 76 (1934). It was observed that in that case a large portion of the profits accruing to the State of Oregon from the operation of the liquor business and similar activities were used by the State in carrying out certain functions, including direct relief of the indigent and unemployment relief, which were essentially governmental. This ruling appeared to rest upon the conclusion that the State was constitutionally immune from income tax on such profits because it was said that the ruling of the Supreme Court as to the right of the Federal Government to impose an excise tax on the right to engage in the liquor business could not properly be extended to include a tax on the profits derived by the State from such activities.

[1] De facto population estimates of the Bureau of the Census, Department of Commerce, as of July 1, 1945, indicate a population of 41,584,838 in those States and 84,535,720 in private license States, all figures exclusive of Armed Forces abroad. Beverage distilling Industry Facts and Figures 1934-45, p. 164, published by Research and Statistical Bureau of Licensed Beverages Industries, Inc.

[2] Harrison and Lane, After Repeal (1st ed. 1936), p. 102.

[3] The only previous State-wide liquor monopoly system was that of South Carolina, instituted in 1893 and discontinued in 1907. There were, however, several municipal and county monopolies in the Southern States. See Byse, Alcoholic Beverage Control Before Repeal, 7 Law and Contemporary Problems, 544, 556, et seq.

In 1935, the question again arose as to the taxability of profits realized by the State of Montana from the operation of liquor stores. Again it was ruled that such profits were not subject to Federal income tax (G. C. M. 14407, supra). But on this occasion it was specifically asserted that the basis of the decision was simply that the income under consideration was not taxable by the Federal Government "under existing legislation," and furthermore that the prior ruling (G. C. M. 13745) should not be taken as a determination of the constitutional question involved.

A. SECTION 116 (D) OF THE INTERNAL REVENUE CODE DOES NOT EXEMPT STATE LIQUOR MONOI OLIES FROM FEDERAL INCOME TAX

Under "existing legislation" as applied today and also at the time the above rulings were issued, gains or profits and income derived from any source whatever are subject to Federal income tax unless specifically exempt or excluded from gross income.

Examination of the exemption provisions relating to States reveals no specific exemption of the type of income in question. The first reference to the exemption of State income is found in section 22 (b) (8) of the Internal Revenue Code.[4]

"(b) *Exclusions from gross income.*—The following items shall not be included in gross income and shall be exempt from taxation under this chapter:

> "(8) Miscellaneous items: The following items, to the *extent* provided in section 116: Income of States, municipalities, and other political subdivisions;" (emphasis supplied).

Section 116 provides that in addition to the items specified in section 22 (b), the following items shall not be included in gross income and shall be exempt from taxation:

"(d) *Income of States, municipalities, etc.*—Income derived from any public utility, or the exercise of any essential governmental function and accruing to any State, Territory, or the District of Columbia * * *."

Section 116 (d) operates to exempt only two classes of income accruing to a State, i. e., that derived from public utilities and that derived from the exercise of any essential governmental function. The inference to be gathered from this section is that Congress intended to tax income derived from all other sources, and when, in addition, section 22 (b) (8) specifically limits the exemption to the extent provided in section 116, the conclusion becomes almost inescapable.

B. LEGISLATIVE HISTORY OF SECTION 116 (D)

The origin of section 116 (d) is the Tariff Act of 1913, section II (G) (a). The bill as first passed by the House contained no provision for exempting any income of the States. The House bill merely provided that the normal tax imposed upon individuals should likewise be imposed upon corporations. The Senate Committee on Finance amended the House bill by adding the following phrase to section II (G) (a):

"There shall not be taxed under this section any income from *whatever source derived*, accruing to any State, Territory, or the District of Columbia, or any political subdivision of a State, Territory, or the District of Columbia, nor any income accruing to the government of the Philippine Islands or Puerto Rico." (Emphasis supplied) (S. Rept. No. 80, 63d Cong., 1st sess. p. 26).

This amendment was adopted by the Senate (50 Congressional Record (pt. 4) 3867) with the further provision, offered from the floor on behalf of the Committee on Finance, that income accruing to States from Public utilities should be exempt (50 Congressional Record (pt. 5) 4380). The House disapproved the Senate amendments and the bill was sent to a conference committee. It was then amended to read—

"* * * any income derived from any public utility or from the exercise of any essential governmental function accruing to any State, etc."

The House managers in reporting out the bill as amended at the conference stated:

"The House provision which only exempted profits accruing to States and their political subdivisions from the operation of their essential governmental agencies is modified to the extent that all such profits accruing from public utilities shall also be exempt." (H. Rept. No. 86, 63d Cong., 1st sess., p. 26.)

It is to be noted that the paragraph of the House Report just referred to mentions the "House provision," which bill as passed by the House had no express

[4] Subsection (7) of section 22 (b) of the Revenue Act of 1934.

provision as to exemption of States. The report therefore indicates that the House managers contemplated that *all* income derived by States would be taxable under the House bill except as derived from essential governmental functions.

C. ADMINISTRATIVE INTERPRETATION OF SECTION 116 (d)

The opinion in G. C. M. 14407 first states that nowhere in the Revenue Act of 1934 is a tax *expressly* imposed upon a State. From this it is reasoned that Congress either did not intend to tax States upon the type of income here in question or that Congress simply assumed that such income was immune from Federal taxation. This approach to the construction of Federal revenue statutes has recently been discussed and discarded by the Supreme Court. In *New York* v. *United States* (326 U. S. 572 (1946)), Mr. Justice Rutledge, in a concurring opinion, expresses his preference for a rule of construction which would require the express statement of congressional intention in order to include State functions when the legal incidence of the tax falls upon a State. But, he continues, "* * * *since State of South Carolina* v. *United States*, supra, such a rule of construction seems not to have been thought required."

The question was previously considered in *Graves* v. *People of the State of New York* (306 U. S. 466 (1939)), in which exemption from State taxation was claimed on the ground that the Federal Government was burdened by the State tax. After reiterating the rule that the silence of Congress may sometimes give rise to an implication as to congressional purpose, the Court stated that there is little scope for the application of that doctrine to the tax immunity of governmental instrumentalities. The Court added, "Silence of Congress implies immunity no more than does the silence of the Constitution." Obviously, the same approach applies as to assumptions made in the case of congressional intention to exempt States or their instrumentalities from Federal tax. Aside from the question of State immunity the congressional intention to tax "pretty much every sort of income subject to the Federal power" is a strong presumption. *Helvering* v. *Stockholms Enskilda Bank* (293 U. S. 84 (1934)). In that case, the Supreme Court held that the United States was included in the phrase "residents, corporate or otherwise," in an income-taxing statute. The Revenue Act of 1921, section 1000, imposed a capital-stock tax upon corporations, and that tax was held to be applicable to States. *Olson* v. *North Dakota* (33 F. (2d) 848 (CCA 8th)), certiorari denied (280 U. S. 528 (1929)). In concluding that the term "corporation" does not embrace a State, within the meaning of section 116 (d) of the Revenue Act of 1934, the general counsel's memorandum quotes from the decision of the Supreme Court in *Ohio* v. *Helvering*, supra, in which it is said, that whether the term "person" or "corporation" includes a State or the United States depends upon the connection in which the term is found. But it was there that the Supreme Court held a State to be within the reach of the excise tax either as a "person" under the statutory extension of that word to include a corporation, or as a "person" without regard to such extension.

Considering the history of section 116 (d) it would certainly seem that the connection in which the term "corporation" is found in the Revenue Act of 1934 is a direct inclusion of the States except to the extent to which they are specifically excluded.

In support of the conclusion that section 116 (d) of the Revenue Act of 1934 exempts State liquor monopolies from the Federal income tax, G. C. M. 14407 invokes the doctrine announced in *Brewster* v. *Gage* (280 U. S. 327 (1930)), to the effect that in determining the meaning of a provision which is ambiguous, the practical interpretation given that provision by the officers charged with its administration must be given great weight, especially when the practice has been long continuing and the provision has been frequently reenacted by Congress.

The ambiguity which has been spelled out by G. C. M. 14407 is difficult to follow. The opinion states:

"It will be observed that the paragraph quoted (sec. 116 (d)) refers to income 'derived from any public utility or the exercise of any essential governmental function and accruing to any State, Territory, or the District of Columbia.' Had Congress meant to include within this exemption income derived by the State itself from an activity which it carries on directly, it is suggested that it would have said 'income derived from * * * by any State, territory, etc.' since the words 'accruing to' connote the receipt of income from a contract or investment rather than from an act of the recipient. The use of these words serves, if not to make clear that the income must have been derived by an entity other than a State, Territory, or the District of Columbia, to raise an ambiguity which justifies resort to extrinsic evidence for its resolution."

If these statements mean that Congress always *assumed* that any income of a State derived from its own activities was tax-exempt it would have been wholly unnecessary to include the provision as to "the exercise of any essential governmental function." Very few essential governmental functions of a State are conducted by entities separate from the sovereign. Furthermore, the strange argument that the words "accruing to" connote only the receipt of income from a contract or investment is defeated by the fact that the words are applied to income derived from the exercise of any essential governmental function as well as to income derived from any public utility. Reading such an unusual and specific meaning [5] into the term "accruing to" in this particular tax statute results only in distorting the meaning of the key term in the provision, which is, "derived from."

Under the doctrine of *Brewster* v. *Gage*, supra, "ambiguity" should be interpreted as meaning an ambiguity created by the terms of the statute itself.

Even assuming the presence of the factor of ambiguity in section 116 (d) it is reasonable to resolve any doubt in favor of the revenue as the section is one which exempts from taxation (*New Colonial Ice Co., Inc.* v. *Helvering*, 292 U. S. 435 (1934)).

That there are many merits to the reenactment doctrine is indisputable but there are also many limitations to the rule, several of which are applicable to this situation. In the first place, it should be noted that the factor of long continuation of this particular administrative interpretation is scarcely present. As a prominent writer in the field of taxation stated: [6]

"This argument seems to fade somewhat, however, when it is remembered that for a period of 15 years of this long-continued practice, from 1917 to 1933, during the periods of wartime and national prohibition, there were no State monopolies."

It was not until 1934 that there were any published rulings on the question and it is not to be presumed that an unpublished administrative interpretation has been called to the attention of Congress (*Helvering* v. *New York Trust Co.* 292 U. S. 455, 468 (1934); *United States* v. *Stewart*, 311 U. S. 60 (1940); Estate of *Sanford* v. *Commissioner*, 308 U. S. 39 (1939)). The Bureau's practice previous to the rulings in 1934 and 1935 merely amounted to nonaction.

GCM 14407 cites *Mintz* v. *Baldwin* (289 U. S. 346 (1933)), and *United States* v. *Farrar* (281 U. S. 624 (1930)), in support of the statement that "The rule does not appear to be limited to affirmative and express construction." We do not believe that these cases are authorities for the proposition announced. The Mintz case involved the question of whether a State order for the inspection of cattle was in conflict with Federal statutes and the Farrar case involved the enforcement of a penal clause under the National Prohibition Act. Furthermore, the Supreme Court has more recently announced a contrary rule in a nontax case (*Union Stock Yard & Transit Co.* v. *United States*, 308 U. S. 213 (1939)). See also Brown, Regulations, Reenactments, and the Revenue Laws, 54 Harvard Law Review, 377, 395.

Considering the situation since the rulings were published in 1934 and 1935, we are of the opinion that the doctrine of congressional approval by reenactment is still inapplicable to sustain the general counsel's opinion. At the most, an executive construction of a statute, followed by congressional reenactment without change is a rebuttable presumption. See Mertens Law of Federal Income Taxation, vol. 1, p. 92.

Only recently, the Supreme Court denied the contention that legislative acquiescence must be assumed when Congress fails to correct a statutory interpretation by the lower courts (*Jones, Collector of Internal Revenue* v. *The Liberty Glass Co.*, U. S. —, decided December 22, 1947). The opinion states, "We do not expect Congress to make an affirmative move every time a lower court indulges in an erroneous interpretation."

See also *Helvering* v. *Clifford* (309 U. S. 331 (1940)); *United States* v. *Maryland Casualty Co.* (49 F (2d) 556 (CCA 7th), certiorari denied, 284 U. S. 645 (1931)). A regulation which does not carry into effect the will of Congress as expressed in the statute is a "mere nullity" (*Manhattan General Equipment Co.* v. *Commissioner*, 297 U. S. 129, 134 (1936), rehearing denied 297 U. S. 728).

[5] The ordinary definition of the word "accrue" as defined by the Century Dictionary is (1) to grow; increase; augment; (2) to happen or result as a natural growth; come or fall as an addition or increment, as of profit or loss, advantage or damage; arise in due course, as a profit accrues to government from the coinage of copper; the natural increase accrues to the common benefit. (3) in law, to become a present and enforceable right or demand.

[6] Griswold, Income Taxes of State Liquor Monopoly, 22 ABAJ 619 (1936).

In addition to the foregoing it may be added that the doctrine of reenactment is always less forceful when applied to informal rulings than to regulations (*Helvering* v. *New York Trust Co., supra; Biddle* v. *Commissioner*, 302 U. S. 573, 582 (1938)). There is even greater reason for its nonapplication in the case of a ruling in favor of taxpayers. As is stated, in Paul, Studies in Federal Taxation, Third Series, p. 429—

"Even long-outstanding regulations are hardly in fact approved by a legislative re-enactment of the statute without change. The very regulations involved in the Reynolds [7] case went through many editions, and there were years of litigation on the subject before they were changed. This is true in many cases; it is particularly true of a regulation in favor of the taxpayer. In such cases taxpayers will not object and the Commissioner is in the position of having to attach his own regulations or amend them by Treasury decision. No person, therefore, could honestly claim that the doctrine of approval by reenactment has any solid factual foundation."

Finally, it may be said, that since the doctrine discussed above exists only for the purpose of aiding in the proper construction of an ambiguous statute a change in the memoranda is entirely permissible if the administrative officials see fit. Administrative interpretation may be changed prospectively through the exercise of appropriate rule-making powers (*Helvering* v. *Wilshire Oil Co.*, 308 U. S. 90, 100 (1939)).

It is submitted that section 13 of the Revenue Act of 1934 [8] clearly imposed a Federal income tax which was applicable to state liquor monopolies. It is equally clear that section 22 (b) (7) of that act granted exemption from tax to some income derived by States. But that section provides that the exemption is limited to the types of income which are specified in section 116 (d).[9] Income derived by a State from its liquor monopolies is neither derived from any public utility for from any essential governmental function.

D. THERE IS NO QUESTION OF CONSTITUTIONAL POWER TO LEVY INCOME TAXES ON INCOME ACCRUING TO STATE LIQUOR MONOPOLIES FROM SALES OF ALCOHOLIC BEVERAGES

Despite the fact that G. C. M. 14407 states that neither of the opinions of the general counsel's office are to be taken as authority for any ruling as to the constitutionality of imposing the Federal income tax on State liquor monopolies, discussion of that question is important in view of the doubt expressed in G. C. M. 13745. Although there has been no occasion for the Supreme Court to speak on the validity of the imposition of the income tax on state monopolies, that Court has emphasized the increasing breadth of the national taxing power.

Time and again the Supreme Court has enunciated the principle that when a State embarks in a business which would normally be taxable, the fact that in so doing it is exercising a governmental power does not render the activity immune from taxation.

As already noted, in *South Carolina* v. *United States, supra*, and in *Ohio* v. *Helvering, supra*, it was held that a State conducting a liquor business was not immune from the Federal excise tax. The doctrine there established is that a State cannot withdraw sources of revenue from the Federal taxing power by engaging in businesses which constitute a departure from usual governmental funtions and which, by reason of their nature, the Federal taxing power would normally extend.[10]

In *Helvering* v. *Powers* (293 U. S. 214 (1934)), income received by State public officers for their duties in operating a State railway was held subject to Federal income tax, although it was conceded that the undertaking was for the public benefit. In that case, the Court also observed that the Treasury Department could not by its regulations either limit the provisions of the statute or define the boundaries of their constitutional application. Certainly it follows that the Treasury Department cannot by its regulations or administrative rulings enlarge the exemptions granted by a statute, which is the result accomplished by G. C. M. 13745, supra, and G. C. M. 14407, supra.

Subsequently in *Brush* v. *Commissioner* (300 U. S. 352 (1937)) the salary of the chief engineer of a city's bureau of water supply was held to be exempt from

[7] *Helvering* v. *R. J Reyndolds Tobacco Co.*, 306 U. S. 110 (1939).

[8] Previously sec. II (G) (a) of the Tariff Act of 1913 imposed the tax and subsequent revenue acts and sec. 13 of the Internal Revenue Code have contained substantially the same provisions.

[9] Sec II (G) (a) of the Tariff Act of 1913, secs. 22 (b) (8) and 116 (d) of the Internal Revenue Code.

[10] See 49 Harv. L R. 1323 (1936).

Federal income tax solely upon the ground that maintenance of the city water supply system was an essential governmental function. The Brush case arose under the Revenue Act of 1928, at which time Treasury Regulations 74, article 643 provided that compensation paid its officers and employees by a State or political subdivision thereof for services rendered in connection with the exercise of an essential governmental function of the State or political subdivision was not taxable. The government, therefore, argued merely that maintenance of city water works was not an essential governmental function. The prevailing opinion of the Court did not discuss the Treasury Regulations, but Mr. Justice Stone and Mr. Justice Cardozo, concurred in the result reached upon the ground that the taxpayer had brought himself within the terms of the exemption prescribed by the regulations saying "* * * which for the purposes of this case may be accepted as valid, its validity not being challenged by counsel for the Government." The following year *Helvering* v. *Gerhardt* (304 U. S. 405 (1938)) was decided by the Court and it was held that income tax imposed upon the salaries of employees of the Port of New York Authority did not place an unconstitutional burden on the States of New York and New Jersey. This case arose under the Revenue Act of 1932. The applicable provisions of that act and of Treasury Regulations 77, Article 643, then in force, remained precisely the same [11] as those applicable in the Brush case and the Court said, "The applicable provisions of section 116 of the 1932 act do not authorize the exclusion from gross income of the salaries of employees of a State or a State-owned corporation. If the regulation be deemed to embrace the employees of a State-owned corporation such as the Port Authority, it was unauthorized by the statute."

As noted in G. C. M. 14407, at that time, the line between those revenue-producing activities of a State which are "governmental" and those which are "proprietary" had been only faintly traced by decisions of the courts. Today the situation is different. Not only have the courts found little difficulty in distinguishing the nature of the activities exercised, but the criterion for determining the constitutionality of taxing States or their instrumentalities has shifted. In the Gerhardt case, Mr. Justice Black, in a concurring opinion repudiated the theory of any distinction between governmental and proprietary functions for income tax purposes.[12] The following year the Court handed down its opinion in *Graves* v. *People of State of New York*, *supra*. A State tax was there claimed upon the salary of an employee of a corporate instrumentality of the Federal Government, the converse of the situation in the Gerhardt case. The Court stated that the single question was whether the tax imposed "an unconstitutional burden" upon the Federal Government. Finally, the "governmental-proprietary" test appeared to be further abandoned in *New York* v. *United States*, *supra*, and emphasis placed upon the "economic burden" test.[13] In sweeping language the Court declared that times have changed and the old conceptions of State immunity from Federal taxation no longer served their purpose.

Any doubt as to the constitutionality of imposing Federal income taxes upon State liquor monopolies have little validity today. In *New York* v *United States*, *supra*, the Court said, "* * * so long as Congress generally taps a source of revenue by *whomsoever* earned and not *uniquely* capable of being earned only by a State, the Constitution of the United States does not forbid it merely because its incidence falls also on a State." (Underscoring supplied.) Mr. Justice Frankfurter would entirely eliminate the governmental versus proprietary distinction and hold all Federal taxes valid as against a State which are levied against private persons engaging in the same activities.

Mr. Justice Rutledge, concurring, remarks that all taxes are good against States except those that discriminate against States.

No one could seriously contend that income derived from the alcoholic beverage trade was uniquely capable of being earned only by a State. Nor can there be any rational contention that a Federal income tax on liquor monopolies discriminates against the State. The situation is decidedly the opposite. It is private industry which suffers a discrimination, not only that it bears more than its share of the Federal tax on income derived from the liquor business, but also suffers many inequities in the business world which are directly traceable to monopoly systems.

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[11] Regulations 101, article 116 (2), promulgated under the Revenue Act of 1938, amended the prior regulations to read. "Compensation received for services rendered to a State is to be included in gross income unless the person received such compensation from the State as an officer or employee thereof and such compensation is immune from taxation under the Constitution of the United States "

[12] See 52 Harv. L. Rev. 1010 (1939).

[13] See 55 Yale L. J. 805 (1946).

No clearer expression of the trend [14] to limit constitutional immunity from Federal tax may be found than that in the Gerhardt case, where it is said:

"With the steady expansion of the activity of State governments into new fields they have undertaken the performance of functions not known to the States when the Constitution was adopted, and have taken over the management of business enterprises once conducted exclusively by private individuals subject to the national taxing power."

The fact that the function exercised may, within the opinion of the State, be for the benefit of its citizens, does not free the State from the Federal responsibilities imposed upon others. In *Allen* v. *Regents of the University System of Georgia* (304 U. S. 439 (1938), rehearing denied 304 U. S. 590 (1938)), a Federal tax upon admissions to State university sponsored football games was held valid even though the proceeds were used by the State to further the university's program of athletics and physical education.

The Supreme Court stressed the usual nature of the activity and added that if it be conceded that the education of its citizens was an essential governmental function:

* * * it does not follow that, if the State elects to provide the funds for any of these purposes by conducting a business, the application of the avails in aid of necessary governmental functions withdraws the business from the field of Federal taxation. * * * the conduct of exhibitions for admissions paid by the public is not such a function of State government as to be free from the burden of a nondiscriminatory tax laid on all admissions to public exhibitions."

Certainly it is questionable that State control of the liquor business is more essentially a State function or that it is of more benefit to the public than is an educational project undertaken by a State. Thus it is seen that, contrary to the reasoning employed in G. C. M. 13745, supra, and apparently ratified by G. C. M. 14407, supra, the decided cases have been concerned with the source of earnings and not with their ultimate disposition.

With each successive decision of the Supreme Court, it has become more apparent that there is no constitutional barrier to the imposition of the income tax upon State liquor monopolies.

In none of the cases cited has the Supreme Court intimated that a State instrumentality was more entitled to immunity from Federal income tax than from a Federal excise tax. Distinctions between income and excise taxes are often more technical than real. No rational distinction between the effects of an excise tax on a State liquor store and an income tax on its net profits seems possible. The burden upon the State is as remote in one instance as in the other. The argument that the income tax is levied upon the property of the State is to beg the question.[15]

While obviously the Treasury Department is not concerned with the merits of the control aspect of a State monopoly system, nevertheless the Federal tax system does emphasize the public importance of the virtual subsidization of the State monopoly liquor systems. As previously observed, at the time the above-discussed rulings were issued, the emphasis underlying State liquor monopolies was that of the welfare of the people. Since that time, the facts have emphasized the magnitude of the liquor business which is conducted by the several States in substantially the same manner in which any business is conducted by private enterprise. Furthermore, it has become evident that the theory of subordination of the profit factor has been discarded, and the success or failure of a particular State monopolistic system is judged largely, if not entirely, by the amount of profit the system can turn over to a State treasury. In this connection, statistics compiled by the Distilled Spirits Institute, Inc.,[16] are revelatory and worthy of consideration. Reports of that organization show that the total net State revenues derived directly from alcoholic beverages in the monopoly-system States for the years 1940 to 1945, inclusive, amounted to $1,148,321,941 (exclusive of local revenues and sales taxes). Today the liquor industry is admittedly vitally concerned with the competitive results of the monopolistic State systems. In 1947, bills have been introduced in the legislatures of 11 States and of Hawaii and Alaska to adopt the monopoly system.[17] In each instance the reason advanced by the supporters of these measures was the claimed revenue advantages of the monopoly system.

[14] See 44 Mich. L. R 853 (1946).

[15] See Griswold, Income Taxes on State Liquor Monopoly, supra.

[16] Public Revenues from Alcoholic Beverages (Bulletin 1945).

[17] Massachusetts, Minnesota, North Dakota, South Dakota, Nebraska, Texas, Arkansas, South Carolina, Delaware, Georgia, and Colorado.

The following editorial comment in the Journal of Commerce, page 19, April 18, 1947, is significant:

"Considerable attention has been focused of late upon the revenue and social aspects of monopoly operation and the relative importance attached to each phase when the State conducts the operation of a liquor system. It has become increasingly apparent that a monopoly operation is designed to function primarily as a business. This point has already been made by Alabama's Governor James E. Folsom, who stated recently: 'The State's liquor business is a big business with total sales of more than $46,000,000 which brought in net revenue of over $14,000,000. * * * Such a big business in which the State is so vitally interested should be conducted as efficiently as any private enterprise. Liquor should be and will be purchased on a business basis and distributed in equal fairness in the State stores consistent with good business management'."

While no attempt has been made to estimate the amount of Federal income taxes from private enterprises engaged in the liquor business, it is obviously a substantial revenue-producing business. It is also obvious that the present tax-exempt status of the monopoly systems of the liquor business, created by G. C. M. 14407, places an inequitable burden on taxpayers engaged in the business in open-license States.

Interest in the question today is by no means confined to Wine & Spirits Wholesalers of America, Inc., on whose behalf this memorandum is presented. The report of the joint committee of the American Bar Association, the National Tax Association, and the National Association of Tax Administrators [18] calls attention to the importance of the matter in the following language:

"Sixteen of the States have entered the field of alcohol distribution, an activity which would otherwise be in the hands of private enterprise. The State liquor-store profits are not subject to Federal income taxation, and the question is pertinent, Should such exemption be continued? The exemption has the advantage to the States that greater revenues are enjoyed under a given price structure. It has the disadvantage to the Federal Government that tax revenues are lost and the disadvantage to private enterprise of subsidized State competition Whether consumers gain or lose from the exemption depends upon the price policy of the State.

"A fundamental principle is involved in this issue. It is unfair to the Federal Government and to competing private enterprise to continue the exemption. The particular problem involved is one phase of a much broader problem, the proper tax treatment of various governmental enterprises which offer services to the public for a price in much the same manner as private enterprise. The joint committee is of the opinion that the profits of all such enterprises, as they are determined by the customary accounting procedure of similar private enterprise, should be subject to taxation in the same manner as the profits of private undertakings. This conclusion is applicable to utilities, liquor-distribution systems and other types of economic enterprise which are maintained by governments or financially aided by them. The principle is also generally applicable with respect to property and other taxes as well as income taxes."

In conclusion, the report states:

"The State liquor stores should be subject to Federal taxation upon their profits, as determined by the customary accounting methods applied in private enterprise, in the same manner as private concerns. (Dissent by J. S. Y. Ivins and T. M. Jenner.) The principle of similar taxation of Government and private economic enterprises should also be followed in all other areas of Government business activity and taxation with the purpose of avoiding exemptions and subsidies for Government activity that are denied to private enterprise."

Considering the fact that State liquor monopolies are not specifically exempt from Federal income tax and in view of the increasing public and revenue importance of the question, it is respectfully requested that G. C. M. 13745 and G. C. M. 14407 be reconsidered. The inequitable treatment of similarly situated taxpayers, which those rulings create, warrant a prospective change of the present rule.

Powers of attorney to represent Wine and Spirits Wholesalers of America, Inc., in this matter are enclosed, together with the required statement of fees.

Respectfully yours,

J. P. WENCHEL.

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[18] The Coordination of Federal, State, and Local Taxation (1947).

STATEMENT SUBMITTED BY INTERNATIONAL HANDBAG, LUGGAGE, BELT AND NOVELTY WORKERS UNION, AFL

To the Honorable Chairman and Members of the Finance Committee:

In behalf of the many, many thousands of members of the International Handbag, Luggage, Belt and Novelty Workers Union, AFL, and their families, in every part of this country from coast to coast, we urge support and passage of the House approved tax bill. Our members are employed in the manufacture of handbags, luggage, traveling bags, and personal leather goods. This industry has been seriously crippled by the taxes on our products.

Firstly, we call to your attention that the Congress is morally obligated to honor its original commitment that this excise tax should have been removed at the earliest practicable date consistent with a sound national tax structure.

Secondly, the original purpose of the excise tax to help raise required funds, has long since ceased to exist.

Thirdly, by no stretch of the imagination can our products be labeled a "luxury." Consequently the continued 20-percent excise tax of handbags, luggage, and personal leather goods is inequitable and unconscionable. Yet, it continues to exist without any justification whatsoever. The fact that milady's handbag is as necessary and essential to the feminine portion of our population as the pockets of a man's suit or coat is so obvious as to require no further comment. It is utterly fantastic and unrealistic for anyone to label this item a "luxury" and to make it subject to a luxury tax. And you, the members of this committee, who must carry back and forth with you to Congress and back to your homes items such as luggage, traveling bags, briefcases, and wallets—are these items luxuries? How could you function as legislators if you were deprived of any one of these items? Could you, by any stretch of the imagination, be charged with indulging in a luxury because of the practical necessity to own and use these items? The traveling salesman, the technician, the professional man, all of whom could not conduct their business or make a living without these items—are they indulging in carrying about and lugging about luxuries? These items are as much the tools of the trade for the people who need them as the mechanic's and laborer's equipment.

There is still another, more important and more persuasive reason for the immediate and complete elimination of the luxury 20-percent excise tax upon handbags, luggage, traveling bags, and personal leather goods. At our recent international convention held in Atlantic City the 240 delegates representing 80 locals from every part of our country went on record unanimously demanding the complete elimination of this unconscionable and inequitable tax. Why? For the very vital reason that this tax is not only inequitable and unconscionable but because it is ruinous and demoralizing to the very industries in which our members are employed, and upon which their families depend for a livelihood. Our survey and report shows that during the past year there was a curtailment of from 30 to 40 percent in production in the plants in which our members are employed. Consequently, there was a resultant enforced idleness experienced by a corresponding lay-off of large numbers of workers. There was a reduced income for those fortunate enough to work part time.

It is for the foregoing reason that our delegates to the convention unanimously demanded the immediate repeal of this unconscionable tax. It is for such reason that the American Federation of Labor supports this demand for the elimination of this "luxury" tax.

Our industries have been hit harder than any other—although there was less justification for imposing this tax on our industries than on any other one.

Let us face this problem with realism. Let us not make this problem a political football. How long can a 20-percent luxury excise tax be maintained on admittedly essential commodities? How long can this condition be continued when it causes irrevocable loss and threatens the very existence of American industries which employ more than 100,000 workers—and affects the hundreds of thousands who are members of their families and who depend upon the continued existence of these industries for their very livelihood? Every survey conducted by us, and yes, by independent impartial agencies, report that there is buyer resistance because of this unconscionable and inequitable tax. The thousands of small business people who retail these items to the general public report that they are constantly asked, "When are these taxes going off?" There is no satisfactory answer and the public does not buy. How many tens of thousands of small-business people are being ruined by such shortsighted policy can be understood by any person willing to face the facts. The demoralization of the industries manufacturing these basic necessities has been permitted to a point that cries out for speedy and immediate

relief. The consequent unemployment in these industries has reached a point of crisis.

Be assured, gentlemen, that our Government is losing money because of the continued imposition of this inequitable tax. Not only have many manufacturers gone out of business during the past year, and others ceased operation for 6, 7, or 8 months, but those who have operated have done so on a part-time basis. Consequently, there has not only been an economic loss to the industry and its workers, but the Government has lost in taxes and will continue to lose in taxes on incomes, business, etc., far more than the ruinous 20-percent excise tax will or can bring in henceforth. So far as the Government is concerned this is "bad business procedure." We have not even mentioned the cost to Government in paying out relief, unemployment insurance, etc.—all of which is directly traceable to the curtailment of manufacture due to the 20-percent tax.

In conclusion permit us to point out to you that the American public does not consider basic necessities such as handbags, luggage, traveling bags, briefcases, personal leather goods, etc., as luxuries. In fact Congress never classified these items as luxuries. The continued levy of this tax upon these products is burdensome and ruinous. It is a suicidal tax policy which literally kills the goose that lays the golden egg.

The imposition of an excise tax on the production of essential goods has no place in a sound tax structure. This is particularly true when the taxation constitutes an obstacle which cannot be hurdled in the path of an expanding economy. It is absolutely ruinous to industries manufacturing essential goods which have already been demoralized and seriously crippled because of this burdensome tax.

To save our industries, to revive and stimulate employment, and to promote the growth and welfare of American industries manufacturing essential items such as handbags, luggage, traveling bags, and personal leather goods require the immediate repeal of the 20-percent luxury excise tax upon these items.

We wish to point out that the action taken by the House Ways and Means Committee proposes to eliminate the excise tax on handbags, wallets, key cases, miscellaneous cases, kits, bags, etc., but proposes to retain a 10 percent tax on luggage, toilet cases, etc. We can see no justification whatsoever in maintaining any excise tax on any branch of our industry. Therefore, if any action is taken by your committee to amend or modify the action of the House Ways and Means Committee, it should be in the direction of removing the proposed 10-percent excise tax on luggage, toilet cases, etc. The retention of any excise tax on any part of our industry will provide a psychological barrier to the industry's recovery.

We urgently request favorable consideration along the lines indicated.

Respectfully submitted.

JACK WIESELBERG,
International President.
NORMAN ZUKOWSKY,
General Secretary-Treasurer.

MAX H. FRANKLE, *Counsel.*

STATEMENT OF JACK GARRETT SCOTT, GENERAL COUNSEL, NATIONAL ASSOCIATION OF MOTOR BUS OPERATORS

The National Association of Motor Bus Operators is the national trade association of the intercity motorbus industry, representing directly, or indirectly through affiliated State motorbus associations, approximately 1,000 intercity motorbus operators.

Our association and its members urge upon the Senate Finance Committee and the Senate, with the utmost earnestness, the early and complete repeal of the present excise taxes upon the transportation of persons. The present tax rate is 15 percent upon the cost of all tickets costing more than 35 cents. An initial 5-percent tax was imposed in October 1941 as a defense measure. A second 5 percent was added in 1942 and the third 5 percent in 1944. The legislative history of the measures which imposed and increased these taxes discloses clearly that the primary purpose of the taxes was not to obtain additional revenues but to discourage wartime travel and to take away from our then overburdened transportation facilities as much as possible of the nonessential wartime traffic. That purpose and incentive no longer exist. Quite to the contrary, all of our public transportation facilities which carry passengers are now vitally in need of some form of relief which will tend to increase their passengers and revenues, and to keep them solvent and in private ownership.

The intercity motorbus industry, although comparatively small and new, in recent years has come to be a very important part of our national transportation system. Although the fact is not generally recognized, nevertheless during the war years and since, busses transported and continue to transport in intercity service more passengers than the railroads. For example, in 1949 our industry transported more than a half billion passengers, which is about 80 percent more than the rails carried during the same period. To avoid misunderstanding, it should be said that total railroad passenger miles are greater than bus passenger miles because of the substantial difference in average haul per passenger. Yet our industry performed 23.6 billion passenger miles in 1948, the last year for which reliable figures are available, which is a most substantial figure. Also, in considering the position and importance of the bus industry in our national transportation system, recognition should be given to the fact that there are literally thousands of communities in this country which have no other public passenger transportation facilities except intercity busses, communities which the railroads and airlines cannot or do not serve.

Despite the large volume of business done by the intercity motor carrier industry, it finds itself in an increasingly precarious financial position, although industry generally outside of transportation is enjoying an unusually high degree of peacetime prosperity. Our singular plight comes about by reason of a continuous downward trend in the volume of intercity travel by commercial carriers, and a sharp and continuing upward trend in operating costs. The primary reason for decreasing travel by commercial carrier is the tremendous recent increase in the manufacture and sale of private passenger automobiles. The intercity bus industry is not actually competitive with the railroads, as is readily admitted by their spokesmen and supported by the facts. Nor is there any real competition between the bus lines and the air lines, because of such factors as wide differences in speed, service, length of haul, travel cost, and the like. Our only real competitor is the private automobile. As a necessary result of this type of competition there is created a natural rate ceiling above which we cannot go without further decreasing bus travel volume. In fact, our fares have decreased consistently and steadily over the years because of this competition. For example, our 1939 bus fares, on the average, were only 64 percent of the 1934 fares, and 1947 fares were only 69 percent of 1934 fares. For these reasons, there is no relief available to us, so far as increasing revenues is concerned, by an increase in fares, even assuming approval of the regulatory agencies of government.

As to costs a comparison thereof for 1948 and 1949 discloses that bus unit costs increased 4½ percent. This is merely illustrative of the constant trend of increased costs in recent years. The primary source of these increases is the steady and continuous increase in our labor bill. Labor costs now constitute about 53 percent of our local operation and maintenance expense and have increased 85 percent since 1939. Consideration of these facts as to increasing costs and as to decreasing fares and revenues discloses the reason for and the nature of our financial dilemma.

We assure the committee that we are doing everything we possibly can to escape disaster as a result of these adverse trends by way of obtaining greater efficiency and economy in operation and increased productivity. But there are severe limits to what we can do in these directions. The wages of a bus driver are the same whether his bus carries 5 passengers or 35 passengers. We cannot eliminate too many of our routes or schedules without depriving the public of a necessary service. Our only hope of economic salvation lies in the encouragement of more travel by common carrier. A complete revocation of the regressive transportation excise taxes would go far to accomplish this purpose and would amount only to simple justice to us, in view of the purpose of discouraging passenger traffic which as we have stated formed the real basis for their original imposition. A mere decrease in the amount of the taxes as from 15 percent, to 10 percent as contemplated by the House Bill, would accomplish nothing of substantial benefit, in our judgment.

A further important consideration in connection with our plea is the fact that Canada completely repealed its 15-percent excise tax on the transportation of persons in March 1949. The result has been not only a major stimulant to travel in Canada, but also a great increase in the amount of travel purchased in Canada, tax-free, but over American transportation facilities. The inequity fof the situation is apparent, as is also the disregard, inherent in the existing situation of those considerations of comity which should exist between friendly neighbor nations.

If, however, because of the foreign situation or other fiscal circumstances and requirements, it is found impossible or undesirable to revoke the entire 15 percent tax on the transportation of persons at this time, we earnestly urge upon the committee and the Senate that the present exemption from the tax be raised to fares which do not exceed $1. Section 3469 (b) of the Internal Revenue Code now provides that the excise tax shall not apply to amounts paid for transportation which do not exceed 35 cents. It is this figure which we recommend be increased to $1. Such action would not completely solve the serious problems which beset us, but would relieve our situation to a very large degree. It is estimated that the average passenger trip by intercity bus is roughly 50 miles. Our average fare is approximately 1.90 cents per passenger-mile. It is quite apparent, therefore, that a very large portion of our present and prospective passengers would be relieved from the payment of the tax by the proposed amendment, and to that extent our situation would be improved.

It is our view that such an amendment would not be a costly one to the Treasury. Although basic data are not available to permit of any accurate computation of the amount of decrease in Government revenue if the exemption figure is raised as recommended, nevertheless our best estimate is that it would represent a decrease in revenues from bus travel of only about $16,000,000 per year. It is quite conceivable, although probably not subject to proof, that such an amount would be made up, or more than made up, from increases in income taxes upon motorbus operators if members of our industry can become or remain solvent and can continue to perform their important public obligations economically, efficiently, and in private ownership.

Statement Submitted by Harold L. Schilz on Behalf of Legislative Committee of the National Retail Credit Association

The legislative committee of the National Retail Credit Association, representing some 26,000 individual members (such as retail stores, banks, utility companies, finance and loan companies, and the like) yesterday noted the results of a survey among, and many complaints emanating from merchants, jewelers and furriers concerning failure to immediately reduce excise taxes. These reports are to the effect that after the President had called upon Congress to give relief to business in the form of reductions of excise tax, there had been a definite decline in the sale of goods to which such taxes particularly applied, such as jewelry and furs, due to the fact that the consuming public has been awaiting such tax reductions before making purchases of such merchandise.

The committee, meeting at the Hotel Statler, Washington, D. C., February 12, 1950, further noted that failure of Congress to act immediately on this matter has resulted in a chain reaction of unemployment in such merchandising establishments flowing from the failure of the public to make its usual normal purchases of such merchandise.

A resolution was passed by the committee to the following effect: "*Resolved,* That the National Retail Credit Association, acting through its legislative committee, now calls upon Congress and the administration to at once pass a law eliminating the war time excise taxes on jewelry, furs, luggage, cosmetics and other similar items; railroad, pullman, and plane transportation, and telephone and telegraph communications."

The membership of the committee who attended this meeting consisted of Clarence E. Wolfinger, Lit Bros., Philadelphia, chairman; Joseph A. White, Harris Stores Co., Pittsburgh, cochairman; J. K. Althaus, manager, Associated Retail Credit Men, Washington, D. C.; S. E. Collegeman, S. Kann Stores Co., Washington, D. C.; R. M. Severa, manager, Credit Bureau of Greater New York, New York, N. Y.; J. P. Stedehouder, Lansburgh & Bros., Inc., Washington, D. C.; Lindley S. Crowder, general manager-treasurer, National Retail Credit Association, St. Louis, Mo.; Richard Shatz, Spokane, Wash., president NRCA.

RESOLUTION OF THE LEGISLATIVE COMMITTEE OF THE NATIONAL RETAIL CREDIT ASSOCIATION, MEETING AT THE HOTEL STATLER, WASHINGTON, D. C., FEBRUARY 12,1950

The committee unanimously adopted a resolution to continue advocacy of sound credit policies but believed it unwise for any action to be taken by the administration which might bring about a return of the consumer credit controls formerly exercised by it under Regulation W of the Federal Reserve Board.

STATEMENT BY KRANTZ KELLER, TREASURER, CARRIER CORP., SYRACUSE, N. Y.

Section 155 of H. R. 8920 as passed by the House of Representatives, submitted to the Senate and referred to the Senate Finance Committee, proposes to impose a 7-percent excise tax on "household type units for the quick freezing or frozen storage of foods, operated by electricity, gas, kerosene or gasoline" and various refrigeration components for, or suitable for use as parts of, or with, such units.

It is difficult for us to understand why food freezers are singled out for the imposition of a new excise tax. This is especially true inasmuch as it is the only item on which a new tax is proposed and there is no increase in the excise tax levied with respect to any other product.

Although foods have been frozen and stored commercially for several years, the manufacture of household-type freezers is a relatively new industry.

We estimate the market is less than 10 percent saturated. It has been generally accepted in sales promotion that a new appliance cannot anticipate large sales volume until the public generally accepts the product and that acceptance cannot be accomplished until the market is 10 percent saturated. Accordingly, we do not anticipate a sweeping demand for food freezers until the industry has placed a greater number of units in the hands of consumers.

Carrier Corp. has consistently lost money on the manufacture and sale of food freezers. We believe, however, that uninterrupted growth of the industry would create sufficient demand in the relatively near future to permit sufficient reduction in manufacturing costs so that profits can be realized. It is our belief that other manufacturers are in the same position. In the event an excise tax is imposed on food freezers at this time, it is probable that the growth of the industry resulting from greater public acceptance will be sustantially retarded, if not entirely stifled.

Congress has consistently indicated its desire to foster new business and small business. The food-freezer industry is made up almost entirely of small manufacturers and new companies. Suppression of public demand for the product would undoubtedly cause severe hardship and probable bankruptcy of many of these business establishments.

Many employees engaged in the manufacture of food freezers have suffered sporadic employment during the development of the products. They stayed with the industry in anticipation of its growth and the resulting steady employment. Curtailment of production would result in severe hardship to these individuals and their families, with a resulting increase in the unemployment insurance and welfare load.

Many appliance distributors, particularly in the rural areas, have relied on their ability to market food freezers or what are commonly known as farm freezers in planning expansion. A reduction in demand for food freezers would be a severe hardship to these individuals and small businesses.

Food freezers can be classified in two general categories: (1) Those that store foods frozen commercially and (2) those that process the food and are then used for storage. The storage units may be used to freeze foods in small quantities but are not usually used for that purpose. In cubical content, the dividing line with respect to food freezers is somewhere between 6 and 10 cubic feet. The smaller units will be in class (1) and the larger units will be in class (2) mentioned above.

The small class (1) units are normally purchased by urban dwellers who can purchase supplies of frozen foods as needed. Class (2) units are generally sold to farmers or people living in rural areas where the food to be processed is produced.

It seems logical to us that, if Congress determines that an excise tax must be placed on food freezers, it should limit the tax to those units in class (1) used strictly for the storage of processed foods. It certainly does not seem consistent for Congress to encourage stockpiling and storage of foods and concurrently impose a restrictive tax on those who wish to carry out these desires.

We have estimated that a 7-percent excise tax imposed on food-freezing units together with frozen-food storage units would not produce revenue exceeding $8,000,000 per year. In this estimate we have necessarily assumed that the industry will not grow beyond its present size, but we have given no consideration to the probability that imposition of a tax would cause a contraction of the industry.

The killing of a new industry, with the resulting penalty that would be paid by owners, laborers, distributors, consumers, and disruption of Government programs, seems to be an extraordinarily high price to pay for the collection of a relatively insignificant amount of revenue.

We respectfully urge that your committee give full consideration to these adverse factors and delete from H. R. 8920 the imposition of the proposed excise tax on the units for quick freezing and frozen storage of foods.

STATEMENT OF DONALD L. BRYANT, REPRESENTING THE TOILET GOODS ASSOCIATION, INC.

My name is Donald L. Bryant. My address is 242 East Seventy-second Street, New York City.

I am an officer of the Richard Hudnut Sales Co., Inc., which is in the business of manufacturing and selling toilet preparations. Some 350 toilet-preparations manufacturers are members of the Toilet Goods Association, Inc., which is the official representative organization of the manufacturers of toilet goods in the United States. It is on behalf of the Toilet Goods Association and its 350 members that I speak. We urge the immediate repeal of the existing 20 percent retail excise tax on toilet preparations.

Technically, manufacturers of toilet preparations are not the taxpayers, since the tax is imposed upon the retail sales. We are, however, vitally interested in this tax bcause of its effects upon us and upon the consumers of our products.

We ask the committee to bear with us while we repeat some of the historical background of this tax which we have presented before but which we feel is still of very great importance. Historically, the toilet-goods tax has been an emergency tax, and it is still of that character. It has been resorted to only in times of war and great emergency. As a retail stamp tax, it made its first appearance in the act of June 13, 1898, which was enacted to raise emergency revenue to meet war expenditures in the Spanish-American War. Three years later, when the war was over, the tax was repealed.

The next emergency occurred in 1914. The outbreak of war in Europe led to a sharp decline in customs receipts and necessitated the tapping of emergency sources of revenue. To meet this need the old Spanish-American War retail stamp tax on toilet preparations was resurrected and reimposed as an emergency tax. Here again, however, the tax was repealed, this time 2 years later, in the Revenue Act of 1916 when the emergency had passed.

Again in 1917 when the Nation faced a war emergency Congress sought extraordinary sources of revenue, and for the first time a manufacturers' excise tax on toilet preparations appeared in the law. In the following year the manufacturers' tax was repealed and a retail tax on toilet goods at a higher rate took its place.

As the First World War emergency ended, the tax was again repealed, and for a period of 10 years toilet preparations were entirely free of excise taxes. Gradually, before and during this 10-year period, an important change was taking place in the toilet-goods industry. Our industry followed the American pattern of mass production so that its products could be and were purchased and emjoyed by all income groups. The luxuries of one generation became the necessities of the next. In the beginning of our industry, our products had been available only as luxuries for the well-to-do. Gradually they became available to all and now are universally regarded as everyday essentials of women's personal care.

At the end of this 10-year period—that is, in 1932—the decline in revenue resulting from the depression gave rise to another emergency, and again emergency sources of revenue were probed. Inasmuch as toilet goods on three occasions in the past had been regarded as being in the luxury category and had been used as an emergency source of revenue, we believe it was purely precedent which again led to the use of toilet preparations as an emergency revenue producer, because by that time our products had become, as we have pointed out, everyday essentials. The Revenue Act of 1932 imposed what was stated to be a temporary manufacturers' excise tax on toilet preparations. At 2-year intervals, up to 1940, the tax was extended, still temporarily. In 1940 it was extended for 5 years (since it was thought that the defense emergency would be of that duration), and a year later the expiration date was removed entirely but without prejudice, according to the report of this committee on the 1941 revenue bill, "to the temporary nature of these levies."

In the same year, by reason of the impossible situation which had arisen with respect to administering a toilet-goods tax at the manufacturing level, the manufacturers' tax was repealed and a retail tax imposed in its place. Two years later, under the subject heading "War taxes and war tax rates," the rate was increased to 20 percent, where it is at the present time.

So we have in the toilet-goods tax today, in a normal peacetime period, a "temporary" emergency tax imposed at a wartime rate. We have a tax, justifiable only as a luxury tax, that is in fact imposed on products that most women regard as a daily essential. And we have a tax that is extraordinary in the Federal tax system; namely, a tax on selected products imposed during peacetime at the retail level.

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The Toilet Goods Association and its members have endeavored to maintain a fair and reasonable attitude toward the excise tax on toilet preparations. We have tried our best to balance the discrimination which this tax has imposed upon our industry and the consumers of our products against the emergency revenue needs of our Government.

We are not among those who have been critical of this committee or of the Congress for failing to repeal the wartime excise taxes before this. While they were enacted as temporary taxes and as emergency taxes, we realize that emergency conditions did not terminate immediately upon the cessation of hostilities. The overly strong seller's market and the serious threat of inflation during the 3-year period immediately following the close of the war was but a continuation of wartime conditions in our opinion, and we recognize that the retention of these wartime excise levies during that period was a justifiable means of curbing inflation.

We do not believe this committee likes excise taxes as a means of raising revenue in normal peacetime periods, particularly when such taxes are imposed on products that a great many people regard as essential and are levied on the retail sale. Since the time in 1932 when your distinguished chairman led the gallant fight which defeated the general manufacturers' sales tax, you have resorted to excise taxation only when immediate emergency revenue was needed for some immediate emergency purpose. We recognize excise taxes are useful in this respect, for they reflect themselves forthwith in revenue receipts. We also know increases in income-tax rates, on the other hand, do not produce the intended increases in revenue collections for a year or more after the increases are put into effect.

But, because it has been necessary during emergencies for you to deviate from the principle of taxation in accordance with ability to pay, we do not believe it is either necessary or desirable that emergency excises, and particularly retail sales taxes, enacted to meet immediate emergency revenue needs become embedded permanently in our Federal tax system.

Responsible Government spokesmen have said there is no emergency today. The war terminated over 4 years ago. The threat of inflation has passed. Business conditions are now normal. By this we do not mean to say that the revenue requirements of the Government are not very great or that they will not continue to be very great for the foreseeable future. We do not view the mere existence of revenue requirements at a level substantially in excess of the prewar level as constituting any emergency. Those revenue needs are apparently permanent, or at least long range, in character and, not being emergency, they should be met on a fair basis.

We do not believe that you will be fair in meeting our present revenue needs, great though they be, if you do so by continuing to tax products that for the most part are used exclusively by women and that are regarded by women as essential to their personal care and appearance. This is particularly true of women who have to earn their own living. They must put up a good appearance every day.

Moreover, we do not believe you will be fair in meeting those revenue needs if you continue to single out, in an economy of intense competition for the consumer's dollar, particular industries and tax their products at the very point of consumer decision, the retail sale.

Both the President in his tax message and the Secretary of the Treasury in his statement before this committee recognized that these retail levies have an extremely deterring effect upon business. Their deterring effect upon the toilet-preparations business is not as apparent from the statistics as it is in some of the other industries subject to the levies, for the internal-revenue collection figures indicate that since the war's end sales of toilet preparations have not diminished but have remained relatively at a standstill. The injury that is being done to manufacturers of toilet preparations is just as real, however. In the last few years new products have been developed in our industry which have received widespread consumer acceptance, but by no means do all of the manufacturers in our industry manufacture such products. It is the acceptance of those products which has prevented a decline in our industry volume.

But, more important, the toilet-goods industry cannot support its costs with a static level of production, any more than the Federal Government could support its current budget if general business activity were not today in a very dynamic state. The toilet-goods industry, like all other industries, must be allowed to enjoy normal growth potentialities. Yet, since the return of normal competition, the growth of our industry has been arrested; and we believe this is due solely to the impact of the 20 percent retail levy.

Today the manufacturers of toilet preparations are experiencing a very severe economic squeeze. The prices of our products have not been increased as have prices in so many other industries, and we believe it is clear from the history of the industry that its highly competitive nature always has and will continue to make price increases impractical. In the past it has been possible for us to absorb the increased cost of labor and materials because over the years we have enjoyed an almost continual increase in our sales volume. Today, because our normal growth has apparently been arrested by this 20 percent levy, we are helpless in the face of rising costs. To continue this levy further is to force the manufacturers of toilet preparations to engage in a competitive struggle under a severe handicap which may even jeopardize the existence of some.

Admittedly, the elimination of the tax will for a short time reduce revenues, but we honestly believe more is to be gained in actual revenue from a dynamically growing toilet goods industry than from one, the normal growth of which has been retarded. And, please, in considering this point, do not think only in terms of the manufacturers of toiled preparations alone. The many different kinds of suppliers of our industry will likewise be favorably affected.

The Secretary of the Treasury in his testimony before this committee on February 3, recommended that the tax on toilet preparations be reduced from 20 to 10 percent. It is, of course, obvious that a 10 percent rate will be less harmful in effect than a 20 percent rate, but any retail sales tax—whatever the rate—upon selected commodities in a period of normal competition inevitably imposes an unjustifiable and unfair competitive handicap upon the producers of these commodities. And it also imposes an unwarranted discrimination against, and in some cases a regressive tax burden upon, consumers to whom the purchase and use of such commodities is necessary. We believe the retention any longer of the retail levies, even at a reduced rate, would violate every accepted principle of normal peacetime taxation, and would continue to retard the growth of our industry.

The time for their elimination from our permanent tax system is now. The manufacturers of toilet preparations urge the complete repeal of the tax on their products forthwith.

Statement of Automobile Manufacturers Association

IT IS ALREADY LATE

The automotive industry is opposed to continuance of automotive excise taxes because:

1. They impede commerce by increasing the cost of moving goods and people.
2. They are an increasing threat to production and employment in the motor-vehicle industry and in supplying industries.
3. They are taxes that affect lower-income groups relatively more than other income groups.
4. They are discriminatory, since they are not imposed on competitive forms of transportation or on other productive equipment.
5. They are unfair, as they place a relatively greater tax load on farmers, small town people and others who necessarily depend mainly or solely on automotive transportation.
6. They are an extreme example of multiple taxation.

These Federal taxes on cars and trucks, on repair parts and accessories, on tires and tubes, and on gasoline and oil, impinge directly upon costs to consumers and have a direct bearing on the automotive industry's sales and employment.

AUTOMOTIVE TAXES IMPEDE COMMERCE

As producers of a major form of transportation—and also as large scale shippers of freight and users of motor vehicles in our own business—we are concerned with any and all obstacles that impede the movement of people and goods.

To the considerable extent that the automotive excise taxes increase the cost of such movement, they undeniably are a drag on the velocity of business and thus obstruct commerce. In 1949, Federal excises on automotive products amounted to about $1,300,000,000.

While Congress as part of the war-preparedness program deliberately intended to reduce car and truck purchase and use by raising these taxes in the Revenue Act of 1941, the original purpose no longer applies and under present conditions, these taxes should be repealed now.

Impeding commerce is certainly not the intent of Congress or anybody else at this critical point in the Nation's postwar economy.

TAXES "TEMPORARY" IN 1932

You are probably aware that similar Federal excise measures were levied against automotive products in World War I and that Congress saw fit to remove them completely in the twenties. May we remind you that a fraction of the current excise taxes on motor products was originally made effective on a "temporary" basis in 1932 (and later doubled in 1941 as part of the defense program). They were imposed solely to provide revenue to help pay emergency relief costs. The conditions which caused Congress "reluctantly" to impose these taxes on motor-vehicle users at that time no longer exist—and in fact, have not existed for some years.

AUTOMOTIVE EXCISES AFFECT EMPLOYMENT

These emergency taxes restrict the sale and use of cars and trucks. They will affect the employment of 920,000 employees in the industry's motor vehicle and parts plants, and they ultimately will affect other employment in a very large area of the Nation's economy.

Approximately one out of every seven paid jobs in America is based on the manufacture, distribution and use of cars, trucks, busses and taxicabs. Over 9,000,000 persons are so employed.

About one-fifth of all retail business is accounted for by automotive sales and service. In wholesaling, the automotive ratio is one-fourth of the total.

Beyond this, hundreds of thousands of jobs in other industries are directly dependent upon continued high activity in the automobile industry. For example, the automotive companies buy 18 percent of all steel, 80 percent of all rubber, 75 percent of all plate glass, 68 percent of all upholstery leather, 34 percent of all lead, and 10 percent of all cotton consumed in the United States.

COSTS AFFECT SALES

Under the abnormal conditions of the postwar years, resulting from the accumulated demand of the war years, the effect of the Federal excise tax on sales cannot be measured exactly. Production to meet demand has been the big problem.

But we know that volume and employment in our individual companies and in our industry as a whole will be increasingly dependent upon merchandising, upon the sales efforts of manufacturers and dealers. Meantime, we must continue to give extremely careful attention to every element of cost and every item which is part of the price to the consumer. Certainly an item as large as the Federal tax on new cars and trucks could become a serious deterrent to automotive sales in coming weeks and months, in the light of the rising price consciousness on the part of the buying public.

NOW IS THE TIME TO ACT; RELIEF NEXT YEAR MAY BE TOO LATE

Therefore, it is vital to the automotive industry, its suppliers and to their employees that Congress act now to repeal these taxes, before they can seriously interfere with sales.

Tax relief should not be deferred until business is affected to the point that employment is declining. It would be too late to regain present momentum and too late to maintain momentum in those other large elements of the economy which directly or indirectly depend upon the automotive industry for so much of their volume.

You are fully aware of the extensive consequential results to the general business of the country that follow immediately upon the heels of reduced business volume in any major sector of our highly integrated national economy. To avoid these results, it is imperative to make this tax change now. It is already late. A year hence, relief from these taxes might come too late to help us maintain sales, production, and employment in our own and in other key industries.

A HEAVY BURDEN ON MOTORISTS

From the viewpoint of the owners of 36,000,000 passenger cars and over 8,000,000 trucks and busses registered in this country, the automotive excise taxes are a heavy burden.

About 20 percent of the Federal automotive taxes are paid by people earning $3,000 or less in annual income, according to data based on payments of 1948 taxes. This same group, in contrast, pays only 11 percent of Federal income taxes. About 35 percent of all passenger cars are owned by persons with incomes of less than $3,000. The same analysis of car ownership shows that 75 percent of all passenger cars are owned by people with incomes below $5,000.

A SUBSTANTIAL PART OF CAR COST

When a motorist buys a new car in the lowest price class, his Federal excise tax amounts to about $79. In addition, during his first year of ownership he has to pay, on the average, about $13 in Federal excise taxes on gasoline, oil, tires, and tubes. State registration fees and State gasoline taxes burden him with an additional $42.97.

It costs the average worker 2½ weeks' wages just to pay the taxes involved in owning and operating a car for 1 year.

These heavy taxes usually are borne by people who have little or no choice—most of them find a car necessary in their daily lives.

AUTOMOTIVE EXCISES A TAX ON NECESSITY

Where he happens to live, his occupation, or the kind of business he is in, largely determines the relative contribution of the payer of the Federal automotive excises—another element of inequity in this system of unfair taxation.

Thus, according to latest available figures, the more than 5,000,000 people who live in 2,074 small towns and villages which do not have busses or streetcars and the 27,000,000 who live on farms and must depend almost entirely on automotive transportation carry a proportionately larger tax burden than their city cousins.

One-eighth of the Nation's passenger cars and more than a fourth of the 7,555,000 trucks registered at the end of 1948 were owned by farmers. Sixty-six percent of farm families own automobiles.

The dependence of farmers on motor transportation is shown by the fact that there are almost twice as many cars as telephones on farms: 5,300,000 cars, 2,700,000 telephones. In the whole of the United States, there are 43,000,000 motor vehicles, 40,000,000 phones.

Governmental figures on car use show clearly the essential character of the automobile in the daily lives of most of our citizens. These Federal excise levies on motor vehicles are, therefore, a tax on a necessity. Of all passenger car mileage of farmers, 67 percent is necessity travel. Of all mileage in urban areas, 51 percent is for necessity purposes. Of all passenger-car trips, 56 percent are to get to work or on other work-related business.

At the bottom of the depression in the 1930's, motor vehicle mileage did not drop below the 1929 level despite the sharp drop in average income. This is further evidence of the essentiality of the automobile.

EXCISE TAXES DISCRIMINATORY

Because they are levied against one form of transportation but not competitive forms, the Federal automotive excise taxes are discriminatory. They discriminate against both the users and producers of automotive transportation.

In addition, there is no more justification for levying Federal sales taxes against passenger cars and trucks than there would be in taxing plows or tractors and other farm tools or other forms of necessary productive equipment.

WHAT EXCISES COST TRUCK OWNERS

Under this discriminatory form of Federal taxation, the business which uses motor transport is penalized in competition with another which does not use motor transportation.

Before he can operate it, the buyer of an average-priced new truck must pay $76 in Federal taxes, in addition to State and local taxes. During his first year of using his truck, he must pay an estimated additional $100 in gasoline taxes and other motor-vehicle levies.

Farmers and small-business men make up the majority of truck owners and thus pay a large proportion of the Federal taxes on motor trucks. About 88 percent of truck owners operate only one vehicle. Collectively these single-vehicle owners operate two-thirds of all trucks. Operators of one or two trucks include 95 percent of all owners and 74 percent of the vehicles.

Since trucks are used generally in hauling products from farms and are the principal means for delivering milk, vegetables, livestock, and many other foodstuffs to our cities, the Federal automotive taxes are a direct charge against the cost of almost all food.

AUTOMOTIVE EXCISES TAX MISFORTUNE

Frequently the Federal automotive excises are a tax on misfortune. A cracked cylinder block, smashed radiator, defective brakes or broken axle is the basis of a special tax when the damage is repaired. The Federal Government levies 5 percent on repair or replacement parts.

Today's average car is 8.4 years old—53 percent older than the immediate prewar average. With the highest percentage of old cars owned by lower-income groups, the tax tends to increase accidents. This is because it increases the cost of keeping vehicles in good operating condition.

Latest figures on accidents show that this aspect of the cost of the Federal automotive taxes is important. Highway fatalities attributable to mechanical defects in motor vehicles have risen to 13 percent from 8 percent of all accidents in the past 5 years.

AN EXTREME EXAMPLE OF MULTIPLE TAXATION

The motorists' annual automotive tax bill—covering those special Federal, State, and local taxes that are visible and measurable—was over 3.7 billions of dollars in 1949. In this total was $654 millions in Federal excises on just the purchase of vehicles, parts, and accessories. Actually, this 3.7 billions in measurable taxes, including Federal excises, is an extra load on top of a huge total of other taxes paid indirectly by the purchaser of a car or truck. This tax load consists of a maze of levies encountered as the vehicle proceeds from the raw-material stage to final sale.

Many of these taxes are so hidden that even the skilled statistician or economist is at a loss to isolate them precisely. However, it has been estimated that as much as 25 percent of the price of a car is taxes. At some point excessive taxation withers the strongest demand for a product, no matter how badly it is needed.

Surely it is shortsighted to overburden, with an extra, discriminatory tax, a product such as the motor vehicle which is used by millions and which provides employment for millions. Motor vehicles are the mainstay of large segments of the economy that, if kept healthy are major providers of Federal tax revenues.

When these Federal excise taxes were first enacted in 1932 to meet the depression emergency and when they were increased in 1941 to help pay defense costs and to discourage the use of automobiles, they were regarded by Congress as objectionable and temporary. Many statements by Members of Congress clearly point up this fact.

In its report to Congress on June 23, 1943, the Treasury Intergovernmental Fiscal Relations Committee, after more than a year's exhaustive study, recommended strongly that the Federal motorist taxes be repealed. It is joined in this recommendation by many other tax authorities.

EXCISE TAXES HAVE MANY OPPONENTS

Federal automotive taxes are opposed by many groups.

When the previous congressional hearing on excise taxes was held in mid-1947, the automobile industry appealed then for relief on behalf of itself and its customers. Its testimony subsequently has been joined and supported by appearances, briefs, and petitions from several hundred groups of highway users—the automobile clubs, the farm organizations, State and local associations of truck operators, and many other large and small groups of automotive consumers.

In summation, we urge repeal of the automotive excise taxes because (1) they impede commerce, (2) they threaten the present high levels of production and sales and employment in our own and in numerous supplying industries, (3) they unduly burden low-income groups, (4) they are unfair and discriminatory, (5) they are taxes on essential tools, and (6) they are an extreme example of multiple taxation.

Repeal of excise taxes now would help maintain high-level employment in a key segment of the national economy; it also would provide substantial tax relief to wage earners, farmers, and all persons in the low-income groups who necessarily must own and operate motor vehicles.

Brief of the Wine Industry of the United States Submitted by Edward W. Wootten, Manager, Washington Office

This brief is filed on behalf of the 19 wine associations, members of the Wine Conference of America, representing the entire wine trade in the United States, including producers, bottlers and importers.

Wine is basically an agricultural product and is so regarded in all producing countries. The tax on wine is in fact a tax on the principal outlet for farmers' grapes. This brief shows the adverse effects of current excise tax rates upon the grape grower.

Following repeal the wine industry was confronted with a strong tradition of home winemaking in the United States, together with a general public impression that wine growing was an art suited to foreign countries and not to us. Under the policy of reasonable taxation established by the Congress in 1936, the United States wine growers increased the volume of professionally made wine from 0.26 gallons per capita in 1934 to 0.85 gallons in 1942 (the last year of unrestricted volume movement). In so doing they raised the United States to about fourth place in production among the 19 principal wine growing countries in the world. However, practically all these countries have a per capita consumption substantially larger than the United States,—ranging from 30 gallons in France, 24 gallons in Italy and 18 gallons in Spain, down to consumption rates in the smaller countries such as 11 gallons for Switzerland, 8 gallons for Hungary, and 17 gallons for Chile.

This prewar policy of reasonable taxation, coupled with coordinated industry efforts in promoting the proper and moderate uses of wine, began to have its effect. Returns to growers improved from the depression levels of the mid '30's, and by 1941 the crop returned to growers in California (where 90 percent of the wine is made) a new high of almost $20 per ton. In other words, at the beginning of the war, the American wine industry had begun to establish itself on a sound economic basis with relatively reasonable returns to growers on the basis of prewar costs.

Since the end of hostilities, however, there has been a definite retrograde economic movement for both the growers and the wineries. During the war, an increased tonnage of grapes (averaging about 400,000 tons annually in excess of the prewar average, or the equivalent of 40,000,000 gallons of wine) was diverted into wartime food channels. With the close of hostilities, this tonnage was (as is normal when there are no other outlets for grapes) necessarily made into wine, thus creating a series of successive surpluses which, for the 1945, 1946, 1947 and 1948 crops amounted to a recurring annual surplus of 25 percent over sales. Beginning with the spring of 1947, there was a marked collapse in the value of wine. Wineries took an inventory loss of about $100,000,000. Returns to growers went to $30 for the 1947 and 1948 crops and to $26 for the 1949 crop just harvested.

For all practical purposes this current return is less than the $20 return received in 1941. Cultivation and picking costs have increased greatly, and the bare cost of grapes to the grower is now estimated to be somewhere between $22 and $25 a ton. In addition, the purchasing value of the dollar has declined to such an extent that it is obvious current returns to growers are actually less than what they were at the beginning of the war. In 1941 growers received 83 percent of parity for their grapes. In 1949 they received only 45 percent.

We feel, therefore, that it would be highly improper to conclude that the current high rate of dollar collections on wine is healthy or desirable. We strongly urge a return to a policy of reasonable taxation consistent with economic conditions as they have existed in this postwar period.

The following table shows the tax collections by calendar years at the beginning of the war, during the war and since the war:

Calendar year:	*Amount collected*
1941	$17, 933, 378
1942–43 average	31, 908, 786
1944–45 average	44, 900, 352
1946–49 average	61, 717, 437

The committee will note that the annual amount collected, since hostilities ceased, has been 37 percent more than the amount collected under the same rates in the wartime years 1944 and 1945. Increased gallonage movement has obviously meant a much greater financial return to the Federal Government than was anticipated at the time the wartime rates were imposed. Yet this condition has been accompanied by steadily declining returns to growers from grapes

crushed for wine to a point where the movement of wine is rapidly becoming of benefit only to the taxing authorities and not at all to the many thousands of farmers all over the country who are attempting to make a livelihood out of growing grapes and producing and finishing wine. It is, therefore, apparent that, if the wine industry is to experience any degree of economic stability, it is essential that the war-time excise taxes be removed without further delay.

Per capita consumption in the last 2 years has amounted to only 0.845 gallons, practically the same as the high point reached at the beginning of the war. It is our strong belief that under a wise taxation policy the wine industry can continue to improve the position of the grower and eliminate, through normal commercial channels, the surplus condition existent since the end of the war. We do not believe we can do this under the present tax levy which bears very heavily on a product regarded by most of its consumers as a part of their daily diet, just the same as it is regarded in most other wine producing countries, which, as we have shown, have a per capita consumption very substantially larger than ours.

The following table illustrates the relative Federal tax burden in relation to returns to growers for their grapes when marketed in the form of wine:

	Grapes per ton	Percent parity received	Tax per ton	Percent tax bears to cost of grapes
1941	$19 90	83	$17 96	90
1949	26 73	45	51.86	194

We believe the committee will agree with us that adjustment of the wartime excise taxes on wine is long overdue.

SURPLUS CONDITIONS ARE CONTINUING

The potential 1950 crop of grapes will only add to our difficulties. In December 1949, the Department of Agriculture called this to the attention of the California wineries and strongly urged that some steps be taken to divert these potential surpluses through voluntary industry action. Under the Agricultural Marketing Act of the State of California, there was established, as an instrumentality of the California Department of Agriculture, the Grape Stabilization Advisory Board which, effective January 9, 1950, laid assessments on all wine moved into commerce during the next year for the purpose of raising a fund of about $3,000,000 with which to divert surplus grapes and grape products of the 1950 crop into noncompetitive channels. At the same time, the board has been making studies to determine the best long-term program of adjusting supply of grapes to demand. The development of a long-term program will take some time because grapes are not an annual crop but take 5 years to bring into bearing. Adjustments cannot be made overnight.

We mention the foregoing self-help program to show that our industry is doing its level best to adjust its own economic problems insofar as that may lie within its power.

However, we can only do the job ourselves if we are not excessively burdened in other directions.

We strongly urge that the Congress take the necessary steps to reduce the excessively high current tax collections on our particular commodity by eliminating the wartime excises on wine.

MEMBER ASSOCIATIONS OF THE WINE CONFERENCE OF AMERICA

American Wine Association, 292 Madison Avenue, New York, N. Y.
Associated Vintners of the Middle West, 33 North LaSalle Street, Chicago, Ill.
Bottle Fermented Champagne Producers, Inc., 901 Barr Building, Washington, D. C.
Council Bluffs Grape Growers Association, 900 South Seventh Street, Council Bluffs, Iowa.
Finger Lakes Wine Growers Association, Widmer's Wine Cellers, West Avenue and Tobey Street, Naples, N. Y.
Maryland Institute of Wine and Spirits Distributors, Inc., Hearst Tower Building, Baltimore, Md.
Michigan Wine Institute, Post Office Box 575, Lansing, Mich.

National Association of Alcoholic Beverage Importers, Inc., National Press Building, Washington, D. C.
National Wine Association, in care of Quality Fruit Association, Yonkers, N. Y.
Ohio Grape and Wine Producers Association, Post Office Box 595, Sandusky, Ohio.
Ohio Grape Growers Institute, 31734 Lake Road, Avon Lake, Ohio.
Ohio Wine Dealers Association, in care of Meier's Wine Cellars, Silverton, Ohio.
North Carolina Association for Wine Control, Carolina Hotel, Raleigh, N. C.
Texas Wine Association, Brown Building, Austin, Tex.
Vermouth Institute, San Benito Co., 601 West 26th Street, New York, N. Y.
Washington Wine Council, The Pommerelle Co., 9117 East Marginal Way, Seattle, Wash.
Wine Association of Pennsylvania, James Moroney Co., 310 South Twenty-fourth Street, Philadelphia, Pa.
Wine Distributors of Northern California, 814 Montgomery Street, San Francisco, Calif.
Wine Institute, 717 Market Street, San Francisco, Calif.

(Whereupon, at 1:25 p. m., the committee recessed to reconvene at 10 a. m., Monday, July 10, 1950.)

REVENUE REVISIONS OF 1950

MONDAY, JULY 10, 1950

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D. C.

The committee met, pursuant to recess, at 10 a. m., in room 312, Senate Office Building, Senator Walter F. George (chairman) presiding.

Present: Senators George, Connally, Johnson, Kerr, Myers, Millikin, Taft, Butler, and Martin.

Also present: Mrs. Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will please come to order.

I am advised that Mr. Frank M. Porter, president of the American Petroleum Institute, is unable to reach Washington this morning. Senator Kerr, have you a statement that you wish to place in the record?

Senator KERR. I have a statement by Mr. James J. Cosgrove in behalf of the American Petroleum Institute which I would like to insert in the record at this point.

The CHAIRMAN. You may have that statement inserted in the record.

(The statement referred to follows:)

STATEMENT OF JAMES J. COSGROVE IN BEHALF OF THE AMERICAN PETROLEUM INSTITUTE

My name is James J. Cosgrove. I am chairman of the board of Continental Oil Co., Ponca City, Okla., and I appear before you today in behalf of the American Petroleum Institute in opposition to section 209 (d) of H. R. 8920, the Revenue Act of 1950. Section 209 (d) of H. R. 8920 reads as follows:

"(d) ABANDONMENT OF CAPITAL ASSETS AND CERTAIN PROPERTY USED IN THE TRADE OR BUSINESS.—Section 117 (relating to capital gains and losses) is hereby amended by adding at the end thereof the following new subsection:

"(1) ABANDONMENT OF CAPITAL ASSETS, ETC.—For the purposes of this chapter, the abandonment of a capital asset or of property used in the trade or business (as defined in subsection (j) without regard to the last sentence of paragraph (1) thereof) shall be considered as a sale or exchange of such asset or property."

This amendment, coupled with the amendment of section 117 (j) which reclassifies losses on the sale of "property used in the trade or business" as capital losses, would have the effect of disallowing the deduction of abandonment losses that cannot be offset by net capital gains.[1] Since businesses do not ordinarily have any capital gains, the real effect of the amendment would be to eliminate the right of businesses to deduct abandonment losses from taxable income. Going concerns simply do not sell their business property, except in those cases where they find that it is of no further use in their business. In view of this

[1] Section 117 (d) of the Internal Revenue Code reads as follows:

"(d) LIMITATION ON CAPITAL LOSSES.—

(1) CORPORATIONS.—In the case of a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of the gains from such sales or exchanges.

(2) OTHER TAXPAYERS. In the case of a taxpayer, other than a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of the gains from such sales or exchanges, plus the net income of the taxpayer or $1,000, whichever is smaller. * * *"

effect, the enactment of section 209 (d) of H. R. 8920 would be a vicious and destructive blow to many businesses and would be a reversal of one of the basic concepts of income taxation that has been in the law since its inception.

Since the first income-tax law was passed in 1913, one of the basic concepts has been that a businessman or a corporation engaged in business is allowed to deduct from gross income an amount at least equal to all of the money spent in an effort to produce the income. Many such expenditures have been required to be capitalized, and in such cases the deduction is deferred, but nevertheless allowed, either as depreciation (or some other form of amortization) or as a loss when the asset is finally disposed of in some manner. When an asset becomes useless to the business and the total cost thereof has not been absorbed by depreciation, sections 23 (e) [2] and 23 (f) [3] of the Internal Revenue Code allow as a deductible loss the portion of the original expenditure that has not been previously deducted as depreciation, depletion, or amortization. If the business had been able to foresee the exact period of usefulness of its property, it would have been allowed to deduct the entire loss in value as depreciation, depletion, or amortization. In many cases, such as in the case of land, unoperated oil leases, and similar items where the useful life or the degree of usefulness is completely unpredictable, no deduction for depreciation, depletion, or amortization is allowed, and the entire loss is deductible at the time of abandonment. In all other cases it is almost impossible to estimate correctly the period of usefulness of an asset. It would be inequitable to penalize an error in judgment as to the life or usefulness of property by providing that any portion of the loss not previously deducted cannot be deducted at all unless the taxpayer is fortunate enough to have capital gains to offset it. There is no connection between capital losses and such business losses. In the case of any property purchased for business purposes—whether it be abandoned through nonpayment of taxes, abandoned because of obsolescence, or sold for some nominal figure when it becomes useless to a taxpayer—the loss is a business loss and should certainly be deductible from business income. Losses from the sale of assets that are purchased for purposes unrelated to the taxpayer's business are already in the "capital loss" category under present law.

It seems probable that section 209 (d) of H. R. 8920 was proposed for the purpose of preventing an escape from the amendment to section 117 (j) of the Internal Revenue Code. That amendment classifies as capital losses those losses resulting from the sale or exchange of business property. This, in itself, is an unjust denial of real economic business losses—but to add the denial of losses from abandonment of business property would work extreme hardship not only on those businesses that find it necessary to sell their assets at a loss but also on those businesses that constantly are finding it necessary to abandon completely their properties without any salvage whatsoever. As an example, the oil and gas industry acquires thousands of leases every year at a staggering cost. Every one of those leases is an unknown quantity, although it is pretty certain that 95 percent of them will be worthless. No amortization of any kind is allowed as a deduction with respect to these nonproductive leases, but under present law their cost is allowed as a deduction at the time they are abandoned and turned back to the lessors. This cost is one of the basic costs of conducting the oil business—there could be no true net income unless it were first deducted from gross income—and yet section 209 (d) of H. R. 8920 would deny almost every dollar of this deduction.

The effect of eliminating this long-standing right to deduct from business income an important part of the cost of doing business would be ruinous to many businesses. Using an example in the oil industry again, an operator who had made a heavy investment in an oil lease which he suddenly found to be worthless because of an expensive dry hole that he drilled on the lease would not be allowed to deduct any of the loss sustained through the lease's worthlessness, and it is probable that the amount spent for the dry hole itself might even be construed as an abandonment loss and disallowed as a deduction. The same thing would be

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[2] Sec. 23 (e) of the Internal Revenue Code reads, as follows:

"(e) LOSSES BY INDIVIDUALS.—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business, or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business, or

(3) of property not connected with the trade or business, if the loss arises from fires, storms, shipwreck, or other casualty, or from theft. No loss shall be allowed as a deduction under this paragraph if at the time of the filing of the return such loss has been claimed as a deduction for estate tax purposes in the estate tax return."

[3] Sec. 23 (f) of the Internal Revenue Code reads as follows:

"(f) LOSSES BY CORPORATIONS.—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise."

true of countless other losses unavoidably sustained in the conduct of many other types of businesses. Denial of these business losses would amount to confiscation of business capital in the guise of a tax on income—a result that Congress most certainly should not approve.

To illustrate one effect of the proposed amendment, for over 20 years oil companies have treated exploration costs (termed "geological" and "geophysical" expenditures) as current expense both in their books of account and in their tax returns. In 1942, however, the Bureau of Internal Revenue began to require a portion of such costs to be capitalized. Finally on April 17, 1950, it flatly ruled in I. T. 4006 that all geological and geophysical expenditures must be capitalized against properties retained or acquired, with the taxpayer recovering his investment through depletion insofar as the property acquired becomes productive or through an abandonment loss in the year in which worthlessness is established. Now the House bill deals the final blow for it proposes to treat such an abandonment loss as a capital loss instead of an ordinary business loss.

As a further illustration of the harsh and destructive results of the proposed new amendment, current operations on the Gulf coast continental shelf may be considered. In this hazardous area operators since 1945 have purchased leases at a cost of about $33,000,000. They have constructed expensive drilling platforms and drilled 92 dry holes in the search for oil, all at a cost of many additional millions of dollars. When leases are surrendered and dry holes completed, the amounts expended for these purposes are complete losses. When platforms have to be abandoned, little or no salvage value can be realized and a similar substantial loss occurs. Operations in the open sea as a whole are three to five times as expensive as comparable operations on land; there is grave doubt whether they will turn out to be profitable even under existing tax laws and regulations. If the law were amended so as to prohibit the deduction of cost of surrendered leases, dry hole expense, and the cost of abandoned drilling platforms, the incentives for further continental-shelf operations will be destroyed, with the result that supplies of petroleum and its products from this area would be denied the Nation and the consuming public.

If section 209 (d) of H. R. 8920 should become law, many oil industry members would no doubt be forced to consider the advisability of selling their properties, in order to realize capital gains against which to offset their losses, since abandonment losses are inevitable in the exploration and development of new sources of oil. This could only mean that eventually they would go out of business. Those who would buy or remain and continue to explore and drill for new oil sources would tend to limit their prospecting only to those leads which had a better than even chance of success. In these threatening times, when every drop of domestic oil supply may suddenly be needed, this is a condition which we believe Congress would be the last to intentionally invite.

The CHAIRMAN. Mr. J. Cameron Thomson was scheduled as a witness and was not able to reach Washington this morning, due to his plane being grounded. His statement will be placed in the record at this point in lieu of his appearance.

(The statement referred to follows:)

STATEMENT OF J. CAMERON THOMSON, COMMITTEE FOR ECONOMIC DEVELOPMENT

I am J. Cameron Thomson, president of the Northwest Bancorp., Minneapolis, Minn. I appear today as chairman of the fiscal and monetary policy subcommittee of the research and policy committee of the Committee for Economic Development. We are grateful for the opportunity to appear before you and present our views on the problem of tax policy in 1950.

Early in January, in presenting its recommendations for tax and expenditure policy for 1950, our committee stated: "Recognizing that there is no ideal solution to the budget problem of 1950, we believe that the best solution, the one most consistent with the demands upon the Federal budget, with the requirements of sound finance, and with the conditions of economic growth, would be:

"(1) Provide for a moderate budget surplus to be realized under conditions that make a surplus possible and desirable, namely, conditions of high employment." In accordance with its general budgetary policy adopted in 1947, we suggested that tax rates should be high enough to yield a $3,000,000,000 surplus in the cash-consolidated budget when 96 percent of the labor force was employed. This would mean unemployment of about 2.5 million.

"(2) Reduce or postpone expenditures that are not immediately essential to the national security or general welfare, and operate all programs more economically and efficiently." We proposed that expenditures for 1951 be cut substantially below the recommendations in the President's budget message, and that additional revenue be obtained by stricter enforcement of the tax laws.

"(3) Revise the tax system in ways that will yield the most benefit to the whole economy from the small net revenue reduction that seems possible with the achievable expenditure reductions." We proposed a specific program of tax reforms for adoption this year.

Attention should be called to the fact that we recommend use of the cash-consolidated budget in making over-all budget policy. The budget figures used in this statement are on the cash-consolidated basis. This differs, as you know, from the administrative budget chiefly in that it includes the receipts and expenditures of the social-security and other trust accounts, and that it includes expenditures only when cash paymets are made. It thus provides an improved picture of the economic effects of the budget.

According to the best estimates available it appears that a deficit in the cash-consolidated budget for fiscal 1951 of about 1¼ billion dollars is now contemplated. This figure compares with a deficit of about 3½ billion dollars in the administrative budget.

It is my understanding that these figures assume an average level of unemployment of about 3½ millions for the fiscal year 1951. This is 1 million higher than the 2½ million we have defined as consistent with high employment. We estimate that under conditions of high employment in fiscal 1951 present tax rates would yield in the neighborhood of $2,000,000,000 in additional revenues, while unemployment compensation payments would be reduced by about $400,000,000. Accordingly the cash-consolidated budget for 1951, under conditions of high employment, would show a surplus of about 1¼ billions of dollars.

In presenting our testimony before the House Ways and Means Committee, I set forth our committee's program for reduction of expenditures below the President's recommendations. This consisted of specific proposals for economies, postponements, and reductions in programs, largely in the fields of veterans' expenditures, home mortgage purchases, national defense expenditures, public works, and proposed new social legislation. Our committee has not revised its recommendations to take account of the numerous subsequent changes in estimates and the revisions effected by the House of Representatives. In the limited time at my disposal I shall not attempt to present our program in detail. In the main, however, the essential recommendations which our committee made last January still stand. While it is late in the session, I believe that it is still feasible to effect substantial economies. Moreover, I believe that wise action to reduce Federal expenditures is one of the most important matters before this session of the Congress. The need for economy and for increased efficiency in Federal expenditures is of especial importance now, in view of the prospect of necessary increases in the burden of national defense.

The impression is sometimes given that our Federal budget is so dominated by postwar and defense expenditures that its size is absolutely determined by necessity for survival. That is not the way I see the situation. The President's budget called for 45.8 billion dollars of expenditures, on a cash-consolidated basis, in fiscal 1951; in fiscal 1948 we spent 36.5 billion; the President's 1951 proposal was 9.3 billion higher than actual 1948 expenditures. How much of this increase was in so-called war or peace items—national defense, international affairs, veterans, interest? Only 1.1 billion dollars, or 12 percent, is in these war or peace categories. The rest, 8.2 billion dollars, is an increase in domestic peacetime programs. If we leave out the new social insurance programs on the ground that they are self-financing we find that 85 percent of the increase is still in domestic peacetime programs. This by itself does not prove that the budget can be cut. But it does show that the size of the budget is not rigidly determined by the costs of waging the war with the Axis or waging the peace with Russia.

In my opinion, through determined action now to reduce expenditures, increase efficiency of operations, and close tax loopholes, it should be feasible to improve the budgetary situation by at least 3 billion dollars for fiscal 1951. I think it essential that every effort be made to achieve at least this goal in the present fiscal year.

Such action would increase the cash-consolidated budget surplus for fiscal 1951 about 1¾ billion dollars at present unemployment levels of about 3.5 million, and to somewhat more than 4 billion at high employment, when the jobless would average about 2.5 million. As I have stated earlier, CED recommends a 3-billion-

dollar surplus in the cash-consolidated budget at high employment. The program of budgetary improvement called for would thus leave somewhat in excess of 1 billion dollars available for tax reduction. It would provide 3 billion dollars for debt retirement in the situation in which the debt should be retired, that is, at high employment.

We believe that tax reform and tax reduction are important for two reasons. First, the present tax system violates in many ways the elementary principles of fairness that should be observed in the relations between the Government and the citizens. Second, the present tax system is an obstacle to progress. If long maintained in force it would seriously contract the growing volume of output upon which the economic welfare of the American people depends.

On several previous occasions our committee has described the tax reforms and reductions necessary to give us a tax system that is fair and consistent with economic progress. The present budgetary situation will not permit all of these improvements in the tax system to be made now. However, certain urgent steps should and can be taken now.

Specifically, we recommend the following tax revisions at the present time.

1. Extend the loss carry-forward period to 5 years and shorten the carry-back to 1 year. This is provided in H. R. 8920. The gains in equity and incentive, especially to small business, are clear.

2. Subject to Federal income tax the interest on future issues of State and local bonds. The present exemption diverts the flow of funds from private productive enterprise and has not basis in equity.

3. Revise section 102 of the Internal Revenue Code, which aims to prevent corporations, particularly those with a limited number of stockholders, from accumulating profits for the purpose of avoiding payment of individual income tax by stockholders. The law as it now stands has caused uncertainty and confusion. We believe that this section should be amended to create a presumption in the case of operating companies that profit accumulations are reasonable unless the Treasury proves the contrary.

The above recommendations involve no net revenue loss for fiscal 1951.

H. R. 8920 contains numerous recommendations for changes in tax legislation which it has not been possible for us to study carefully, and on which I am therefore not in a position to speak for our Committee. I do, however, wish to present our views with regard to two groups of recommendations in the Bill which are of major importance.

First, with regard to excise tax reduction. Our recommendation, presented to the House Ways and Means Committee on March 1, was as follows:

"Wartime excise rates should be repealed or reduced to the extent of about $1,000,000,000 of net revenue loss. It is now generally recognized that these taxes are unfair and an impediment to production. In the light of the budget picture as we see it, considerably more reduction than the President suggests is possible and desirable."

Our committee did not recommend a specific schedule of excise tax reductions. The schedule contained in H. R. 8920, involving a net revenue loss of less than $1,000,000,000, has obviously been worked out with great care and is well within our committee's recommendation.

Second, with regard to changes in the corporation income tax.

Last January, our committee proposed that a step be taken this year in the reduction of the double-taxation of corporate income, recommending that the first 16.6 percent of the corporate income tax be considered a withholding tax on distributed profits, comparable to the present withholding tax on wages. In the light of the expenditure situation as it now appears, it may not be practicable to put this recommendation into effect for fiscal 1951; it would involve a revenue loss of approximately $1,000,000,000. The proposal in the House bill that 10 percent of dividends be withheld by the payor, while it does not reduce double taxation, would establish the machinery for subsequent reduction of this inequitable practice and would at the same time reduce tax evasion. Our committee therefore favors this proposal.

Our committee recommended the elimination of the 53 percent "notch rate" on corporate incomes between $25,000 and $50,000, stating that this could be accomplished by applying a gradually rising scale of rates to the first $50,000 of income of all corporations. The cost of eliminating this inequity would be relatively small.

The House bill, however, goes far beyond our committee's recommendation for elimination of the "notch rate" and proposes that corporate tax rates be increased on the larger corporations. We are strongly opposed to this proposal.

We believe that the tax levied on corporate income is a basically bad tax. It is wrong to think that the corporate income tax is paid by corporations. The corporate profits tax is paid by individuals who invest in certain kinds of business enterprises, by individuals who buy the products of corporations, and by individuals who work for corporations. In just what proportion the tax is ultimately divided among these three classes is unknown. But however it is divided it is a bad tax, discriminating without basis among individuals and retarding efficiency and economic growth.

In recommending an increase in the corporate profits tax rate we believe that the House bill is taking a step in exactly the wrong direction. As I have indicated, with the exercise of reasonable economy the requirements of sound budgetary policy can be met without increasing corporate tax yields. If revenue requirements permit, corporate tax rates should be reduced, not increased, for all corporations.

Since our recommendations were presented to the House committee last March, the Nation has been confronted with an increased threat to our national security. No one yet knows how serious this threat may be or what the effect of recent international developments may be on the need for defense expenditures. It is clear that adequate national defense must be a first call on our national resources. If it should become clear that defense expenditures must be substantially increased, our committee would wish to reconsider the recommendations which I have presented today, in the light of the new situation.

In preparation for developments which may lie ahead, it is essential that we review our fiscal situation with utmost care. Tax reform to increase the equity of our tax system, to preserve and strengthen the conditions of economic growth, is important at all times but now is of special urgency. The reduction or postponement of nonessential expenditures and the exercise of economy in all programs becomes of particular importance in a situation in which we may face heavy additional drains on our economy. As Secretary Snyder recently stated before your committee, "A healthy economy, a sound fiscal and tax policy, fair and adequate taxation are all parts of our pattern for national strength and world leadership."

The CHAIRMAN. Mr. James H. Killian.

STATEMENT OF JAMES R. KILLIAN, JR., PRESIDENT, MASSACHUSETTS INSTITUTE OF TECHNOLOGY, CAMBRIDGE, MASS.

Mr. KILLIAN. My name is James R. Killian, Jr. I am president of the Massachusetts Institute of Technology, Cambridge, Mass.

The CHAIRMAN. Are you appearing for your institute or generally?

Mr. KILLIAN. I am appearing in behalf of the Committee on Financial Support and Taxation of the Association of American Universities, a group of 37 American universities.

The CHAIRMAN. We shall be glad to have your statement. You may proceed.

Mr. KILLIAN. This committee includes President Colgate W. Darden, Jr., of the University of Virginia; President Harold W. Dodds, of Princeton University; President Theophilus S. Painter, of the University of Texas, and President Harold E. Stassen, of the University of Pennsylvania.

After a careful study of H. R. 8920, this committee respectfully submits a brief, which I attach to this statement, recommending changes in the House bill. These suggested changes seek to accomplish the following objectives:

1. To leave the educational institution wholly exempt from taxes, as now provided by section 101-6 of the Internal Revenue Code, and to rely on the taxation of feeder corporations to stop any abuses of tax exemption and to tax unrelated income.

Our committee believes that when a manufacturing or mercantile business is carried on as an entity separate from the university and

has no substantial connection with educational or scientific work of the university, that it should be taxed.

The committee believes that the taxation of such separate entities, or feeder corporations, would cover practically all the college business investments which have been subject to criticism. Few boards of trustees of universities would be willing to accept the liability which would be involved if such business enterprises were to be owned directly by the universities, rather than by separate or feeder corporations or foundations. Any change in the revenue laws designed to tax such business operations should be aimed not at the university but at the separate entity. Any effort to tax the university or some part of it would violate the historic principle of tax exemption.

Senator CONNALLY. What do you mean by "feeder corporations"?

Mr. KILLIAN. A feeder corporation is a corporation that may be set up by a charity or university to hold a business operation of a separate entity or separate corporation which would be wholly owned, say, by the charity and all of the income would be paid over to the charity.

Senator MILLIKIN. If this charity conducted an unrelated business, it should be exempted from taxation?

Mr. KILLIAN. If the charity directly operated and owned an un related business, I hold to the principle that the charity should be wholly tax-exempt for reasons that I will discuss later on. I think though it very unlikely that the charity will hold any appreciable unrelated business enterprises because of the liabilities that are attached to the charity. It would be a very hazardous thing to do.

Senator TAFT. Would you provide that if they did, they would be subject to taxes?

Mr. KILLIAN. I think if you try to discriminate between the types of income that a university has, you get into very serious difficulty, and that is the basic problem. There are all kinds of business operations which the charity must engage in. A hospital has a private pavillion. A university operates dormitories. It would be very difficult to distinguish between unrelated business income. That I think is the basic difficulty.

Senator MILLIKIN. Would you not open up a new field of evasion if you denied the exemption to feeder corporations that were separately incorporated? Would not a new field of evasion be to dissolve the incorporation and run the thing directly by the university? That would be a question of weighing the risks, would it not?

Mr. KILLIAN. It certainly would. If the business were of any magnitude, I think it would be very unlikely that a well-run university would want to undertake that liability.

Senator TAFT. They are doing it, in fact. That is what I have been told. Why is a feeder corporation subject to tax anyway? Why is there any problem at all if it is a separate corporation?

Mr. KILLIAN. I know of no business enterprise that is completely owned and operated by a university directly. There may be some but our committee is not aware of it. Every major one that we know of has been set up and handled as a separate entity.

Senator TAFT. How do they get exempt?

Mr. KILLIAN. They have not been exempted so far. They have applied for exemption. There has been a court decision recently in one case, the Mueller Spaghetti Co., that it was not tax exempt.

Senator KERR. Tell us what differentiated that situation from others?

Mr. KILLIAN. From what others?

Senator KERR. Tell us what there was about that which caused it to be held unexempt from taxation?

Mr. KILLIAN. It was a separate corporation operating a business enterprise that had no relation whatsoever to the educational activities of the university and the court ruled that it was taxable.

Senator KERR. That is what you refer to as a feeder corporation?

Mr. KILLIAN. Yes.

Senator KERR. Did I understand you to say that your position is that income earned by such a corporate institution should be exempt from taxation?

Mr. KILLIAN. No; that it should be taxed. Our committee feels very strongly that unrelated business enterprises held by separate entities should be taxed.

Senator MILLIKIN. The distinction is whether it is a separate entity?

Mr. KILLIAN. Yes.

Senator MILLIKIN. Whether the liability goes directly back to the school or whether it does not?

Mr. KILLIAN. That is correct.

Senator MILLIKIN. How about lease-backs?

Mr. KILLIAN. Lease-backs I would prefer not to discuss since they are going to be handled by other testimony to come before the committee.

Senator KERR. How would you feet about the situation if it did arise where a business was operated by a university?

Mr. KILLIAN. I would hope that the university would still be tax exempt. I would hope that this could be handled by the universities policing themselves, and certainly this association has taken a firm stand that it is improper for a college or university to undertake to own or operate an unrelated business enterprise. We can bring great influence to bear on our own members, I am sure.

The CHAIRMAN. Do some of the universities own and carry on a printing business?

Mr. KILLIAN. They do.

The CHAIRMAN. Do they do that through a separate corporation?

Mr. KILLIAN. In some cases they do and in some cases it is directly held by the university. The question immediately comes up, is that an unrelated business enterprise?

The CHAIRMAN. I thought in some instances they were operated by the university.

Mr. KILLIAN. They are.

The CHAIRMAN. I thought in some instances they were operated by the university where they published their own college publications and university publications and occasionally, or maybe generally, some books.

Mr. KILLIAN. That is correct.

The CHAIRMAN. That has your approval?

Mr. KILLIAN. Yes.

Senator MARTIN. Several universities put out books which you are able to buy direct. Is that a part of the university or is it a separate corporation, or what is it? The University of Pennsylvania does it,

the University of Pittsburgh does it. There are several others I have bought books from myself.

Mr. KILLIAN. Practically every major university operates a university press either directly owned by the university or held by a subsidiary corporation, the objectives of that press usually being to make available scholarly material that otherwise would not be published. This is an educational institution.

Senator TAFT. Did you ever hear of any university making money on its printing?

Mr. KILLIAN. I have never heard of it. Perhaps it is done.

Senator CONNALLY. Do they not print for people other than their own? For instance, if a man writes a book can he not have it printed at the Harvard Press or the Yale Press?

Mr. KILLIAN. It certainly is done.

Senator CONNALLY. They can make money out of it?

Mr. KILLIAN. Yes; but it is usually to support those books that are unprofitable.

Senator CONNALLY. I am not talking about their books; I am talking about books that they print for other people. They do not do it free?

Mr. KILLIAN. No; they sell it just the same as the other publishers.

Senator CONNALLY. That ought to be taxable?

Mr. KILLIAN. I would say that the income that they make on that kind of books should be used to help defray the cost of publishing books that never pay their own way. That is the major function of the university press.

Senator MILLIKIN. That is the problem of every business. Every business has some lines which do not pay their way and the loss is made good profitable lines.

Mr. KILLIAN. Yes; although the objective of the university press is to make scholarly material available that cannot be handled through trade channels.

Senator MILLIKIN. You have a self-censorship question there. You can print the old classics, including fiction; but if you print a modern piece of fiction, that would probably not qualify. So, someone has to sit in judgment on what is classic.

Mr. KILLIAN. That is correct, but the Oxford University Press and the Cambridge Univerity Press have made available some of the major classics that otherwise would not have been available.

Senator MILLIKIN. The University of New Orleans runs a radio station and makes money out of it.

Mr. KILLIAN. Some of the State universities do operate radio stations.

The CHAIRMAN. There is one that operates a radio station and operates it directly.

Senator TAFT. Is there any evidence that they make any money out of it?

Mr. KILLIAN. I know of no evidence although I do not have the facts.

Senator CONNALLY. All radio stations make money, do they not? They would not be in business otherwise.

Senator TAFT. Most of the university radio stations operate part time. It is largely educational and if they break even they are lucky.

Mr. KILLIAN. That is right; they use it for educational extension activities.

Senator MILLIKIN. If they do not make any money, they are not taxable under either theory.

The CHAIRMAN. All right, you may proceed.

Mr. KILLIAN. H. R. 8920 breaches the tax exemption principle and thus may be a first step toward a gradual destruction of this principle. Under the provisions of this bill, hair-line administrative decisions would have to be made in distinguishing between taxable and non-taxable income and thus our colleges would have all the uncertainties involved in such difficult decisions and the litigation which might ensue.

These are the considerations that cause college administrators throughout the country to fear this bill and to believe it to be a serious threat to the future stability of their institutions.

I urge that the Senate Finance Committee reexamine the alternative approach—the taxation of the separate entity. Certainly this should be tried first rather than the drastic breach of the tax exemption principle embodied in the present bill. I urge that our colleges be treated on the same basis as our churches; their status is similar and they need the same protection.

2. Clarification of the bill as presently written to make it clear that capital gains on the sale of investments are not to be taxed.

Senator CONNALLY. You mean generally?

Mr. KILLIAN. The capital gains resulting from the handling of your normal endowment should not be subject to taxation.

Senator CONNALLY. You mean only with regard to universities and colleges; you do not mean generally?

Mr. KILLIAN. That is right.

The bill specifically excludes from taxation capital gains on the sales of real property but is silent on capital gains on the sale of securities.

Senator MILLIKIN. That again is where the school itself is handling its own investment portfolio?

Mr. KILLIAN. That is correct.

Senator MILLIKIN. That investment portfolio, but subsidiaries, separate entities.

Mr. KILLIAN. I am speaking of its own directly held securities.

The CHAIRMAN. It is not believed that they intend to tax these.

Mr. KILLIAN. I think that is correct.

The CHAIRMAN. But your suggestion is that it should be clarified?

Mr. KILLIAN. That is right. I think the intention is certainly not to do this but the language does not accomplish that result.

3. The definition of the university as stated in the bill can be made more precise by changing "regularly organized body of students" to "regularly enrolled body of students."

4. The withholding of dividends as now set forth in the bill penalizes charitable institutions by slowing up their receipt of investment income and by permanently denying them about half of a year's investment income. This can be remedied by the addition of a clause simplifying and expediting action by the Treasury on these withholdings.

5. All income derived from research for the United States Government is excluded from unrelated business net income, but nothing is said about research which may be supported by States and municipalities. The exclusion should also cover development work and edu-

cational work performed for Federal, State, and local governments. I think for example, of our land-grant college programs.

I am sure that this committee is fully cognizant of the financial crises which now grip our universities. The impact of inflation, the decline in interest rates, and the great increase in enrollments have combined to make the financing of our universities desperately difficult.

Senator MILLIKIN. What is your average rate of interest from the bond part of your portfolio?

Mr. KILLIAN. It varies greatly among institutions. In our own institution our return this past year was 4 percent on the pool investment.

Senator MILLIKIN. Is that on the bonds or the whole program?

Mr. KILLIAN. The whole program.

Senator MILLIKIN. Your bond income is probably only half of what it was 20 years ago?

Mr. KILLIAN. That is correct. My own institution was doing better than 5 percent 10 years ago. While our endowment has gone up $10,000,000, our endowment income has gone down.

Senator MILLIKIN. Are you permitted to diversify your income between bonds and securities and real estate holdings?

Mr. KILLIAN. Yes; we have complete freedom.

Senator MILLIKIN. Do you have any limit on what you may invest in?

Mr. KILLIAN. Nothing in Massachusetts.

Senator TAFT. Except in the case of specific wills and trusts?

Mr. KILLIAN. Yes; that is right. We are given securities from time to time which we have to hold but that is the only kind.

Our universities perform an essential national service in war and in peace. In the last war they demonstrated how essential they are to our national security by making a contribution which has never been duplicated in any country.

I submit that our national policy and the policy of Congress should be to help maintain the strength and growth of our universities and to help them to help themselves. Our great and numerous privately supported institutions save the Government money by performing an essential public service with private funds. Neither they nor the public institutions should be handicapped by impairment of their tax exemption, particularly when they are struggling to keep their heads above water at the present time. The gradual impairment of the long-standing principle of tax exemption possible under H. R. 8920 could fatally weaken our American system of higher education.

The critical need now is not for legislation increasing the universities' financial problems but positive measures to conserve and increase the income and resources of these institutions if they are to meet the educational needs of the youth of the Nation. We need a Government tax policy which will not only protect university resources, but stimulate increased support through private philanthropy.

Senator MILLIKIN. That is becoming more and more difficult due to the high rate of the personal income tax and estate and gift taxes?

Mr. KILLIAN. That is right, and the low value of the dollar.

The Association of American Universities strongly recommends, for example, that the income tax law be changed to permit the deductible charitable gifts of an individual in any year to be free of the

present 15 percent limit. It recommends that State and Federal laws be modified to encourage corporate giving to education.

That is one of the real hopes for the support of our educational institutions at the present time.

Senator MILLIKIN. What right has a corporation to make a gift?

Mr. KILLIAN. That right must be established by a statute. Of course they can make a charitable contribution up to 5 percent but that might be challenged by the stockholders. There is a growing recognition of the propriety of corporate grants to institutions. Sometimes they tie those grants-in-aid to the support of a specifically stated research or educational objective and thereby it is tied into the purposes of the corporation.

Senator MILLIKIN. I would say that the average corporation has no authority to make gifts, or they can make certain types of small gifts on the theory that it is promotion, but I doubt whether a normal corporation has the right to make gifts.

Mr. KILLIAN. There is a growing feeling that corporations have a responsibility and an opportunity to do that kind of thing. I think there are four States which have revised their corporate laws which ease up on the restrictions and make it possible for a corporation to do that.

Senator TAFT. It is on the theory that a corporation in a town or village has interest in the charitable activities of that village or that town and that it has a certain public duty, particularly a corporation that comes in from the outside with no direct ties. But as to their gifts, just giving money away to institutions with which they have no direct research connections, it seems to me there is a question there.

Mr. KILLIAN. They have extended that to take in the point of view that they have a responsibility to make sure that the kind of specialists they need are trained by the colleges.

Senator MARTIN. If the stockholders approve it in our State they have a right to donate to colleges. Of course all corporations donate when there are certain types of research. For instance, at our State College the oil and coal industries have a research facility there which has now become of the best in our country. It must be approved by the stockholders.

Mr. KILLIAN. One of the great developments in the past two decades has been the support of our graduate scholarships by industry because they relate directly to their recruiting but it is making a very important contribution to the support of graduate study in this country.

Senator MILLIKIN. I would suspect that would be a deductible expense.

Mr. KILLIAN. I think perhaps it is. They are extending that now to make grants-in-aid for the support of broad research in those fields that are of direct importance to the corporations. That is another very vital part of the support of our scientific programs in universities at the present time.

Finally, the universities need encouragement and help in meeting their present financial crises. The proposed bill is certainly no encouragement and in its long term effects may be harmful.

Mr. Chairman, I submit with this statement a brief which undertakes to show how these proposed changes could be incorporated in the bill. I will not read this brief unless it is the desire of the committee to do so.

The CHAIRMAN. You may file the brief for the record and it will be incorporated in the record. I presume that will be of sufficient assistance to the committee. You are undertaking to point out specifically how these changes that you suggest can be made?

Mr. KILLIAN. That is correct, sir.

(The brief referred to follows:)

BRIEF OF JAMES R. KILLIAN, JR., CHAIRMAN OF THE COMMITTEE ON FINANCIAL SUPPORT AND TAXATION OF THE ASSOCIATION OF AMERICAN UNIVERSITIES

Re: H. R. 8920
To: The Senate Finance Committee,
Hon. Walter F. George, Chairman.

Before presenting my chief suggestion for amendment of the present bill, I will present as briefly as possible the following important detailed suggestions:

1. Capital gain from sales of securities

In section 301b, on page 99 line 13, the bill specifically excludes from "unrelated business net income" all dividends and interest. No doubt this is done for fear that the holding of investment securities might be regarded as an unrelated business, so that, but for this provision, dividends and interest might be made taxable.

Profit from the sale of such securities should also be excluded from "unrelated business net income." The failure to mention such profit might lead to an inference that it is intended to be taxable.

I believe that it is clearly not the intention to tax such a profit.

The remedy would be to add to the proposed words of sec. 422 (a) (1) (see p. 99 line 14) after the word "royalties" the following words "and all gains or losses from the sale, exchange or other disposition of securities."

Note that such gains with reference to real estate are specifically excluded from "unrelated business net income" in section 422 (a) (2) (see p. 99, line 16, et seq.).

2. Definition of a university

In three places in the bill a university is defined as an educational organization which * * * has a regularly organized body of pupils or students * * *.

Bill, page 106, line 16.
Bill, page 115, line 23.
Bill, page 124, line 15.

It is not clear that pupils or students are regularly organized. They are regularly enrolled.

The remedy would be to change the word "organized" in each of the above three instances to the word "enrolled."

3. Income from research work

The bill at page 100, line 19, excludes from "unrelated business net income" all "income derived from research for the United States or any of its agencies."

I believe that the word "research" is unintentionally too narrow, and that it was certainly intended to include development and instruction. Government contracts given to universities often include development and instruction.

The remedy for this point is stated shortly below.

Sometimes such work may be done for a State or municipality. I believe that income from such a governmental contract is also intended to be excluded.

Therefore if the excluded work is intended to be all such work performed for Government, the remedy would be to insert on page 100 in line 20 after the word "research" the words "development or instruction performed for" and to insert on page 100 in line 21 after the word "agencies" the words "or for any State or municipality or any of their agencies."

4. Tax withheld on dividends

Under the bill (see p. 137 et seq.), 10 percent of all dividends payable to tax-exempt institutions is required to be withheld by the paying corporation and paid over to the Treasury, even though such dividends are exempt from tax.

There is no way in which the exempt institution can recover the withheld tax by credit so that it will be faced with the need of filing repeated claims for refund and facing the long delays before the Government acts thereon.

These refund claims would be filed under provisions of the law not contained in the present bill. Assuming that dividends are paid throughout a year it would

probably be at the earliest from 3 months to 15 months after the withholding before the withheld tax could be recovered by the tax-exempt owner, and apparently no interest would be allowed.

In effect this would mean that the university would be permanently deprived of 10 percent of its dividend income for an average period of more than 6 months. This deprivation can amount to a very considerable sum for an institution already under great financial pressure.

I have been informed that permitting an exemption certificate to be filed with the dividend-paying corporation to prevent the useless withholding would impose too great a burden on the paying corporation.

Therefore I suggest that the remedy should be an amendment of existing legal provisions for refund to permit a simple form of refund petition for recovery by a tax-exempt institution of such withheld tax, and to permit the filing of the same as soon as the withholding is made, without waiting for the end of a taxable year, and to require the Government to pay reasonable interest on the refunded amount unless it is refunded within 30 days after the refund petition is filed.

I realize that the drafting of the above provision would have to be done carefully in order to be coordinated with existing law, and therefore do not include here my own draft for this proposal.

5. Needless tax on exempt institutions based on their income from unrelated business

In my oral statements I have already emphasized the needlessness of imposing a tax on exempt institutions, particularly universities, on account of their net income from unrelated business, other than lease-backs.

The total volume of unrelated business so far carried on by exempt institutions has not, from a national point of view, been very large. Moreover almost all of such unrelated business has been carried on by feeder organizations.

This has been, and is likely to continue to be so, because few trustees of tax-exempt institutions would be willing to have such institutions incur the liabilities which would necessarily be involved in carrying on directly a substantially entirely unrelated business.

If such feeder organizations are made taxable, the desired result will be accomplished, without becoming involved in the enormous difficulties of computing the unrelated business income of tax-exempt institutions and without taking the dangerous step of beginning to impair—except as to lease-backs—the tax exemption under which these institutions, so valuable in the Nation, have grown up.

The bill itself furnishes a cogent analogy for the above suggestion. Under it no church is subject to tax on any unrelated business income (see p. 97, line 20).

On the other hand a feeder organization, through wholely owned by a church, is subject to tax.

Universities, hospitals, and other nonprofit institutions rendering educational, health preserving, and other such work on a nonprofit basis should be accorded the same treatment.

I believe that this approach to the problem would cost the Government very little in taxes, and would save it and the universities and other charities great expenses.

If at any future time it was found that this course was costing the Government substantial taxes the law could then be amended.

The amendment of the present bill to accomplish the above suggestion would be wordy, and could be made in a number of different ways.

One way to accomplish the object would be to limit the definition of unrelated business net income as set forth in section 422 (see p. 99, line 6, et seq.) to the proper proportion of supplement U net lease income, which is added to unrelated business income by section 423 (d) (see p. 104, line 20, et seq.).

Respectfully submitted.

J. R. KILLIAN, Jr.

NOTE.—All references to pages and lines of the bill are to the draft submitted to the Committee of the Whole House, June 23, 1950.

Senator TAFT. I think you might develop a little this business about unrelated businesses. Just what does the statute do and how do you propose that it be changed? What does this bill do now?

Mr. KILLIAN. This bill says that unrelated business activities carried on by a charity, university, or college, whether it is held by a separate entity or feeder or directly by the university, are taxable.

There is a complicated provision for determining what is income, which includes the income from this unrelated business enterprise.

Senator TAFT. The difficulty comes in the definition of unrelated business?

Mr. KILLIAN. That is correct.

Senator TAFT. Do you object to the definition if we do approach it from that connection?

Mr. KILLIAN. I think the definition in the bill as now drawn, provided you take this approach, is very skillfully drawn except for these several technical provisions.

Senator TAFT. Was it worked out with university representatives?

Mr. KILLIAN. Not to my knowledge.

Senator TAFT. To my mind it seemed to be rather protective to universities, as I read it over.

Mr. KILLIAN. If this approach is taken that you are going to break down the tax exemption and go in and try to make a distinction between one kind of income and the other, then the bill is very well drawn and drawn with the interest of the charity itself in mind.

Senator TAFT. One question that interests me is the question of investments in real estate. Is there any danger under the bill that ordinary investments in real estate will be considered an unrelated business?

Mr. KILLIAN. I do not see that there is any danger of that kind in the present bill. I think the lease-back provisions in this bill are again very carefully drawn.

Senator TAFT. I know of a case where the University of Cincinnati owns a building which contains a theater and two stores and they have three separate leases covering that building. Do you feel that under the terms of this bill that would still be an investment and not a business?

Mr. KILLIAN. Yes, provided they have not borrowed money to hold these leases.

Senator TAFT. That is the lease-back question.

Mr. KILLIAN. That is correct.

Senator TAFT. Suppose, however, that a corporation attempts to run an office building with 100 or 150 tenants and in the operation of the business, in the operation of selling light, heat, and so forth; is that unrelated business?

Mr. KILLIAN. I think there are probably a lot of real-estate holdings of that kind where a charity holds a complete office building.

Senator TAFT. Ordinarily though, in my experience, it is leased as a whole to somebody to run.

Mr. KILLIAN. That is usually the case.

Senator TAFT. What do you think would be the effect of this law if they actually tried to operate the office building? Is that an unrelated business?

Mr. KILLIAN. I think they could very easily handle that by passing it along to another agency to operate. I think the universities have a remedy on that.

Senator TAFT. Mr. Stam, what do you think about that?

Mr. STAM. That would be out because they are getting money from rents and it is pretty difficult to distinguish between a case where the university operates directly and where it just collects rent through an agent.

Senator TAFT. So that under the terms of the bill passed by the House that operation would not be unrelated; that would be an investment rather than an unrelated business?

Mr. STAM. That is right.

Senator MILLIKIN. Even though the university itself ran the office building?

Mr. STAM. That is right.

Senator TAFT. Where the income is all from rents?

Mr. STAM. Yes.

Mr. KILLIAN. I can give you another example. A university was left a hotel in a will. Now, that university undertook to get rid of that hotel as fast as it could without a sacrificial sale because it did not want to operate a hotel business.

Senator TAFT. Would a hotel be an unrelated business or not?

Mr. KILLIAN. The operation of a hotel as a hotel, I should think, would be an unrelated business.

Senator KERR. If they leased the hotel to some operator, then their rental income from the lease would not be unrelated business, as I understand it?

Mr. KILLIAN. That is correct, but the income from the operation of the hotel, the hotel being a separate entity, certainly should be taxed under our general concept.

Senator MILLIKIN. There are instances, I believe, where universities have received patents and have drawn quite a few royalties from those patents.

Mr. KILLIAN. I would interpret that as related income under the bill. That is an investment. It is treated like investment income under this bill. I do not think there is a great volume of that kind of thing except in the case where the patents are held by a separate feeder corporation.

Senator BUTLER. Mr. Chairman, there is another type of income that is more prevalent in the Western States than in the Eastern States. That is income from real-estate investment, I mean farms where the institution is the landlord and the tenant shares the crop with the institution. Would that be considered nontaxable?

Mr. KILLIAN. I would say that the farm operated as a part of the agricultural school and helping to contribute to the program of the agricultural school ought to be a related business operation.

Senator BUTLER. That is not the case. This is a case where the college owns 50 or more farms and leases them to individuals. The tenant operates the farm.

Senator MARTIN. Are the farms an investment?

Senator BUTLER. The farms are part of the endowment of the institution.

The CHAIRMAN. That would be exempt, Senator, under the bill, as I interpret it, as rents and royalties.

Mr. KIRBY. Yes; that would be treated as rents. Under your example I gather there was a lease to the actual operator of the farm.

Senator KERR. Even though the income was in the form of a share of the production, it would still be rent?

Mr. KIRBY. The question would be to determine whether it was rent that was received. I think in the Senator's example that would be rent.

Mr. KILLIAN. Mr. Chairman, as I understand it the bill is so written that churches are treated in the way we are proposing that universities be treated. In other words, they own a feeder corporation. The feeder corporation pays taxes but the church directly, itself, is not taxed. We are suggesting that the universities and colleges be treated in the same way.

Senator TAFT. If we had control over the chartering of universities, we could simply say they could not do that, but the States do that. The States could set up universities to do anything and avoid the whole question. I do not know what the evidence is to prove it has been done. I do not favor passing something to deal with an imaginary abuse. I understood there were actually cases where universities operated these things in their own manner.

Mr. KILLIAN. All the major cases that I know of are held by separate feeder corporations and there is a remedy available. If this court decision holds, that already has been taken care of although that creates difficulties for colleges that have feeder corporations because the decision makes it retroactive over a period of time and that could seriously damage some of our institutions.

Senator MILLIKIN. The institutions have made long-range plans on the assumption that the exemption would continue?

Mr. KILLIAN. That is correct.

Senator MILLIKIN. I guess that is just their hard luck.

Mr. KILLIAN. The point I would like to emphasize is that all responsible universities are anxious not to do those things that would appear to be an abuse, an undue abuse with respect to the tax-exemption principle. I think it is fair to say they are prepared to police themselves so that they do not indulge in that kind of investment that would be improper and against the public interest.

Senator TAFT. You have spoken only of universities. I do not see how you can distinguish between universities and all sorts of gradually shifting educational institutions of varying character, besides a lot of charitable corporations, that have dividends. Are you asking for a special provision for universities?

Mr. KILLIAN. I have already distinguished between churches and other kinds.

Senator TAFT. I know that. That is different. You have a broad field of charitable corporations of different sorts and you have these semieducational institutions that shift over toward a more and more commercial basis.

Mr. KILLIAN. It depends on what their tax status is within their State, does it not, whether they are profit institutions or nonprofit institutions?

Senator TAFT. If you are asking it for universities on the special ground that universities will police themselves, I am suggesting that there a lot of institutions besides universities that will not police themselves and will not be policed. I am just wondering whether we can make a special provision drawing a line as to universities. Are educational institutions different from other cases?

Mr. KILLIAN. I think there are clear recognitions of what a true university and true college is.

Senator MILLIKIN. How about an ordinary business school where you learn bookkeeping and typing?

Mr. KILLIAN. Many of those are proprietary institutions; they are run for profit, so there would be no difficulty.

Senator TAFT. Pretty soon a fellow who is going to retire will set it up as a charitable institution and it will fall within the nontaxable class very rapidly.

Mr. KILLIAN. Surely.

Senator MILLIKIN. Of course, the student would get business experience operating an office building, for example.

Mr. KILLIAN. That is right.

The CHAIRMAN. Thank you very much, Doctor.

Mr. KILLIAN. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. George Fuller.

Mr. FULLER. Mr. Chairman, I would like to have Mr. Bahr, our tax expert, testify this morning. Henry Bahr is the secretary of our organization.

The CHAIRMAN. Is he testifying in lieu of your appearance?

Mr. FULLER. Yes; in lieu of my testimony.

STATEMENT OF HENRY BAHR, SECRETARY, NATIONAL LUMBER MANUFACTURERS ASSOCIATION, WASHINGTON, D. C.

Mr. BAHR. My name is Henry Bahr. I appear here in behalf of the National Lumber Manufacturers Association, 1319 Eighteenth Street NW., Washington, D. C., of which I am secretary. The National Lumber Manufacturers Association is composed of 16 regional associations, representing agencies, products, and regional groups of lumber manufacturers located throughout the United States.

This tax bill, H. R. 8920, proposes to amend section 115 (b) of the Internal Revenue Code by striking out the two sentences which permit tax-free distribution of dividends paid by corporations to their shareholders out of earnings, profits, or gain from an appreciation in value which accrued prior to March 1, 1913 (p. 53, line 14 of H. R. 8920). I have a complete statement reviewing the history of this exemption and setting forth reasons why the law should be retained as it now is, which I would like to file for the record.

The CHAIRMAN. Yes; it may be inserted in the record.

(The statement referred to follows:)

STATEMENT OF THE NATIONAL LUMBER MANUFACTURERS ASSOCIATION WITH RESPECT TO THE PROPOSED AMENDMENT OF SECTION 115 (B) OF THE ITERNAL REVENUE CODE AS CONTAINED IN H. R. 8920

H. R. 8920 proposes to amend section 115 (b) of the Internal Revenue Code so as to render taxable to corporate stockholders the distribution of earnings and appreciation in value of assets which accrued prior to March 1, 1913. This is in line with the recommendations made before the House Ways and Means Committee on February 3, 1950, in exhibit 4 submitted with the statement presented by the Secretary of the Treasury.

It is our opinion that this proposed amendment of existing law is unjustified, inequitable, and discriminatory.

THE STATUTE

Distributions of earnings and profits or from appreciation in value accrued before March 1, 1913, are not now taxable because of the following provisions in the Revenue Code:

"SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

"(a) *Definition of Dividend.*—The term 'dividend' when used in this chapter (except in section 201 (c) (5), section 204 (c), (11) and section 207 (a) (2) and (b) (3) (where the reference is to dividends of insurance companies paid to policy-

holders)) means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) *out of its earnings or profits accumulated after February 28, 1913,* or (2) out of the earnings or profits of the taxable year (Computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made. Such term also means any distribution (to the extent of its subchapter A net income, whether or not a dividend as defined in the preceding sentence) to its shareholders, whether in money or in other property, made by a corporation which, under the law applicable to the taxable year in which the distribution is made, is a personal holding company, or which, for the taxable year in respect of which the distribution is made under section 504 (c) or section 506 or a corresponding provision of a prior income tax law, is a personal holding company under the law applicable to such taxable year."

"(b) *Source of Distributions.*—For the purpose of this chapter every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated, earnings or profits. *Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax,* after the earnings and profits accumulated after February 28, 1913, have been distributed, *but any such tax-free distribution shall be applied against and reduce the adjusted basis of the stock* provided in section 113. The preceding sentence shall not apply to a distribution which is a dividend within the meaning of the last sentence of subsection (a)."

HISTORY OF THE EXEMPTION

The history and development of the pertinent parts of the above quotations from section 115 show that under the 1916 and subsequent acts provisions were inserted exempting from income taxation dividends declared out of earnings and profits and increase in the value of assets accrued prior to March 1, 1913. (See 1916 act as amended, sec. 31 (a); 1918, 1921, 1924, 1926 acts, sec. 201 (b); 1928, 1932, 1934, 1936, 1938 and subsequent acts, I. R. C., sec. 115 (b).)

Shortly after the enactment of the first Income Tax Act under the sixteenth amendment in 1913, the Commissioner of Internal Revenue announced that he would collect a tax on dividends declared by a corporation subsequent to March 1, 1913, even when the dividends were from earnings and accumulations developed prior to March 1, 1913. In January 1916, a Federal district court (in *Lynch* v. *Hornby*) reversed him and held, in effect, that such dividends were a distribution of capital and not subject to tax.

Congress confirmed the court's interpretation in the Revenue Act of 1916 by expressly limiting the definition of taxable dividends to distribution of earnings or profits accruing after March 1, 1913. The Supreme Court later, in 1918, reversed the lower court (*Lynch* v. *Hornby*, 247 U. S. 339) and held that dividends from pre-March 1, 1913, accumulations were constitutionally taxable; but, despite the technical constitutional basis for such taxation, Congress from 1916 to the present time has repeatedly rejected proposals to tax pre-March 1913 accumulations on the grounds of equity and fair treatment, bearing in mind matters of substance, as will be hereinafter pointed out. The attitude and intention of Congress are clearly reflected in the following language used by Senator Oscar W. Underwood in defense of the 1916 act, which is found in the Congressional Record of November 4, 1921:

"Mr. President, I had personally something to do with this legislation in its initial stages. There is no doubt in the world that the men who wrote the original bill and the Congress when they enacted it—at least, a majority of the Conress—were attempting to fix the status of the property throughout the United States so that the power to tax the increase—no matter what it was, earnings, profits on unearned increment—should begin on March 1, 1913, and that before that time it should be exempt. I do not think that there is a doubt in the world that that was the original intention. Of course, the recent decision of the Treasury Department puts a different interpretation on the case; but, to my mind, it is clearly not the interpretation which is proper, if the viewpoint of the men who passed the legislation has any weight in the decision of the question" (vol. 61, pt. 7, p. 7300).

Other significant statements explanatory of that congressional intent made in the Senate debate on November 4, 1921, are set forth in exhibit "A", hereto attached.

This question has been carefully studied by this committee and the Congress on many occasions in the past. In 1921, 1924, 1928, 1932, 1934, and 1942 it

was given extensive consideration. Since 1916, and for 34 years, a provision exempting from income taxation pre-March 1, 1913, earnings and increases in value of assets when distributed to corporate stockholders has been maintained.

In *Helvering* v. *Canfield*, 291 U. S. 163, 167, the Supreme Court mentioning *Lynch* v. *Hornby*, 247 U. S. 339, said that the provision under the 1916 and subsequent revenue acts above referred to was a "concession to the equity of stockholders" with respect to receipts as to which they had no constitutional immunity.

PRE-MARCH 1, 1913, SURPLUS IN SUBSTANCE IS CAPITAL

Accumulated earnings and increase in value of assets of a corporation accrued prior to March 1, 1913, in reality and for all practical purposes are in their very nature capital, and were so treated in *Lynch* v. *Turrish* (247 U. S. 22), decided June 3, 1918, the very day on which the case of *Lynch* v. *Hornby*, supra, was decided.

The material facts in *Lynch* v. *Turrish*, supra, are these: Prior to March 1, 1913, and continuously thereafter until the surrender of his stock as hereinafter mentioned, Turrish was a stockholder in the Payette Lumber & Manufacturing Co., which was organized in the year 1903, with power to buy and sell timberlands. Immediately after its organization this company began to invest in timberlands, and prior to March 1, 1913, had thus invested approximately $1,375,000.

On March 1, 1913, the value of its assets was not less than $3,000,000, of which sum the value of the timberlands was not less than $2,875,000. The increase was due to the gradual rise in the market value of the lands. At that date the value of the Turrish stock was twice its par value, or $159,975. Turrish had paid for this stock the sum of $79,975.

In 1914 the company sold all of its assets for a price which would make available for distribution to its stodkholders twice the par value of their stock. The cash was distributed to the stockholders on the surrender of their certifidates of stock, and the Payette Co. went out of business. In this way, upon the surrender of his shares, Turrish received $159,950.

The Commissioner of Internal Revenue held that one-half of the amount received by Mr. Turrish, or $79,975, was taxable to him as income for the year 1914 under the act of 1913.

The case finally reached the Supreme Court, and the Commissioner was overruled. The Supreme Court took the view that the entire amount received by Turrish was in effect a return of his capital. In sustaining its decision, the Court said:

"The district court and the circuit court of appeals decided that the amount so distributed to Turrish was not income within the meaning of the statute, basing the decision on two propositions, as expressed in the opinion of the circuit court of appeals, by Sanborn, circuit judge:

"(*a*) The amount was the realization of an investment made some years before, representing its gradual increase during those years, and which reached its height before the effective date of the law—that is, before March 1, 1913—and the mere change of form of the property 'as from real to personal property, or from stock to cash' was not income to its holders because the value of the property was the same after as before the change;

"(*b*) The timber lands were the property, capital and capital assets of their legal and equitable owner and the enhancement of their value during a series of years 'prior to the effective date of an income tax law, although divided or distributed by dividend or otherwise subsequent to that date, does not become income gains, or profits taxable under such an act.' "

The Supreme Court further said, referring to *Gray* v. *Darlington*, 15 Wall. 63:

"If increase in value of the lands was income, it had its particular time and such time must have been within the time of the law to be subject to the law; that is, it must have been after March 1, 1913. But, according to the fact admitted, there was no increase after that date and, therefore, no increase subject to the law. There was continuity of value, not gain or increase. * * *

"And again, 'The mere fact that property has advanced in value between the date of its acquisition and sale does not authorize the imposition of a tax on the amount of the advance. Mere advance in value in no sense constitutes the gains, profits, or income specified by the statute. It constitutes and can be treated merely as increase of capital.' This case has not been since questioned or modified * * *.

"Besides, the contention of the Government does not reach the principle of *Gray* v. *Darlington*, which is that the gradual advance in the value of property

during a series of years in no just sense can be ascribed to a particular year, not therefore as 'arising or accruing,' to meet the challenge of the words, in the last one of the years, as the Government contends, and taxable as income for that year or when turned into cash. Indeed, the case decides that such advance in value is not income at all, but merely increase of capital and not subject to a tax as income."

The same conceptions of accumulations that accrued to a corporation through surplus earnings or appreciation in property value before the adoption of the sixteenth amendment (February 1913) as being capital and not income for the purposes of the Income Tax Act of 1913 is indicated in the case of *Southern Pacific* v. *Lowe* (247 U. S. 335), decided June 3, 1918. In that case, the court said: "* * * we are bound to consider accumulations that accrued to a corporation prior to January 1, 1913, as being capital, not income, for the purpose of the act. And we perceive no adequate ground for a distinction, in this regard, between an accumulation of surplus earnings, and the increment due to an appreciation in value of the assets of the taxpayer."

The Supreme Court in *Lynch* v. *Hornby* on very technical grounds decided that under the Income Tax Act of 1913 dividends declared and paid in the ordinary course by a corporation to its shareholders after March 1, 1913, out of surplus accumulations before that date, were taxable to the individual shareholders as income. The distinction made by the court between *Lynch* v. *Hornby* and *Lynch* v. *Turrish* is a very tenuous one, and very difficult to justify from the standpoints of reality and practicality. In fact, the distinction rests entirely upon the following facts as recited by the Court:

"In the present case there was no winding up or liquidation of the Cloquet Lumber Co., nor any surrender of Hornby's stock. He was but one of many stockholders, and had but the ordinary stockholder's interest in the capital and surplus of the company; that is, the right to have them devoted to the proper business of the corporation, and to receive from the current earnings or accumulated surplus such dividends as the directors in their discretion might declare." Here the court found a constitutional basis for the tax imposed. It is obvious that Hornby was penalized because a corporation in which he held stock was not liquidated, but instead it kept the pre-March 1, 1913, surplus in a going business. His proportion of the accumulated surplus was taxed to him as income, and not capital, although it was when realized readily identifiable as such. In poiut of substance, what difference should it make that a stockholder (as in *Lynch* v. *Turrish*) realizes the pre-March 1, 1913, surplus by a corporate liquidation after that date instead of (as in *Lynch* v. *Hornby*) realizing it by virtue of the fact that the corporation after that date operates the assets in which the surplus inheres and sets aside for distribution the proceeds of such operation? There is no difference when the standard of fair and equal treatment is applied.

The reasoning of the Supreme Court as finally announced in the Hornby case, was anticipated by the Congress, and was renounced by it when it enacted the 1916 Revenue Act.

ARGUMENTS AGAINST SECRETARY SNYDER'S PROPOSAL

On March 31, 1942, the National Lumber Manufacturers Association, speaking through Hon. William S. Bennet, made a presentation to this committee in opposition to the same proposal that is now being made by Secretary Snyder. This presentation is found at page 1691 et seq., in volume 2 of the hearings before the Ways and Means Committee on Revenue Revision of 1942. In this presentation are found arguments against the proposal that are just as valid and cogent today as they were in 1942.

Beginning on page 1698 of volume 2 of the hearings above referred to is set forth a verbatim copy of a statement by the National Lumber Manufacturers Association in opposition to a similar proposal to amend section 115 made in the Congress when the revenue bill of 1928 was up for consideration. A copy of this statement, marked "Exhibit B" is hereto attached. The arguments made in that statement, with some amplification, may be profitably reviewed and summarized at this time.

1. Secretary Snyder's proposal amounts to a serious and fundamental departure from a principle heretofore consistently followed in Federal income tax legislation. It has been followed for 34 years.

2. March 1, 1913, has long been definitely established in the law and in the concepts of the Congress as the dividing point between property (capital) and income for purposes of Federal taxation. Earnings and profits, and increase in the value of property accrued prior to that date have been properly treated as capital, and not subject to tax whenever or however realized, or to whomsoever distributed in dividends.

3. Secretary Snyder's proposal, if adopted, would result in the imposition of discriminatory tax burdens:

(*a*) Only corporation stockholders are affected by the change. Constitutional limitations on the powers of Congress would of course nullify any similar legislation affecting individuals and partnerships. The proposal discriminates against those who have chosen to accumulate savings by means of corporate investments.

Individuals and partnerships may dispose of their property assets held on March 1, 1913, and pay only a capital-gain tax on the excess of price received over the value of that date. They pay no tax whatsoever on appreciation in value accrued prior to that date.

(*b*) It discriminates against the stockholders of those corporations that have kept their pre-March 1, 1913, surpluses in the business and used them to expand industry for the purpose of increasing the economic strength of the country.

Only the stockholders in conservative and thrify corporations which instead of extracting from their business all earnings and profits as soon as accumulated, make use of these profits as new capital, thus creating new worth and new opportunities for employment, and thus contributing to the progress and industrial welfare of the country. Stockholders in improvident corporations, and those corporations which have relied on borrowings instead of saving to provide for their development and expansion, would not be affected by Secretary Snyder's proposal. They already have received their distributions tax-free. The proposed change therefore would be a penalty upon the very type of financial investment conservatism which is recognized as primarily responsible for the great industrial and commercial progress of the people of the United States, at least since the 1916 Revenue Act was passed.

4. Since the Revenue Act of 1917 a corporation has not had a fair opportunity to distribute its earnings and increase in value of assets accrued prior to March 1, 1913, free of income taxes in the hands of its stockholders. In order to take advantage of the exemption from income taxation it must first have distributed all earnings accumulated by it since February 28, 1913. Thus a corporation is required to keep itself "stripped to the bone" in order that its stockholders may avail themselves of the exemption in the 1916 Revenue Act. If it did so strip itself, and then distributed whatever pre-March 1, 1913, surplus it had, no argument is needed to show that its potentiality as a soundly financed and growing concern would be severely crippled, if not destroyed.

It is a matter of common knowledge that all well managed corporations, especially those which envision growth, must devote a certain portion of each year's income to betterments, additions, and general business expansion.

In this connection it must be remembered that pre-March 1, 1913 accumulations, especially in the case of those engaged in holding and developing natural resources, of necessity have been invested in such resources and in plants, equipment, lands, and other working assets. Such properties are not easily convertible into cash, nor distributable in kind. Such dispositions would speedily wreck the corporation.

5. Enactment of Secretary Snyder's proposal would constitute a breach of faith with stockholders, who, in reliance upon the 1916 and subsequent revenue acts, have sanctioned keeping the pre-March 1, 1913, surpluses in the business.

Their contribution to constant industrial growth and the economic strength of the country should not be thus penalized.

If stockholders insisted that corporations distribute not only all their earnings but also accumulated backlogs of capital, the industrial potentiality of the country would present a different picture than what we have today.

6. Alleged simplification of tax computation and collection procedures by adoption of Secretary Snyder's proposal is illusory. Pre-March 1, 1913, earnings and appreciation in values have already largely been determined. Where they have not been it is still necessary to go far in determining them for purposes of administering other sections of the Internal Revenue Code. However that may be, simplification in income tax procedures should not be attained at the price of inflicting unfair and discriminatory treatment upon taxpayers.

7. Adopting Secretary Snyder's proposal would not be closing a loophole in the revenue laws, as suggested by him. It would be gouging out from the code a provision which, after full and mature deliberation, Congress put there in 1916 and has since kept there in the face of all of the repetitive arguments now being urged against it.

EXHIBIT A

(Excerpts from Senate debate on November 4, 1921, found in vol. 61, pt. 7, Congressional Record, pp. 7299, 7300, 7301, 7302, and 7305)

Mr. BROUSSARD. I have here Bulletin No. 43-21 with reference to this particular matter, issued October 26, 1921, by the Bureau of Internal Revenue. This applies to the existing law. If the Senator will permit me, I think we might save a little time by presenting this matter now.

Mr. LENROOT. I yield for that purpose.

Mr. BROUSSARD. Here is the case upon which the decision was argued. I read two brief paragraphs:

To illustrate the point, the M corporation purchased capital assets in 1910 for $10,000. On March 1, 1913, these assets had a value of $20,000. In the year 1918, or a subsequent year, the M corporation sells these assets for $20,000 and distributes the $10,000 realized gain to its stockholders as dividends. The question asked is whether the $10,000 thus distributed is taxable as income to the stockholders.

The decision answers that, and before I read it I wish to go over the figures again. These stocks were purchased for $10,000 in 1910 and on March 1, 1913, the assets had a value of $20,000.

In the year 1918 this party sells the identical stock for $20,000. This is a case, by the way, submitted under the existing law. Here is the decision rendered under such a state of facts:

For the reasons above stated it is concluded that profit made by a corporation in 1918 or subsequent years from the realization of appreciation of corporate assets accrued before March 1, 1913, is taxable income to the stockholder when distributed as a dividend in 1918 or subsequent years.

Now, it would appear to me that that is a clear misinterpretation of the existing statute. The property was acquired in 1910 for $10,000. On March 1, 1913, its value was $20,000, and in 1918 the stock was sold for $20,000, and still under the existing statute, as I interpret this, because the decision was rendered in October 1921.

Mr. HARRISON. That is the opinion of the Treasury Department? It is not the opinion of any court?

Mr. BROUSSARD. No; it comes from the Treasury Department. It would seem to me that the interpretation of existing law is very much broader even than the amendment which the Senator from Wisconsin proposes. I have no doubt that when this opinion is taken to court it will not stand, because under the facts admitted, as I understand the amendment of the Senator from Wisconsin, there would be no tax due in such a case under the Senator's amendment. Is not that correct?

Mr. LENROOT. There would be no tax paid at all.

Mr. BROUSSARD. Therefore, it would seem that if the intention of the Senator from Wisconsin is to set at rest the meaning of the existing statute, the Senator should first insert something in his amendment in order to make it known to the Treasury Department that the amendment offered by him is merely for the purpose of interpreting the existing law; otherwise, if that were not stated, the Treasury Department might take the position that any distribution of funds or transaction in stock made prior to the enactment of the amendment which is proposed by the Senator from Wisconsin is taxable under the decision to which I have just referred. I think no one before this decision ever believed such a case would present a just claim on the part of the Government to ask for a tax on income.

* * * * * * *

Mr. UNDERWOOD. Mr. President, I discussed this question rather briefly the other day and I do not intend to take much of the time of the Senate for further discussion. By a very decisive vote the Senate, in Committee of the Whole, decided the question some days ago, and I thought conclusively, fixing the time for the operation of the income tax on gains and profits as the 1st day of March 1913. But for some reason the question continues to arise; and the reason evidently is that there are gentlemen in the Treasury Department and gentlemen in the Senate who believe that the taxing power of the Government ought to reach behind the 1st day of March 1913 to accumulate income taxes for the benefit of the Government. That is evident from the decision to which the Senator from Louisiana (Mr. Broussard) just referred, and which I hold in my hand.

Mr. President, I had personally something to do with this legislation in its initial stages. There is no doubt in the world that the men who wrote the original bill and the Congress when they enacted it—at least a majority of the Congress—were attempting to fix the status of the property throughout the United States so that the power to tax the increase—no matter what it was, earnings, profits on unearned increment—should begin on March 1, 1913, and that before that time it should be exempt. I do not think that there is a doubt in the world that that was the original intention. Of course, the recent decision of the Treasury Department puts a different interpretation on the case; but, to my mind, it is clearly not the interpretation which is proper if the viewpoint of the men who passed the legislation has any weight in the decision of the question.

* * * * * * *

Mr. McCumber. The amendment which has been handed to me is as follows:

On page 7, line 14, after the word "accumulated," to insert "or increase in value of property accrued."

Mr. Underwood. I think that language covers it—"or increase in value of property accrued."

Mr. McCumber. Yes.

Mr. Underwood. That undoubtedly would cover the unearned increment. I should be very glad to support the amendment when the opportunity comes, and hope that it will be adopted. I shall not detain the Senate longer, as the acting chairman of the committee proposes to offer the amendment, which I think goes to the real merit of the case, except to say that if the Congress should accept the decision of the Treasury Department in this matter, taking the viewpoint that when we used the words "earnings or profits accumulated prior to March 1, 1913," we did not mean the unearned increment, and it should not be included in this legislation, we would thereby harass the American people almost as greatly as they would be harassed by a war.

Just visualize the situation for a moment. Here is a man who bought a piece of city property, say in 1900, for $100,000. In 1913 it had increased in value to $200,000. Now, 8 or 9 years have run by and the time comes for him to sell that property. He sells it for $200,000. The entire increase in value occurred before the income tax amendment to the Constitution was adopted by the people of the United States; and yet it is proposed to go back and apply the heavy and severe taxes growing out of the recent war to the accumulations which came to him by the increased value of his property. Such action might halfway destroy an estate.

Of course, I realize that there are those who believe in the theory of government and the theory of taxation that no man is entitled to the unearned increment of his property; that if he was fortunate enough to buy a lot close to a growing town and it becomes a city and he finds himself in his old age with a piece of city property in his possession instead of a country town lot, the increased value of the property does not belong to him because he did not earn it. Of course, he earned it by paying taxes on it, by holding it, by using it. I will not go into that theory; it is not a theory to which I subscribe; but if the Congress of the United States is going to adopt the theory that the unearned increment does not belong to the citizen, let us do so as a matter of legislative policy and not by backing up an ill-considered decision of the Treasury Department.

Mr. Moses. Mr. President, inasmuch as I have stated the sole objection which could be offered against the amendment which has been proposed by the Senator from Wisconsin [Mr. Lenroot], and since that Senator has intimated that he will make a feebler resistance than he ordinarily displays on a proposition which he opposes on the floor to the amendment which I am about to offer to his amendment, I now move to amend the amendment of the Senator from Wisconsin in line 11, on the first page, by striking out the words "since February 28, 1913," and inserting in lieu thereof the words "subsequent to the passage of this act."

Mr. Broussard. Mr. President, I discussed very briefly this matter when it was under consideration in connection with the amendment offered by the majority of the committee. I stated at that time—and I wish to repeat very briefly what I then said—that I cannot distinguish between the original investment and the accrued and undivided profits which were on hand on March 1, 1913. If there was $100 invested originally on that date and the assets would justify a value of $200 per share, all of that, in my opinion, is necessarily capital, because the Congress cannot take the position because on February 28, 1913, the $100 was not distributed and thereby would escape future taxation except when reinvested that that would distinguish it from the undivided profits. I think that all of it is capital. Under what theory does the Congress pretend that it is just to reach back of March 1, 1913, and to apply the income-tax principle to one of

the hundred dollars, when both of them are capital? If no tax may be levied against the original investment, as that investment and the accretion are not distinguishable one from the other, and both are capital, both of them should be exempt and be tax free from any subsequent tax.

The $100 of undivided profits has remained in the corporation; it has produced revenue, and that revenue produced from that $100 of undivided profits has to pay a tax the same as the other and original investment of $100, and there is no period when you can stop and say, "This is the $100 that must be taxed and this is the $100 that should be exempted because it was the original investment." That is absolutely impossible, so that, Mr. President, it would appear to me that when the Congress decided that for the purpose of assessing the income tax the value of the property as of March 1, 1913, was absolutely correct, and any attempt to go back of that under any excuse or theory is a violation of that correct principle.

* * * * * * *

Mr. UNDERWOOD. I think the difficulty in the situation is that in the amendments that have been proposed by the committee, which go further than the amendment proposed by the Senator from Wisconsin and enforce his amendment, they are trying to fix the status of the property on the ownership of the individual, whereas the ownership of the individual ought to have nothing whatever to do with it. The status of the property on the 1st day of March 1913 ought to establish the whole situation.

Mr. BROUSSARD. Absolutely.

Mr. UNDERWOOD. Therefore, we ought not to consider these amendments.

Mr. MOSES. The attempt, if I get the Senator's point, is to change the policy which was established by the statute which the Senator had a part in framing 8 years ago, and to set up now the doctrine that this accumulated capital may be taxed—a doctrine to which I do not subscribe.

Mr. FLETCHER. To make the law retroactive, in other words.

Mr. MOSES. Yes.

Mr. BROUSSARD. Mr. President, I desire to conclude my remarks, and I refuse to yield further.

It would appear to me that the situation that is presented here by the explanation of the Senator from Wisconsin in justification for offering this amendment is already covered under the present law, because if we accept as a basis the valuation of the property on March 1, 1913, then we may treat any transaction dealing with these stocks just as though we were buying any other sort of property, such as real estate or any other property which might be bought one day and sold the next day. The Government, under the present law, reserves the right upon the making of that return to investigate the true value, and it does that very thing, so that there is no reason to go back of March 1, 1913, in any instance; but here is the injustice that I desire to call to the minds of Senators:

It has been established by the Congress under this income tax law that the valuation of property as of date March 1, 1913, was to be the basis, and that everything belonging to a corporation on that date was capital. People have been buying stocks ever since, and they have acquired these stocks under the assumption that the Congress had decided something permanently, and there was no discount to cover this tax in these transactions up to this time. If a man wanted to buy stock he acquired it, say, at $300 a share, and if he sold it for $400 he made a return for a profit of $100 never taking into consideration any of the earnings which had accrued prior to March 1, 1913, because the Congress had very equitably decided that everything was to be valued as of date March 1, 1913. If the Congress is about to change its mind now, after all these transactions have been taking place since March 1, 1913, and people in good faith have acquired these stocks, and then they are about to dispose of them, and there is a question as to whether or not the Government will go back so as to find out what the undivided profits were before March 1, 1913, my opinion is that we are going to interfere with transactions which have been made under the law in good faith, and for that reason I think we should permit the law to remain as it is.

There is just one other fact that I want to call the attention of Senators to before I conclude.

We find that a decision was rendered here on October 26, 1921, with reference to this very subject under the existing law, so that we are convinced now that it takes years for the Treasury Department to get at a correct interpretation of a law. Everybody on this floor, I think, will dissent from that opinion. I do not think any Senator on this floor would hold that that is a correct opinion, and still the Treasury Department has been working on this very subject now for several years, and the business people of this country are not yet acquainted with what

the Treasury Department will hold to be the meaning and the intent of Congress with reference to this particular question. Therefore, when the question is on its way for a definite settlement—because I am certain that this decision will be taken into the courts and will be reversed—why should we reopen it by changing it, and by inference, indicating that the Congress has some desire to go back of the principle which it has established as the basis for the computation of income-tax returns as of March 1, 1913?

* * * * * * *

Mr. McCumber. Mr. President, I now move to amend subdivision (b) of section 201, page 7, line 14, by inserting, after the word "accumulated," the following:

Or increase in value of property accrued.

This will need only slight explanation. The Senator from Alabama has already alluded to it. The old law reads about as follows:

For the purpose of this act every distribution is made out of earnings or profits, and from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913; but any earnings or profits accumulated prior to March 1, 1913, may be distributed exempt from the tax, after the earnings and profits accumulated since February 28, 1913, have been distributed.

It was understood, I think, by all of us and by the country generally that the mere increase in the increment value of the property prior to March 1913 was really a part of the undistributed earnings prior to March 1913; but lately a decision has been rendered by the Treasury Department which was made as late as October 26, 1921. I need only quote from this decision the following:

The expree exemption—that is, applying to the old law, which I have just read—

The express exemption applies to "earnings and profits" accumulated prior to March 1, 1913; and, as has already been demonstrated, these terms do not include unearned increment.

We have always supposed that they did.

A distribution like that under consideration in this case is not, therefore, within the exemption. For the reason above stated, it is concluded that profit made by a corporation in 1918 or subsequent years from the realization of appreciation of corporate assets accrued before March 1, 1913, is taxable income to the stockholders when distributed as a dividend in 1918 or subsequent years.

As that clearly was not the intent of Congress, and to make it clear that, no matter how distributed, if the distributee does not receive any more than his stock was worth on the 1st day of March 1913 all of that sum will be free from taxation, no matter what he may have paid for that stock any number of years prior to 1913, I proposed to amend this provision by inserting the words I have given after the word "accumulated," on page 7, line 14. It will then read:

"But any earnings or profits accumulated or increased in value of property accrued prior to March 1, 1913, may be distributed free of taxation."

That is practically all there is in the proposition.

Mr. Simmons. Mr. President, I wish to say that this decision or ruling of the department was brought to my attention, and it was my purpose to introduce the amendment which the Senator has just introduced, and I trust that it will be agreed to. It is clearly the meaning that we had in mind at the time we adopted the original provision which we have reenacted in this section.

Exhibit B

Statement of the National Lumber Manufacturers Association in Opposition to Section 115 of the Revenue Bill of 1928 Which Proposes To Tax Distributions by Corporations From Surplus Accumulated Before March 1, 1913

To the Honorable Members of the Senate Finance Committee:

Section 115 of H. R. 1, revenue bill of 1928, as referred to the Committee on Finance of the Senate of the United States, proposes a serious and fundamental departure from the principle heretofore consistently followed in Federal income-tax legislation, in its proposed treatment of distributions by corporations from earnings and profits accrued or increase in value of property accumulated prior to March 1, 1913.

Section 115 of the revenue bill of 1928 proposes to wipe out the distinction made in section 201 (the corresponding provision) of the Revenue Act of 1926, and all prior acts, between earnings and profits accumulated before and those accumulated after March 1, 1913. The effect of the change is to impose a tax on distributions to stockholders paid out of surpluses accumulated before Congress had even the constitutional authority to levy an income tax—merely as though such distributions were income to the stockholder for the year in which distribution is made.

This proposal would directly reverse a cardinal principle of taxation, recognized in all previous revenue laws, and on which taxpayers, the Treasury Department, and Congress have for a dozen years been satisfactorily working, and which has been repeatedly and emphatically reaffirmed after careful consideration and debate in successive Congresses. That principle is that the property accumulated prior to March 1, 1913, by the people of the United States, whether through the agency of a corporation or otherwise, is capital and as such should be distributed exempt from tax, at any time and in any form.

THE PRINCIPLE OF MARCH 1, 1913, VALUES

The date, March 1, 1913, has been definitely established in the law, and in the practice of Congress, as the dividing point between property (capital) and income for purposes of Federal taxation. Earnings and profits, and increase in value of property accrued prior to that time have been properly treated as capital and not subject to tax, whenever, however, or to whomsoever distributed in dividends. Similarly, earnings and profits, and realized increases in value of property accrued after March 1, 1913, have been considered as income, and therefore taxable in accordance with the law.

There is no way in which an "income" tax may be imposed upon that which on March 1, 1913, constituted capital without doing violence to this sound and fundamental principle of congressional legislative policy defining the lawful and proper objects of income taxation. No tax such as is contemplated by section 115 of the revenue bill of 1928, is defensible in law, equity, or fairness. It is in direct conflict with the recognized principle adhered to since the income tax became operative. Insofar as it applies to surpluses accumulated before March 1, 1913, it is a tax on capital. It is more than that—and worse. It is a tax on thrift practiced in corporate form by millions of individual shareholders.

BURDEN OF THE PROPOSED CHANGE

Only corporation stockholders are affected by the change. Constitutional limitations on the powers of Congress would, of course, nullify any similar legislation affecting individuals and partnerships. The proposal, therefore, discriminates against those who have chosen to do their saving by means of corporation investments.

All corporation stockholders are equally affected to the extent of their respective interest in undistributed pre-1913 corporation surpluses. But the immediate burden of the proposed tax would fall most heavily, of course, on stockholders in corporations having a limited operating lifetime. These include primarily the natural-resources industries such as timber, mining, oil, and paper companies in which eventual liquidation and the distribution of assets to stockholders is inevitable. The proposal, therefore, although it involves stockholders of all corporations in business before March 1, 1913, would more immediately affect and discriminate against stockholders in certain types of corporate business.

Only the stockholders in conservative and thrifty corporations which, instead of extracting from their business all earnings and profits as soon as accumulated let these profits serve the purpose of new capital, thus creating new wealth and new opportunities for employment, providing for future expansion and contributing to the progress and industrial welfare of the country, are affected. The stockholders in improvident corporations and those corporations which have relied on borrowings instead of savings to provide their development and expansion would not be affected. They already have received their distributions—tax-free. The proposed change therefore is a penalty upon the very type of financial and investment conservatism which is recognized as primarily responsible for the great industrial and commercial progress of people of the United States during the last quarter century.

EXAMPLE OF EFFECT OF PROPOSED CHANGE

The exact effect of the proposed change may be illustrated by taking for an example a mining or timber or land company whose stock represented an original cash investment of $100 a share in 1900. In many such companies, by March 1, 1913, each share of stock had acquired a book value of as much as $300 a share, due to increase in the value of its property accrued during the intervening period and to the reinvestment by the company of earnings and profits as new capital.

Since the beginning of the income-tax law, this accumulation of earnings and profits has been uniformly recognized as capital and has been exempt from tax when distributed to stockholders. Under the new revenue bill each stockholder receiving his share in the distribution of this capital would have to pay tax on $200 for each share, all of it earned before the income-tax law went into effect, in fact before Congress had the constitutional power to impose an income tax.

CHANGES ENTIRELY UNEXPECTED

The proposed change was, it is generally understood, not suggested by the Treasury Department and is not now favored by it. Nor so far as public announcement has been made, was the change discussed by the Joint Committee on Internal Revenue which was charged with studying for the Ways and Means and the Finance Committees a plan for the simplification of the law; nor by its advisory committee. No mention was made of it during the public hearings before the Ways and Means Committee held shortly before the opening of Congress. The change was made during the executive sessions of the Ways and Means Committee. The details of its adoption are of course not known. But manifestly the vast majority of the Members of Congress, and members of the committee itself had no idea that, in a widely published tax-reduction bill, it was imposing new and additional income taxes on distributions of capital, consisting of corporation surpluses accumulated before March 1, 1913. The explanation of this provision by the committee itself in reporting the bill makes this fact manifest.

REASONS STATED FOR PROPOSED CHANGE

The public notice of the reasons for the change was made in a short paragraph contained in the report on the bill by the Ways and Means Committee. This paragraph in full is as follows:

"Under previous revenue acts corporate distributions from surplus accumulated prior to March 1, 1913, were exempt from tax. There appears to be no reason for continuing this exemption indefinitely. Over 14 years have elapsed since March 1, 1913, and most corporations have distributed the surplus accumulated by them prior to March 1, 1913. It seems an appropriate time (particularly in view of the resulting simplification) to eliminate this exemption."

This argument in substance is (1) that corporations have had 14 years in which to distribute their pre-1913 surplus; (2) that most corporations have done so; (3) that there is no reason for continuing the exemption indefinitely; (4) that this seems an appropriate time in view of resulting simplification to eliminate the exemption.

Each of these four statements is inaccurate. It is inconceivable that the provisions of the existing law would have been eliminated had the complete facts been before the Members of Congress at the time of voting on the bill. These facts would have been made readily available had the Ways and Means Committee, prior to its public hearings, indicated its intention or desire to consider changes in this respect in the existing law.

CONCERNING OPPORTUNITY TO DISTRIBUTE SURPLUS

1. Corporations have not had 14 years of opportunity to distribute their pre-1913 surpluses. For 4 years (or until 1917) they could "earmark" dividend distributions as coming from pre-1913 surplus, but during those years few such distributions were made. Since 1917 the revenue acts have prohibited corporations from making any distributions out of their pre-1913 surplus until they had distributed all of their earnings or surplus accumulated since that time.

It is true, numerically, that 14 years have elapsed since the income-tax law went into effect, but it is equally true, and much more important, that during the last 10 of these 14 years corporations have been prohibited from distributing their pre-1913 surpluses unless they wanted to liquidate and quit business. And it should not be overlooked that pre-1913 surpluses retained by corporations are not in the form of stocks, bonds, cash, or other property easily converted into cash.

In practically all cases they have been invested in plant, equipment, lands, mineral ore and timber resources, and working assets. Distribution would require conversion into cash of assets which in many if not most instances cannot be so converted without liquidating the business.

CONCERNING EXTENT OF SURPLUSES NOT DISTRIBUTED

2. The fact is that, practically without exception, corporations which are still in business have not distributed their surpluses accumulated prior to March 1, 1913. If corporations generally had made such distributions, they would have been unable to expand their operations as they have done during recent years. This expansion has been the principal source of national economic prosperity and of the great increase in Federal revenues since derived from the tax on corporation incomes.

It is a matter of common knowledge that it is the practice of every well-managed corporation, including banks, mercantile establishments, factories, and stores, to put a certain portion of each year's income into additions, betterments, and expansions, and to pay dividends out of such moneys as are not required for those purposes. That is the practice under which the business of the country has grown. If each corporation each year had distributed all its earnings and dividends, there would have been little progress. One of the purposes of a corporation is to provide the means whereby the capital contributed by the stockholders can be used not only to earn immediate dividends for the stockholders but to enlarge the business. Since no solvent corporation since the passage of the act of 1917 has been permitted to distribute its pre-1913 profits until its profits earned since 1913 have been distributed, it is safe to say that there is no solvent prosperous going corporation in the United States which has distributed the surplus accumulated by it prior to March 1, 1913.

CONCERNING CONTINUATION OF EXEMPTION INDEFINITELY

3. The third assertion is that there is no reason for continuing this exemption indefinitely. No argument or fact is cited to support this statement. The assertion is, in fact, unsupportable by facts because unsound. Accumulated and undistributed pre-1913 surpluses are serving useful purposes in the hands of corporations. Why should corporations not continue to use such surpluses as long as good business dictates? On what plea of public interest or Government policy does Congress propose to stop such use and what beneficial results will flow therefrom? And entirely aside from the valid and sound reasons for continuing this policy indefinitely, why should stockholders in corporations with undistributed pre-1913 surplus be penalized now or hereafter and those in corporations which have distributed and expanded through borrowings go free? As a class the former have surely contributed more to national progress and welfare.

If the provisions of section 115 are permitted to stand, the earnings, for instance, of the Bank of the Manhattan Co., set aside by it for expansion in 1790 and each of the 123 years which elapsed prior to March 1, 1913, will, if, when, and as distributed as dividends, become subject to tax. The older a corporation is the more substantial it is; the more conservative it has been the more stockholders would be penalized by this provision.

CONCERNING SIMPLIFICTATION

4. The simplification which it is alleged would result from adoption of section 115 is illusory. March 1, 1913, earnings and values have in most instances already been fixed by the Treasury Department. Where they have not been it is still necessary to determine them for purposes of administering other sections of the revenue law. The administration of that portion of section 201 of the Revenue Act of 1926 which is omitted from section 115 of the new bill requires only simple mathematical computations to determine whether distribution is from pre-1913 surplus or from subsequent earnings. Considerations of tax simplification, for both the Treasury Department and the taxpayer, would demand the return to the provision of the 1926 act.

The pending bill has not made all distributions of earnings or profits prior to March 1, 1913, taxable. Individuals and partnerships and corporations can, of course, sell their property and distribute their earnings and profits prior to March 1, 1913, tax-free. They are protected by the constitutional limitations on the powers of Congress which do not permit a tax on capital. The corporations themselves are protected. It is the owners of corporations—the stockholders—who would suffer by the change made by section 115.

SUMMARY

The proposal to subject to taxation as "income," any part of corporation surpluses, consisting of earnings and profits accumulated or increase in value of property accrued before March 1, 1913, when distributed in dividends to stockholders, is unnecessary, unsound, and unjust. There is no substantial reason for it. There is manifest reason against it.

Tax exemption of the distributions from pre-1913 corporation surpluses resulted from the clear and proper understanding by Congress that pre-1913 surpluses were in fact capital and should not be taxed as income when distributed to stockholders.

Contrary to the report of the Ways and Means Committee there has been in fact no substantial opportunity to distribute such surpluses. Nor should corporations, now or hereafter, be forced to make such distributions, contrary to the interest of their business, merely to enable their shareholders to exercise a right which they have always had heretofore, and should always have hereafter, i. e., to receive free of tax distributions paid out of surpluses accumulated before there was any income tax, or any constitutional authority to impose one.

Contrary to the report of the Ways and Means Committee most pre-1913 surpluses have not been distributed. Billions of dollars of such surpluses are in the hands of corporations as trustees for their shareholders.

The elimination of the exemption as proposed would not appreciably simplify the law or its administration. But it would work great hardship on reliable, well-established, and conservative industries and would impose undeserved and unjust penalties on the thrift of their stockholders.

There are many sound and forceful reasons for continuing as heretofore the tax-exemption of distributions paid out of pre-1913 surpluses. There are no substantial reasons for its abandonment in part or whole.

The Senate has consistently rejected on its merits proposals in every form in which advanced, to invade with an "income" tax the field of capital, as represented by pre-1913 surpluses, by imposing an income tax upon it when distributed. The policy of tax-free distribution of earnings and profits accumulated before March 1, 1913, was reaffirmed in the income tax laws of 1916, 1917, and 1918.

The question was againn carefully, and at length, considered in the Senate, and fully debated, when the revenue bill of 1921 was under consideration. At that time several amendments had been proposed either in committee or on the floor of the Senate in public debate, to limit in various ways the tax-exempt distribution of pre-1913 surplus. The Senate at that time by the emphatic final vote of 60 to 4, rejected all such amendments. There have been no developments since 1921 and there are no new facts which would support proposals that this principle should now be abandoned; or which would justify the Senate in accepting in any form the proposals which it so decisively rejected in 1921.

We respectfully submit that the Committee on Finance, and the Senate of the United States, should restore the provisions of the Revenue Act of 1926 relating to distributions by corporations, to stockholders, paid out of surpluses accumulated before March 1, 1913. These provisions of existing law are known to be acceptable to both the Treasury Department and the taxpayers generally.

Respectfully submitted.

WILSON COMPTON,
Secretary and Manager, National Lumber Manufacturers Association and Associated Wood-Using Industries.

APRIL 13, 1928.

Mr. BAHR. In order not to trespass upon your time, I would like to but briefly summarize those reasons.

Earlier this year before the House Ways and Means Committee, Treasury Department officials misrepresented this provision of section 115 (b) as a tax loophole. However, the Department's main objection seems to be that section 115 (b) presents administrative difficulties, and for that reason the Secretary of the Treasury recommended that it be amended.

Section 115 (b) is neither a loophole nor a windfall to the taxpayer. This exemption was given specifically by law in order to express the intent of the Congress. It fortified an early belief that such taxation of pre-March 1, 1913, accumulations was unconstitutional. The Supreme Court, however, in the case of *Lynch* v. *Hornby* held that

such accumulations could be taxed when distributed to stockholders as dividends. However, even before that decision of the Supreme Court the Congress specifically exempted such distributions and has consistently followed that policy ever since.

I think some of you gentlemen will remember that this question has been before the Congress about 10 times now. In every case the Senate Finance Committee and usually the House Ways and Means Committee have rejected the Treasury's arguments. To eliminate this exemption now would be inequitable, discriminatory, and unjustified.

It would be inequitable because the present provision of law was born in equity—a desire of the Congress to make a deliberate distinction between earnings and accumulations prior to March 1, 1913, and those accruing thereafter. The intent of the law was to recognize the true nature of pre-March 1, 1913, accumulations as being capital, and not subject to the income tax.

The amendment proposed by H. R. 8920 is discriminatory against stockholders who have permitted the retention of pre-March 1, 1913, surpluses in their companies. It would penalize well-managed companies which have remained in business and have caused those surpluses to serve the Nation's economic well-being. This is particularly true where timberlands are involved, timber being one of our very few renewable natural resources. Investment in timberlands requires great foresight and investment courage, and those stockholders who have permitted such accumulations to remain or to be reinvested by their companies have a right to be guided by the assumption that there will be no inequitable reversal of so long an established tax policy.

That the proposed amendment is discriminatory is further amplified by the statement of Treasury Department General Counsel Lynch before the House Ways and Means Committee on February 7, when he stated that it was mostly natural resource companies interested in this section—timberlands, coal, iron, and so forth. Now, since the benefits of section 115 (b) applied to all corporation shareholders without regard to the nature of their businesses, an elimination of such benefits merely because only natural resource companies are now interested would be clearly discriminatory.

As to the Treasury Department's contention that previous consideration of this matter has given persons sufficient notice to effect distributions of pre-March 1, 1913, accumulations, I am not aware that there was any statutory limitation to the law. Nor is there any reason why shareholders, acting through their corporations, should be intimidated into making such distributions. Many lumber companies are today set up as permanent operations, conserving their own lands, replenishing their own forestry stock, and cutting timber on a perpetual or sustained-yield basis. It would not be practicable for them to distribute pre-March 1, 1913, surpluses without injuring the financial positions which made this long-term outlook possible. We are not calling for special treatment. The benefit is already in the law and, because of the peculiar nature of natural resource companies, they have maintained their interest longer than have other companies. To amend section 115 (b) as proposed here would be singling out these companies for special treatment, but it would be unjust and inequitable. Shareholders

should not now be penalized for having permitted reinvestment of surpluses in timberlands. The Nation as a whole has benefited from their vision and faith in the future.

Nor should the law be amended for the administrative convenience of the tax officials. That is the least tenable argument against section 115 (b) as it stands. There is nothing involved here but the question of equity and fair treatment. This committee has considered the matter several times in the past and upon each occasion has found that to be true. For that reason, we urge that section 115 (b) of the Internal Revenue Code remain as it now is and that you gentlemen report a bill striking the House amendment.

The CHAIRMAN. Are there any questions of Mr. Bahr?

Senator MYERS. How many shareholders are affected by this?

Mr. BAHR. That would be impossible to determine, sir. Many corporations are involved in it and some of the corporations have a very large number of shareholders.

Senator MYERS. Do you have any knowledge as to the market value of stock held by those shareholders who would be affected by it?

Mr. BAHR. No, sir; I do not.

The CHAIRMAN. If there are no further questions, we thank you, sir, for your appearance.

Mr. BAHR. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. H. Cecil Kilpatrick.

STATEMENT OF H. CECIL KILPATRICK, CHAIRMAN, SECTION OF TAXATION OF THE AMERICAN BAR ASSOCIATION

Mr. KILPATRICK. Mr. Chairman, my name is H. Cecil Kilpatrick. I am chairman of the section of taxation of the American Bar Association.

I believe the committee is familiar in general with the interest that our association has taken in the improvement of the revenue laws. We have pending in the House now a bill which embodies a number of recommendations that we have made for changes in the code. I assume this morning, however, that I should confine my statement to matters which are germane to the pending bill. I shall do that.

The CHAIRMAN. There is no rigid requirement that this committee should not look beyond the pending bill, but obviously at this late hour in the session if we are to get very far with this legislation we are somewhat restricted.

Mr. KILPATRICK. Yes, sir.

There are a number of provisions in the pending bill which our association normally would have recommendations on but we are careful not to ask the association to recommend changes in the statute without pretty thorough study and screening and we are therefore not able officially this morning to express an opinion on a number of the sections in the law that we think do need study. There are some, however, on which I am authorized to speak for the American Bar Association and I shall confine my discussion to those.

First is section 208 which deals with the subject of redemption of stock to pay death taxes.

The problem arises where a person dies and the bulk of his estate is represented by stock in a closely held, usually a family corporation, one or more such organizations. The necessity arises to meet the

death taxes. The chief asset being stock of this sort, the estate is faced with the problem of selling or disposing of that stock in order to raise the money. In that type of organization there is no established market for the stock and an outsider, unless the estate owns all of the stock in the enterprise, will sell them off for anything like the intrinsic worth. The logical customer for that stock usually is the corporation itself.

Here, however, we run into the problem of section 115 (g) which provides that any redemption of stock which is in substance the equivalent of taxable dividends shall be taxed as such. There have been some situations where such family investments have been practically wiped out because of the application of that provision.

The purpose of section 208 of the present law is to meet that problem. We made a recommendation to the House Ways and Means Committee some time ago along the same line. Section 208 of the pending bill has a limitation in it which our recommendation did not contain, namely, that the stock so redeemed or sold to the issuing corporation must constitute 70 percent or more of the value of the decedent's estate. We questioned the desirability or necessity of that because it does not take care of the situation where the family enterprise may have incorporated its several branches. You might have one corporation holding the manufacturing company's stock and another the selling organization's. The two combined might equal 90 percent of the taxable estate but neither of them would equal 70 percent.

If the limitation is continued in the law, however, it seems to us that it does not meet another situation which frequently occurs. The decedent may have put some of this family stock in a trust for his children or his wife. That trust may be includible in the estate and if under the terms of the will or of the State law—and a good many States have these laws—the trust must bear its portion of the burden of the State tax, the only source from which it can get it is from the redemption of some of the stock it holds. We suggest here that if a limitation is to be continued, consideration should be given to that situation to provide that where the person, the trust or donee, or what not, is required to contribute, then it may retire stock of this sort without dividend tax implications if the stock constitutes 70 percent or more of the stock held by that particular contributor.

The next section that we discuss is that dealing with transfers in contemplation of death. The provision of the statute is very similar to one that the bar association recommended in 1947, I believe, in that gifts made more than a stated period prior to the date of death should not be included in the estate on the theory of contemplation of death. Our recommendation fixed that period at 5 years. The pending bill set it at 3 years. But the theory is the same, that in determining the contemplation of death you are looking into the mind and intent of a dead man. If the gift was made years before his death, witnesses might be dead, records would not be available, and very often the executor fails simply because he cannot prove the facts.

The Treasury's position, as I understand it, differs with ours only with gifts made within this 3-year period prior to death. Before the House Ways and Means Committee the Secretary of the Treasury recommended that all gifts made within 3 years of death be treated as taxable as part of the estate regardless of motive.

In effect this created a conclusive presumption that any gift made within 3 years of death was made in contemplation of death. Neither our recommendation nor the pending bill contains that conclusive presumption. It is a prima facie presumption and we think it should remain one in order that the executor may be able to prove the facts in that situation.

We support section 501 of the bill in principle.

We are very much opposed to section 602 which reduces the rate of interest on refunds of taxes. I think it will be conceded that most overpayments, like most deficiencies, result from honest mistakes on the part of the taxpayer. For that reason there should be no differentiation in the rate of interest paid in one case and in the other.

Furthermore, there are a substantial number of deficiencies and refunds that automatically result from the taxpayer guessing the wrong year in which to claim a reduction or return on an item of income. Under our laws as construed by the courts it is often very difficult to determine in which taxable year a particular item of income should be returned or a deduction claimed.

If the taxpayer does his best to find the answer to that, he returns the item in 1940, it is an income item and it should have been in 1941, it seems to us highly inequitable that he should be required to pay 6 percent interest on the resulting deficiency for 1941 and get only 3 percent interest on his refund for 1940.

Senator MILLIKIN. Mr. Chairman, may I ask Mr. Kirby what the Treasury's theory is on that?

Mr. KIRBY. Senator Millikin, our feeling is, and it was announced by the Secretary of the Treasury, that there should be the same rate of interest for deficiencies as for refunds. This section was put in by the House committee over our objection.

Mr. KILPATRICK. I point out in my statement that the Secretary of the Treasury has said that he considers this inequitable and he hopes it will not be enacted.

Senator CONNALLY. Are there any questions?

If not, we thank you very much, sir.

Mr. KILPATRICK. Thank you, Mr. Chairman.

(The formal statement follows:)

STATEMENT OF H. CECIL KILPATRICK, SECTION OF TAXATION OF AMERICAN BAR ASSOCIATION

FOREWORD

My name is H. Cecil Kilpatrick. I am chairman of the section of taxation of the American Bar Association, which section has a membership of about 3,200 lawyers, practicing throughout the country.

H. R. 8920 contains a number of provisions to which our group would like to give serious study, but which were first made public when the bill was reported to the House of Representatives on June 23. The brief time intervening has not permitted us to give sufficient study of these to present considered conclusions to your committee. There are a few provisions in the bill, however, to which we have given study and on which I am authorized to speak on behalf of the American Bar Association. I shall confine my detailed statement to these few provisions.

Before doing so, however, I call the committee's attention to the fact that the American Bar Association has a substantial number of recommendations for general tax revision which we hope will receive the consideration of the Congress in the near future. Our recommendations have been embodied in a bill now pending in the House of Representatives. This bill was introduced by Representative Camp of Georgia as H. R. 7738 and Representative Reed of New York as H. R. 7825. There has been no general tax revision since 1942. There is a crying need

for the amendment of numerous provisions of the Internal Revenue Code, to relieve inequities as well as to close loopholes and improve administration. We hope that time will permit action along these lines at an early date.

The provisions of H. R. 8920 on which I desire to speak today are the following:

SECTION 208. REDEMPTION OF STOCK TO PAY DEATH TAXES

There have been widespread complaints of the difficulty experienced by decedents' estates in providing money to pay Federal and State inheritance taxes where the assets of the estate include stock of a closely held corporation, usually a family corporation. Stock and securities of that character are quite often difficult, if not impossible, to sell at a price approximating the value determined in fixing the Federal estate tax. If forced to sell, the result is often the absorption of the family enterprise by larger competitors. One source of funds for that purpose is the sale of stock to the issuing corporation or its retirement, if it is preferred or redeemable stock. However, section 115 (g) of the Code taxes as a dividend any distribution in cancellation or redemption of stock that is "essentially equivalent" to the distribution of a taxable dividend, and unless the estate sells all of its stock, it is likely to be faced with substantial income tax liability as result of such a sale or redemption. Section 208 would provide the necessary liquidity and remove the threat of section 115 (g). It contains safeguards against improper applications in that section 115 (g) is made applicable only to the extent that the distributions do not exceed the death tax liability. The exception applies only to distributions in respect of stock of a corporation if the value of that corporation's stock comprises more than 70 percent of the net estate, and it applies only to distributions made after the death of the decedent and within the period of limitation for assessment of estate taxes.

The American Bar Association recommendation (H. R. 7738, sec. 129) did not contain the 70 percent limitation. While we have not had time to consider this particular provision as thoroughly as we would like, we question its necessity or desirability. In addition, it does not meet the problem, if the limitation is to be retained, in many estates where there will be included in the taxable estate the assets of a trust, or of a gift held to be made in contemplation of death, where either the State law or the will itself require apportionment of the Federal estate tax among all the assets included in the gross estate. For example, the decedent may have created a trust, the sole assets of which consist of stock in the corporation in question. Assume that all of the stock of the family corporation held by the decedent, plus that included in the trust, amounts to 65 percent of the value of the net estate and that the stock held in the trust amounts to 40 percent of the net estate. Where the State law or will require apportionment, the trust must pay 40 percent of the estate taxes. The only source from which it can obtain this money is the sale of the stock in question. The problem is difficult enough where there has been a substantial appreciation in value of the stock since the creation of the trust because the trust basis is the basis of the donor. Under the proposed section, the redemption of the stock held by the trust might be subject to the provisions of section 115 (g), in which event the trust's share of the estate tax liability plus its income tax liability under section 115 (g) could exceed 100 percent of the value of the trust assets. At a minimum, consideration should be given to an amendment to provide relief where the stock equals more than 70 percent of the estate assets in the hands of the person required to pay a proportionate part of the estate tax.

SECTION 501. TRANSFERS IN CONTEMPLATION OF DEATH

This section of the bill amends section 811 (c) of the Internal Revenue Code to provide that no property shall be included in an estate on the theory of contemplation of death, if the transfer occurred more than 3 years prior to death.

In enacting the contemplation of death provision, Congress intended to meet those situations where, in a very real sense, the transferor attempted to get rid of his property at a time which bore some reasonable relation to impending death. Where the gift has occurred long prior to death the likelihood of tax motivation is remote, and, of equal importance in the satisfactory administration of the law, the problem of proof and the motive for the gift is so difficult as to result often in much unfairness simply by virtue of the fact that the executor often is unable to prove his case. As was well stated by the Secretary of the Treasury in his statement to the Ways and Means Committee on February 3, 1950:

"One of the more difficult problems in the administration of the estate tax is the determination of whether gifts which the decedent made during his lifetime were

in contemplation of his death. The purpose underlying the subjection of gifts in contemplation of death to the estate tax is the prevention of tax avoidance. The present statutory provision attempts to reach those gifts which are induced by the same motives which customarily underlie disposition by will. In depending for its application upon proof of the state of the decedent's application upon proof of the state of the decedent's mind, the provision has produced administrative complications and a great deal of litigation and has not been very effective in preventing estate tax avoidance."

The American Bar Association's proposal (H. R. 7738, sec. 204), adopted some years ago, was identical in substance with section 501 of the pending bill, except that we used a 5-year period instead of a 3-year period, beyond which gifts would not be taxable on this theory. Both our recommendation and section 501 would create a presumption that all gifts made within a few years prior to death were made in contemplation of death. That presumption, however, is rebuttable, the burden of proof being placed upon the executor. The Secretary of the Treasury recommended to the Ways and Means Committee that gifts made within the 3-year period be required to be included in the estate; in other words, that they be conclusively presumed to have been made in contemplation of death. We oppose this provision. Conclusive presumptions of this sort are often demonstrably contrary to the undisputed facts and, therefore, work unnecessary inequity and hardship. The door should not be closed to proof that such a transfer was not made in contemplation of death.

SECTION 602. REDUCTION OF RATE OF INTEREST ON OVERPAYMENTS

This section provides that interest payable on refunds of internal revenue taxes shall, beginning November 1, 1950, run at the rate of only 3 percent, although interest on deficiencies will continue to run at the rate of 6 percent.

There are numerous situations in which it is extremely difficult for a taxpayer to determine the exact point of time at which an item of income accrues or at which a loss or bad debt deduction may be taken. If section 602 be enacted, a taxpayer who, in all good faith, makes the wrong determination of the time for inclusion of income or deduction of a loss will be unfairly penalized in that he will be charged 6-percent interest on the resulting deficiency and will be allowed only 3-percent interest on the refund of tax overpaid by him. Another situation in which the section would operate inequitably would be in the case of a partnership, valid under State laws but not taxable as such under court cases construing the internal revenue laws. In such a situation, upon a determination that one of the partners is taxable on partnership profits actually distributed to another, the partner so taxed would be required to pay 6-percent interest upon the deficiency but the partner who erroneously reported the income would receive only 3 percent on his refund.

The Secretary of the Treasury has recognized the inherent unfairness of section 602 in his statement to this committee on July 5, and we respectfully urge that such a change in the law not be made.

In connection with this matter of interest on refunds and deficiencies, we respectfully direct the committee's attention to the American Bar Association's recommendation (H. R. 7738, sec. 151) covering interest on deficiencies offset by overpayments. Because the excess profits tax was imposed under a separate title of the Internal Revenue Code from that which imposed income taxes, corporations are unreasonably penalized in situations where an overpayment of excess profits tax results in an underpayment of income tax or vice versa. Because the titles were separate, the Commissioner takes the position that interest on the deficiency is due from the due date of the return, whereas interest on the overpayment, which automatically results, runs only from the date of the overpayment, which very often is the date of payment of the last installment of tax for the taxable year. It is our recommendation that in any case of that sort the interest should be paid only on the amount of the excess of the deficiency over the overpayment, and that if the result were a net overpayment, interest should be payable to the taxpayer only on the net amount, without change in the provisions as to the date upon which interest begins to run. This particular recommendation deals only with a deficiency in one tax and a resulting overpayment in the other tax for the same taxable year.

Senator CONNALLY. Mr. Charles R. Sligh, Jr.

STATEMENT OF CHARLES R. SLIGH, JR., PRESIDENT, CHARLES R. SLIGH CO., HOLLAND, MICH., AND CHAIRMAN, TAXATION COMMITTEE, NATIONAL ASSOCIATION OF MANUFACTURERS

Mr. SLIGH. Mr. Chairman and gentlemen of the committee, my name is Charles R. Sligh, Jr. I am a furniture manufacturer and president of the Charles R. Sligh Co. of Holland, Mich. I appear here as chairman of the taxation committee of the National Association of Manufacturers, and a member of its board of directors.

Senator CONNALLY. Do you want to put your whole statement in the record and comment on it?

Mr. Sligh. I would like, sir, to submit a summary of the entire statement and if I may I would like to submit the full statement for the record.

Senator CONNALLY. You want to present a summary and a full statement?

Mr. SLIGH. I would like to read a summary and present the full statement.

(The statement referred to follows:)

A STATEMENT BY CHARLES R. SLIGH, JR., CHAIRMAN OF TAXATION COMMITTEE OF THE NATIONAL ASSOCIATION OF MANUFACTURERS, AND PRESIDENT OF CHARLES R. SLIGH CO., HOLLAND, MICH.

My name is Charles R. Sligh, Jr. I am president of Charles R. Sligh Co., Holland, Mich. I appear here as chairman of the taxation committee of the National Association of Manufacturers, and a member of its board of directors.

In this statement on the pending tax bill (H. R. 8920), it is my purpose to present the views of NAM with respect to the major issues raised by this bill. Our Federal tax program deals with some topics which are not covered in this statement. For your information a copy of that program is appended to this statement and I ask that it be accepted for the record as part of this statement. Many other matters in the bill are passed over here because they have not come within the purview of our committee studies.

It is our purpose here, as in the deliberations of our tax committee and the board, to be genuinely constructive and to approach the Nation's tax problems from the standpoint of the best good of the whole economy rather than from that of the special advantage of any particular group or interest. Our testimony will be in opposition to the major provisions of H. R. 8920, and the reason is that, in our judgment, enactment of these provisions would be a disservice, not a service, to the whole economy. After presenting our criticisms and objections, we shall offer some constructive recommendations. We consider these recommendations sound, and our view is that if the Congress does not now have adequate time for consideration of them, we would much prefer no tax bill rather than H. R. 8920.

TAX REDUCTION AND BUDGET BALANCE

The testimony on the subject of new tax legislation before the Ways and Means Committee has revealed strong cross currents of conflicting views and interests. In general, the witnesses representing particular businesses or commercial groups have pressed for specific reductions of the excise taxes applicable to the products made or sold by them. There was a paucity of suggestions as to how the revenue loss from these reductions was to be made up, although there was some attempt to show that increased collections under other taxes would minimize, or entirely offset, them.

On the other hand, the President took the position from the outset that there must be no net revenue loss from any excise tax changes made, and this view was accepted by the Ways and Means Committee.

Viewing the record as a whole, the issue may be stated as one between tax reduction as a primary consideration, with only incidental regard for the immediate effect on the revenues, and tax revision through modifications of tax provisions which would readjust the distribution of tax burdens without affecting the over-all total of receipts.

NAM believes that the first of these courses, that is, tax reduction without regard for the revenue effects, would not serve the public interest. Although the deficit for 1950 is less than had been estimated, there is still a deficit. Various witnesses before the Ways and Means Committee insisted that a sufficient reduction of spending was possible to enable the tax cuts they were asking for to be made within a balanced budget. We do not believe that such a cut in spending is possible, but we have shown that budget balance is possible in 1951. This was demonstrated in a association study entitled "Why Deficit Spending?"[1] The same view was developed in a statement on behalf of the association before the Senate Appropriations Committee.[2] The NAM position has been that spending must be reduced sufficiently to provide a margin for debt reduction before serious consideration is to be given to tax reduction. During the hearings on this bill, the chairman and other members of the Ways and Means Committee were in cordial accord with the objective of reducing Federal expenditures, but they always came to the conclusion that there was little prospect of very much being done about it. This pessimism among prominent House Members indicates a moral certainty that any reduction of excise or other taxes under existing conditions and political attitudes necessarily means a loss of revenue and the prospect of an increase, by so much, of the deficit.

The objective of budget balance, moreover, cannot safely or wisely be attained at this time, in our opinion, by a further increase of the tax load. The Nation's tax bill—Federal, State, and local—is over $55,000,000,000, which is 20.8 percent of gross national product, and 25.1 percent of national income, both at currently estimated annual rates. This load cannot, with safety, be raised further. It should be reduced, and it must be reduced if we are to continue our economic advance on a sound basis rather than on that of a disastrous inflation.

The bill before this committee (H. R. 8920) aims at tax revision. It proposes reductions of tax in certain areas, notably the excises, and counterbalancing increases in other areas, notably the corporation income tax.

BASIS FOR CRITICISM OF H. R. 8920

NAM opposes the major features of the pending bill for the following reasons:

The bill proposes a further imbalance of the Federal revenue structure

The policy of tax revision contained in the bill runs counter to the fiscal philosophy which large committees of representative businessmen have developed during recent years, with the approval of the NAM board of directors. This philosophy is that there should always be a substantial reliance on excise taxes in the Federal revenue system. In our judgment, there is, even now, too great reliance on direct taxes, notably the income taxes, and not enough dependence on excise—or indirect—taxes. The collection figures for the fiscal year 1949 are used to illustrate the point. These figures are as follows:

Type of tax (less refunds)	Millions	Percent of total
Individual income tax	$16,352	
Corporation income tax	11,140	
Total income taxes [1]	27,492	
Estate and gift taxes	778	
Total direct taxes	28,270	78.3
Excise taxes	7,503	
Customs	367	
Total indirect taxes	7,870	21.7

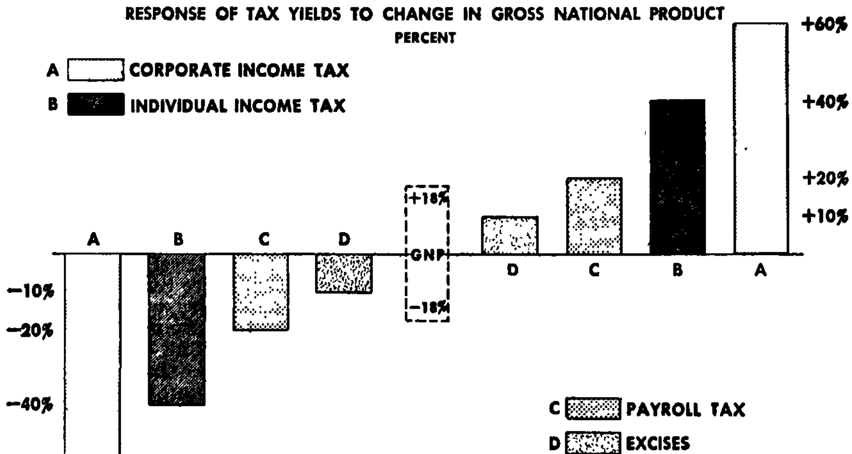
[1] The employment and other social security taxes are excluded.

The experience of 1949 indicates that we are depending upon the direct taxes, notably the income taxes, for more than 78 percent of total Federal tax revenues. This is entirely too many eggs for one basket. In recent years the Dominion of Canada has collected only about 54 percent of total revenue through direct taxes, and the remainder through indirect taxes. This is a much better distribution that our own.

[1] Published as NAM Economic Policy Division Series No. 19, November 1949.
[2] This statement, by Dr. Harley L. Lutz, tax consultant for NAM, was reprinted in pamphlet form under the title "The Way To Cut Is To Cut."

Federal taxation is already heavily overbalanced on the side of the income taxes. The revenue shifts produced by H. R. 8920 will result in a further emphasis on income taxes. If we apply these shifts to the revenue situation of 1949, the direct taxes would constitute 81.2 percent, and the excises only 18.8 percent, of total tax revenues. The sources of danger in this situation are these:

First, income taxes are notoriously unstable in yield, by comparison with excise taxes, under varying business conditions. They are capable of producing a large flow of revenue, at given rates, under boom conditions; and equally capable of a serious decline in revenue, at the same rates, under conditions of recession or depression. These matters are familiar to economists, and the following chart is offered to illustrate a formalized comparison of the behavior of certain taxes under assumed variations of national income. The chart is based upon data in a publication of the Federal Reserve Board of Governors.



Source: R. A. Musgrave, *Public Finance and Full Employment*, Federal Reserve Board, 1945

Confirmation of this volatility, in the case of the individual income tax, is supplied by the record of collections under this tax. We have two periods during which there were no changes of the rates or exemptions under this tax, and also, in which there were marked variations in the volume of business activity. The first of these periods extended from 1926 to 1932, and the extent of the rise and fall of business activity over those years is well known to all.

The individual income-tax collections varied as follows:

Individual income-tax collections

	Millions		*Millions*
1926	$732	1930	$477
1927	831	1931	246
1928	1, 164	1932	330
1929	1, 062		

A second, shorter period extended from 1936 to 1940. The famous "recession" occurred during this period. Individual income-tax collections were as follows:

	Millions		*Millions*
1936	$1, 214	1939	$929
1937	1, 142	1940	1, 496
1938	766		

Source: Tax collection figures from Statistics of Income, Part I.

Here we have a convincing demonstration from actual experience of the erratic returns from the individual income tax. The collections of corporation income tax are also highly variable over these periods, but there were frequent, small

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changes in the rates which prevent a strict comparison with the individual income tax.

National income, tax rates, and tax yields are today at levels very much above those on which the preceding comparisons occurred. But these current high levels are not assuredly constant. One need not be a prophet of gloom to suggest that some variations of the tempo and volume of economic activity are not only natural, but inevitable.

The conclusion of this stage of the argument is that we are extremely unwise to place as great degree of dependence as we do on this erratic and unstable method of taxation. When a government is in the position that ours is now—budget out of balance and no evident disposition to tighten the belt, a public debt exceeding in face value the worth of all real and personal property, a price situation that already penalizes severely those large groups in the population whose economic security depends on a stable purchasing power of the dollar—I repeat, when a government is in this situation, every effort must be made to assure budgetary stability, and to avoid further additon to a debt now so large as to threaten the value of our currency and the other values that are tied to the dollar. It is short-sighted to increase further relative dependence on the income taxes, which are the most unstable and undependable of all taxes.

Crippling effects of excessive tax rates

A second source of danger from the imbalance in the Federal revenue sources, between income and excise taxes, is that the pressure of revenue requirements compels the levy of excessive rates when the tax base is narrowed by an undue limitation to one principal form of tax. The NAM position is that the Federal Government should use both income and excise taxes, not only because of the contribution to revenue stability which will be made by a liberal proportion of excise revenue, but also because it is only in this way that there can be moderate rates of tax at all points. Excessive rates of tax on income frustrate the incentives to get income, and thus tend to restrict production, to cause unemployment, and to impair the economic growth on which the well-being of all depends. Excessive excise taxes interfere with consumption. It is obvious that, to be prosperous and dynamic, there must be both production and consumption on a large scale. The tax system should be so devised as to involve the least impediment to both production and consumption. The NAM position is that this happy result will be best achieved when there is a sufficiently broad base of Federal taxation so that the necessary revenue can be obtained without resort to excessive rates at any point.

Revolutionary departure in corporate taxation

The two major changes which the bill proposes with respect to the corporation tax are (1) an over-all increase of the revenue from this tax and (2) the principle of full graduation of the rates. We think it is extremely bad fiscal policy to increase the corporation income tax revenue for the reasons already given in my discussion of the dangers of a seriously unbalanced Federal revenue structure.

The second of these tax changes is truly a revolutionary departure. I am aware of the positiveness of the declarations from members of the House and others that the corporation tax provisions of the bill do not constitute tax rate progression. To go no further with definitions, I quote from a Treasury study of 1947 entitled "Taxation of Small Business": [3]

"If the low rates on the first brackets of income are restricted to taxpayers with net incomes below a certain size, as in the present corporate tax, the bracket method results in limited graduation. If, however, the low rates on the first brackets are available to all taxpayers, as in the present individual income tax, the result is full graduation." The signficance of the change made by H. R. 8920 is that it converts the present limited graduation of the corporation tax rate structure to full graduation. It does this by making use of the technical, and now virtually obsolete distinction in the law between normal tax net income and surtax net income. The bill provides for a flat rate of 21 percent on normal tax net income, and a flat rate of 20 percent on surtax net income in excess of $25,000. This arrangement fits exactly the terms of the Treasury's definition of full graduation, for the low rate of the first bracket is available to all corporations, and the additional rate of the second bracket applies to all corporate taxpayers with taxable income of $25,000 and above. Here is a perfect parallel to the graduation of the individual income tax, in which the low rate of the first bracket is available to all taxpayers, and the rates of succeeding brackets are applicable to the larger in-

[3] Taxation of Small Business, Treasury Department, Washington, for release morning newspapers October 29, 1947. Press Service S-515, p. 10.

comes. In fact, the individual income tax rate as established by the Revenue Act of 1940 may well have served as the model for the corporation tax scheme in H. R. 8920. In 1940 there was a normal tax of 4 percent, applicable to all taxable income. The act of 1940 provided for a schedule of surtaxes, levied on surtax net income of $4,000 and more. In other words, there was an exemption of $4,000 from surtax, although it was not expressly defined as such No one questions that the individual income tax rates of 1940 were progressive, and there can be no question that the corporation tax rates of H. R. 8920 are progressive. There is no difference in principle, and the only difference in form is in the number of rate brackets of the two taxes.

The bill's reliance on the statutory distinction between normal tax net income and surtax net income does not prevent this from being foot-in-the-door full progression. The implication is that because there are two concepts of corporate income, to each of which a separate flat rate is applied, there is no progression. But for the vast majority of corporations, the difference between these income concepts is nonexistent, or at most negligible. The principal difference between these two concepts of net income is the exclusion, or inclusion, respectively, of interest on partially tax-exempt Federal bonds. The latest summary of ownership of Federal bonds, in the Treasury Bulletin for May 1950, shows that all other investors aside from banks, insurance companies, the Federal Reserve banks and the Government trust accounts, owned $1,635,000,000 of these partially tax-exempt bonds. Included among these outside investors must certainly have been some individuals. Assuming interest at 4 percent, the amount involved as income on $1,635,000,000 would be some $65,000,000, which is so small a drop in the corporation income bucket as to be wholly unimportant as the basis for a profound change in the method of taxation. Certainly there is not enough difference of a fundamental nature between the two income concepts, in the case of the ordinary business corporation, to support the idea that H. R. 8920 does not establish progression, but rather two separate flat rates taxes on two wholly separate and distinct classes or kinds of income.

The use of only two rate brackets in the bill does not invalidate the fact of full progression, and there is nothing whatever to prevent a future Congress from introducing a third, and a fourth, and other rate brackets with steadily rising rates for each. For example, how simple it would be to provide that the 20 percent rate on surtax net income above $25,000 should apply to such income from $25,000 to $100,000, and that a 50 percent rate, say, should apply to surtax net income above $100,000.

The answer is that there is nothing whatever to prevent just such a development, and nothing whatever to prevent the rates from being raised to a level that would destroy every large corporate business enterprise in the country. As long as the graduation was confined to net incomes below a certain size, with a flat rate levied on the total net income when it exceeded this specified limit, there was no possibility of getting full progression into the picture. The pending bill removes the ceiling on rate graduation, and makes the sky the limit. It is impossible to agree with the majority report of the Ways and Means Committee when it says: [4]

"The bill eliminates the notch rate by providing a $25,000 exemption which would be available to all corporations. This will provide tax advantages to small businesses without introducing a system which is readily adaptable to a drastic graduation of rates."

We have demonstrated above that the system which the bill introduces is readily adaptable to a drastic graduation of rates because it has removed the ceiling of the flat rate on total net income at $50,000. We hold that precisely here is the grave danger which this new system of tax rates presents. And if American corporate business goes along with this initial, foot-in-the-door application of full progression, it will be estopped hereafter from opposing whatever upward extension of the rates and rate brackets may be proposed. NAM is not willing to be particeps criminis in this case. We protest, with all vigor, against this violation of precedent, logic, and economic precepts.

The many assurances that Members of Congress have given to the effect that the proposed tax change is not progression indicates their awareness of the evils and dangers of this method of taxation as applied to corporations. Various witnesses before the Ways and Means Committee dwelt at length upon this matter, and I shall limit my discussion of the point to a brief outline.

Wherever a justification of the use of tax rate progression is offered, it is always based on the assumption that such rates exemplify and apply taxation according

[4] H. R. Report 2319, 81st Cong., 2d sess., to accompany H. R. 8920, p. 27.

to ability to pay. And when the term "ability to pay" is thus used, it invariably refers to individuals and the income at their disposal. Some persons have confused a large corporation income with a large individual income, and have concluded that if size indicates greater ability to pay taxes in the case of the individual, it must also indicate greater ability in the case of the corporation.

This would be true only if the corporation existed and operated solely for its own corporate purposes and were entirely free to retain and dispose of its entire income in support or furtherance of these purposes. The concept of legal personality does not extend this far. Every corporation is an association of individuals who, collectively, own the capital stock and whose investments have made the corporate activity possible. Fundamentally, the corporation is a form of business organization which exists to earn income for its stockholders. The amount of income earned, as such, shows nothing whatever regarding the ability of the several stockholders to pay taxes, or regarding the amount of tax which any one of them should pay as an individual. All of the large corporations in this country have many thousands of stockholders. These persons have, at one extreme, incomes so small as to be exempted entirely under the personal income tax, and at the other extreme, income so large as to be subjected to the maximum rate of that tax. The levy of progressive taxes on large corporation incomes would result in a most inequitable taxation of these widely varying personal incomes, with no regard whatever to the basic conditions of other sections of the income tax law, and indeed, in violation of the clear intent of these other provisions.

In another respect, also, the taxation of corporation income at progressive rates is unsound, and it could be actually destructive of the structure of American business. Under normally competitive conditions, profit margins in relation to sales tend toward uniformity within a given industry, and the aggregate amount of profit becomes dependent mainly upon sales volume. When the tax is applied to the total income at progressive rates, it follows that there is a progressively deep cut into the profit margin as sales volume increases. This would strike directly at management's effort to expand sales volume, and when the tax rates become heavy enough, the distortion of the competitive situation would compel dismantlement of the large companies. Let us recognize that the country needs a large number of prosperous small businesses, but let us not forget that it also needs some large businesses, nor that small and large business need each other. Taxation of corporation incomes according to size at progressive rates would force the country back into the "corner grocery" economy. It would lead eventually in sharing the poverty, for there would be nothing else left to share.

In spite of the assurances of the Members of this Congress that they do not intend to apply the progressive tax principle to corporate taxation, it is a fact that neither the assurances nor the enactments of this Congress are binding on any future Congress. American business is here being asked to accept a principle, and if a future Congress should decide to extend and carry it further, this acceptance would then be used and cited as an approval of the policy. Some of us can still remember the assurances that were given when the sixteenth amendment was under consideration, to the effect that the rate would never be as high as 10 percent.

The passage quoted above from the report of the Ways and Means Committee indicates that the dangerous innovation of full graduation was devised to eliminate the notch rate, a device which is used to produce a smooth transition from the method of limited graduation of tax on small incomes to the method of flat-rate taxation on all income when the amount earned rises to a certain amount, under present law $50,000. The proposed remedy is far worse than the difficulty to be relieved. It is like burning down the barn to get rid of the rats. And, as a matter of fact, the difficulty itself has been exaggerated. Some data relating to the statistical aspects of the notch situation contained in the first addendum of this statement support this view.

We should not forget that the only purpose of the notch rate since its introduction in 1939 has been to avoid the application of full graduation to corporate incomes while still providing some tax benefit to small corporate incomes. The high standard rate is the fact which makes necessary a high notch rate. The latter could be lower if the standard rate were lower, or it could be lower if the scale of rates on the first $25,000 of corporate income were somewhat higher. And if the standard corporate tax rate were reduced sufficiently, there would be no warrant for special tax treatment of the so-called small corporate incomes. This, however, is a matter for the future.

NAM has not been unmindful of the discontent aroused by the notch provision. For years our tax program has carried a recommendation that methods be sought whereby a smoother transition to the standard rate might be effected. It is my intention, as chairman of NAM's taxation committee, to ask for continued study of this problem and I am confident that we shall be able to produce some helpful proposals early next year. In the meantime, the fundamental point on which NAM stands firmly is that the method by which the pending bill seeks to deal with this matter is wrong in principle, fallacious in logic, and extremely dangerous if it is ever put into operation. In other words, the NAM position is definitely against full and unlimited graduation or progression in the corporation tax.

Alternative to withholding tax on corporate dividends

The pending bill contains another income tax provision which we believe is a cumbersome and unnecessary innovation. This is the withholding tax on dividends. It is significant that more than a dozen pages of the House print of the bill are required to cover all aspects of this innovation. To put our objection briefly, we believe that the purpose sought by this cumbersome and complicated addition could be achieved far more simply and with much less burden on all concerned by requiring corporations to file an information return on all dividends above some small amount, say $1. The recommendation, as approved by our tax committee and the board of directors, sets this minimum at $1. Perhaps every necessary purpose would be served by a somewhat higher minimum, say $10. To accomplish this, only a very simple change would be involved in the regulations applicable to section 148 (a). This section provides that corporations, when required by the Commissioner, shall report the names and addresses of stockholders, the number of shares held, and the dividends paid. The regulations limit this requirement to dividend payments of $100 or more to one person during the calendar year.

The Ways and Means Committee report states that the Bureau intends to remove the $100 limitation, applicable for returns filed in 1951 on 1950 income. The result will be that the payor corporations will be subjected to the additional clerical cost of making a complete report of all dividends paid, whatever the amount, and also the additional clerical cost of computing and withholding the 10 percent, and of notifying stockholders of the fact and the amount of such withholding. In view of the large amounts of stock held by owners of record instead of the actual owners, a further complication is encountered here in the obligation of the record owners to transmit the requisite information to the actual owners.

It is our belief that general knowledge of full dividend reporting by payor corporations will go far to prevent deliberate or inadvertent omission of small amounts of dividend income, just as general knowledge of the limitation on such reporting may have encouraged careless or intentional omission heretofore.

Under our plan, the Treasury would have a larger job of matching up the full information returns against taxpayer returns, but it would not have to assume the substantial burden of handling many thousands of additional refunds.

The provisions of the bill, together with the reported change of the regulations, will involve a double burden on the Treasury as well as on the payor corporations. That is, the Treasury would have to match up all information returns and make the additional refunds, just as the payor corporations would have to file complete information returns and withhold the tax on all dividends.

Moreover, there is a possibility of a considerable injustice to small income recipients having only a nominal amount of dividends. The law now provides that persons with gross income of $5,000 or less, of which not to exceed $100 is from sources other than wages, may elect to pay the tax under supplement T. This supplement contains a tax table according to which the tax is determined. If the other source of incidental income is dividends, these persons will be obligated to file a refund claim, or else to itemize the incidental income in order to be certain of the proper adjustment of tax. The whole purpose of Supplement T was to simplify the collection of income tax from the wage incomes up to $5,000 by relieving the recipients of such incomes from the burden and annoyance of executing a detailed return. The new procedure will introduce an unnecessary complication for these taxpayers. And, of course, in the case of all tax withholding on dividends, there will be a varying period of delay before the refund is paid, during which time the person entitled to the dividend will be deprived of the money he should have received promptly.

RESOLVING THE EXCISE-TAX PROBLEM

I come now to the problem of the excises. H. R. 8920 obviously does nothing to correct the basic defects of the existing Federal excise-tax system. Our insistence upon a substantial amount or porportion of excise revenue in the Federal system does not carry with it approval of the present system. This system, if it can be called such, is a product of successive enactments during the depression thirties and the war-tensioned forties. It is a fair target for all of the criticisms that were leveled at it during the House hearings on the bill. It is hit or miss; illogical; discriminatory; and inequitable.

The pending bill does not eliminate these basic defects. It contains some exemptions, and numerous reductions of rates. But the discriminatory selection of taxable items still remains, the relatively wide range of rates on different classes of taxable items is but little affected, and it is still true that the excise taxes fall upon only a minor part of the consumption goods bought and used by the people. The bill can naturally satisfy few, if any, of those who so confidently approached the Ways and Means Committee with their appeals for excise tax modification in the early part of this year.

Our desire is to be helpful. To that end I summarize at some length from NAM's current Federal tax program in order to give this committee, the Congress and the Nation the benefit of our considered judgment on this aspect of the Federal tax program.

NAM position on excises

The NAM position on excises is based on two propositions which are regarded as fundamental. First, the Federal revenues should always rely substantially upon excise receipts, to promote stability and to avert or diminish deficits under adverse conditions. This thesis has already been developed in the present statement.

Second, the present excise system is not suited to the job which excises should do. In 1948 the NAM position on excise taxes called, first, for "a thoroughgoing investigation of the distribution of tax burdens under the present tax system with the aim of achieving a better-balanced and more realistic structure," and second, for the policy that "any modification of the excise system should be carefully worked out so as to establish equity among producers of competing products and among consumers of different classes of products."

There are two ways of achieving equity—or equality—among competing producers and among consumers of different products, so far as concerns excise taxes. One way is to repeal all excises, the other is to subject all consumer goods except foods to excise tax.

The choice between these alternatives is clear. The first method is excluded by the tremendous loss of revenue that would be involved, and the greater revenue instability it would provide. Replacement could not be effected by higher individual and corporate income taxes without crippling effects on the whole economy. Its adoption would be most unwise, further, because it would deprive the Federal budget of the stabilizing contribution which excise taxes make. In fact, from this standpoint, there is strong reason for increasing the proportion of total revenues provided by the indirect taxes. As already noted, they are far more resistant to depression conditions than are the income taxes, and hence, under some circumstances, they would be a veritable bulwark in the budget.

The second method, namely, the application of excise tax to all consumer goods except foods would eliminate the discriminations that now exist and would put all producers on an equal basis in competing for the consumers' dollars. It would at the same time equalize the situation as it involves the consumers in making their choices among different products.

Uniform excise tax recommended

It is therefore recommended, by the Taxation Committee and the Board of Directors of NAM, that the present inequitable, discriminatory, illogical system of excises be swept entirely away and replaced by a general manufacturers' excise. Such a tax, it is proposed, would be in substitution for all of the present excises except those on alcoholic beverages and tobacco. It should be levied at a uniform rate which would produce approximately the same total revenue as is now obtained from the specific taxes to be repealed. In the fiscal year 1949 this was about $4,000,000,000. According to the best estimates we have been able to make, a flat rate of 5 percent would produce this sum.

Aside from the segregation of alcoholic beverages and tobacco for separate taxation in accordance with our traditional policy, the one exemption we propose

from the general manufacturers' excise is foods and food products. This exemption is recommended because food expenditure comprises such a high proportion of the small-income budgets. Since rent is a service, not a commodity, it would not be taxable, and in consequence the majority of all small-income expenditures would not be affected by the proposed tax.

Some explanatory comments concerning the proposed uniform excise are in order.

First, this is not a new form of excise taxation in the Federal experience. The present excise-tax system contains not less than 20 classes of goods which are taxed on the basis of the final manufacturer's price. In 1949 the total yield from these taxes was 1,771.5 million dollars, or nearly half of the total of the excises here under consideration.

Second, the tax would be levied on the value of the article at the final point of manufacture. This point would be determined for all taxable goods as it is now under the present manufacturers' excises. The Federal procedure is that the seller of materials or partly fabricated goods does not include the tax if his buyer can furnish an exemption certificate. This certificate is obtainable from the Bureau of Internal Revenue on a showing that the buyer ordinarily uses the materials purchased in some further process of manufacture. But a time comes when the finished article passes into the hands of some one who has no exemption certificate. At that point the last seller includes the tax.

The Canadian tax system has included a manufacturers' excise tax since 1920. There the tax is imposed at the final stage of manufacture by a control procedure similar to our own.

Third, it is not feasible generally to provide that the tax be shown as a separate item and thus invoiced through the several stages of the distribution process. When it is finally imposed at the end of manufacturing, it is collected in the first instance from the wholesaler, jobber, or other middleman who first takes title to the merchandise. It is therefore, to him, part of the cost of the goods. Eventually there will be reimbursement of this advance payment of the tax by the ultimate consumer.

I pass now to consideration of some points that may be raised against this proposal. With regard to all of them, however, it should be borne clearly in mind that the people have been living with exactly the kind of tax that is here recommended for a number of years, and under it they have been contributing a large amount of revenue through the levy of a wide range of rates upon a limited list of taxable items. All that we are proposing is that the list be extended to include everything except foods and that a moderate, uniform rate be levied across the board instead of the discriminatory rates now applied to a crazy quilt of taxable goods.

One point that is likely to be mentioned in connection with the proposed tax is that it will be pyramided. This matter of pyramiding the tax as goods pass down from one layer to another of the distributive organization has been exaggerated. If pyramiding were to occur consistently, the practical result would be that profits at the several distribution levels would be greater than they would be if there were no such tax because inclusion of the tax would create a larger cost base for computing mark-ups. And it would follow, also that the higher the rate of tax, the greater the middleman profits would be. This view disregards the source and reason for profit, which is a return that is gained from the successful performance of a service that others are willing to pay for. In the field of merchandise distribution, this service consists essentially of supplying to consumers the kinds and qualities of goods that they want, at prices they are willing to pay. The value of this service, from the consumer standpoint, is not enhanced by the fact that the various middlemen are acting, in turn, as relays in a tax collection process. The competition for the consumer dollar in which all of the thousands of merchants and other distributors are engaged is the effective determinant of the profit rewards which any of them will get. The issue involved is not whether the consumer will bear the burden of the tax, but rather one of how much more than the tax he will pay because of the actual pyramiding. It is evident that whatever the consumers pay, over and above the tax, would constitute enhanced middleman profits. The position taken here, on the basis of economic logic, is that competition throughout the distributive mechanism will tend to prevent any abnormal surcharge above the tax, because the mere relaying of the tax is not a service which the consumer would value enough to pay for.

The point that has been exaggerated is that there will be an abnormal expansion or blowing up of the original tax by the time it gets to the consumer. If it were really true that all distributor profits would be materially enhanced because of

this tax collection service, the middleman groups should logically demand a high tax rather than a low one or none at all. Actually, they know that a high tax would diminish both their sales and their profits. The advantage of a low tax rate across the board is that it does not discourage sales unduly, and it tends to keep the general competitive situation in a state of balance, so far as concerns all classes of goods, all producers, and all consumers.

The fact that this, as well as all other excise taxes, must be borne by consumers is not a valid argument against such taxes. All taxes come out of income, either as it is received or as it is spent. Regardless of where or by whom the original tax payments are made, their burden falls ultimately on the income of the people. This ultimate burden cannot be escaped by avoiding excise tax and concentrating the levies upon income. To some extent such levies are shifted promptly, and in any event the final result of excessive income taxes will be to hamper the formation of capital to a point where the consumers will be forced to foot the bill in higher prices or lower living standards.

Another point is likely to be the objection that such a tax would be "regressive." As this term is used by the academicians, it means that a given amount of tax is a larger proportion of a small income than the same amount of tax would be of a large income. Being a matter of arithmetical relations, this criticism can be brought against many taxes, but the argument is always advanced most vociferously when the contestant is opposing a tax. If he happens to like a tax, this point is soft-pedalled.

The fact that is usually overlooked in such arguments is that the purchase price of a given article is itself a larger proportion of a small, than of a large income. In other words, the complaint which is lodged against the tax, usually a small part of the total price, could, with even greater force, be lodged against the whole system of market prices. There is no practical way, in a free economy, by which the system of prices can be so modified as to produce a different result. The implication of the criticism directed against the excise taxes as being regressive is that there is involved some sort of unique oppression of those with small incomes. By this standard there is a far greater degree of oppression in the whole price system than there can be in taxes which are ordinarily only a small proportion of the price. And, if this line of argument were valid, either as to its major or its minor applications, there should be some indication of this oppression somewhere in the economy. There is no such indication. On the other hand, the Nation has grown and prospered under a regressive price system. A moderate, uniform excise tax would not impede or dampen that prosperity as much as would the additional heavy income taxes that would be required if the Federal Government obtained no revenue from excises.

Another point to be mentioned briefly is the concern of some that the people will not be aware of paying excise tax. It is true that complete awareness would require of the citizen an encyclopedic knowledge of the tax law and of the economic theories of tax shifting and incidence. Very few persons carry such details in their heads, and hence very few are likely to be aware whether or not there is an excise tax on a given article, and if so, what is the rate of tax. It can be said of the proposed uniform excise that since there is only one rate, applicable across the board, there would be very much less excuse for people generally not having knowledge of it than there is in the case of the present complicated system.

Mr. Chairman, and gentlemen of the committee: NAM recommends a uniform excise on all end products of manufacture except foods, alcoholic beverages, and tobacco, and strongly urges its adoption as the only fair solution of the present excise tangle, as the only way of putting all producers and all consumers on a basis of equality in producing and spending, and as a necessary step toward the stabilization of the Federal finances.

We strongly urge, further, that you do not accept the principle of full graduation of the corporation tax rates which is contained in H. R. 8920, and that you do not jeopardize the stability of the Federal budget nor endanger the Nation's economic growth by a further increase of the proportion of income taxes in the Federal revenues. Our national strength is founded on the accumulation and employment of capital in private hands, and any increase in the burden of income taxes would have serious implications for the ability of industry and business to keep pace with the Nation's needs for expanding job opportunities and constantly improving living standards.

I repeat, in closing, my beginning statement that the issues involved are so serious that if there is not now time for their adequate consideration and proper solution in this session, it would be much better to have no tax bill than to enact H. R. 8920.

This testimony was prepared during the period of uncertainty produced by the far eastern crisis, and a final point should be emphasized. Nobody wants

another war. We all want peace. But this issue appears to lie outside our power of decision. If it should come to the calamity of another war, there is still time for the Congress to put the excise part of the Federal revenue system on a sound basis. It would be unthinkable for us to enter upon the financing of another war with the kind of scatter-gun excise system that was used in the last war. Whether the future brings war or peace, the arguments for a broadly based excise at a moderate rate are strong, and to us, convincing.

ADDENDUM 1

EFFECT OF THE NOTCH PROVISION

Every business witness who appeared before the Ways and Means Committee admitted that the effective rate of tax on the entire corporate income was never as much as 38 percent until the $50,000 net income level was reached. As a reminder of this fact, the following tabulation of effective rates on selected income brackets is presented:

Taxable income brackets, actual and effective tax rates, and taxes, on corporate incomes to $50,000

Taxable income brackets	Combined normal and surtax rates (actual)	Tax on maximum bracket amount	Effective tax rate on total taxable income
	Percent		*Percent*
Not over $5,000	21	$1,050	21
$5,000 to $20,000	23	4,500	22½
$20,000 to $25,000	25	5,750	23
$25,000 to $30,000 [1]	53	8,400	28
$30,000 to $40,000	53	13,700	34½
$40,000 to $50,000	53	19,000	38

[1] The statutory bracket includes income from $25,000 to $50,000. The intermediate brackets shown in the table are introduced in order to illustrate the graduated adjustment of the effective tax rate in more detail.

The principal objection to the notch rate is that it is a barrier to business expansion across the notch zone of $25,000 to $50,000. The House committee report summarizes the testimony of numerous witnesses on this point by stating that the notch rate discourages the investment of additional funds in such corporations. If one were to judge from the number of objectors and their volubility, the conclusion would be reached that the notch zone is a soft spot, a decadent area, in corporate development. The record indicates otherwise. Beginning with the Revenue Act of 1938, there has been a notch rate provision in the corporation tax law. The height of the notch rate has, of course, been in relation to the standard flat rate. The present notch rate of 53 percent was introduced by the Revenue Act of 1942, first applicable to returns for the income year 1942. There is supplied herewith a tabulation of the numbers of corporations and their total net incomes, arranged according to the taxable net income brackets as established by all of the tax acts since 1939.

Number of corporations and net income, by net income brackets, selected years, 1940–46

[Net income figures in millions]

Net income brackets	1940		1942		1944		1946	
	Number	Net income	Number	Net income	Number	Net income	Number	Net income
Under $5,000	142,711	$194	150,095	$239	140,657	$238	149,300	$264
$5,000 to $20,000	43,703	447	63,110	647	80,759	843	102,534	1,112
$20,000 to $25,000	5,703	128	7,455	167	9,392	210	18,118	408
$25,000 to $50,000	11,058	388	17,465	615	21,505	758	35,645	1,248
$50,000 and over	17,802	10,046	31,817	20,847	36,591	25,075	53,713	24,152
Total	220,977	11,203	269,942	24,052	288,904	27,124	359,310	27,185

Sources: Years 1940–44, Statistics of Income, 1944, pt. 2; year 1946, Treasury release, Apr. 21, 1949, Statistics of Income for 1946, pt. 2.

The critical income area in which the notch rate applies is the bracket $25,000–$50,000. The principal purpose of this table is to show the number and net income of the corporations falling within this area in each of the years 1939 through 1946. It will be seen that the number of corporations subjected to a notch rate has risen from 9,391 in 1939 to 35,645 in 1946, and that the total net income of these corporations has risen from $331,879,000 in 1939 to $1,248,324,000 in 1946. It is true that the notch rate in the early years of this table was not as high as at present, but the standard rate to which the notch rate was adjusted was not as high as the present standard rate. It is most revealing that even after the present high standard rate was established in 1942, with its proportionately higher notch rate, there continued to be a further growth of both the numbers and the net income of the corporations falling within the notch area.

The complaint against this rate would be more nearly valid if the same group of companies were to be subject to the 53 percent notch rate year after year. There is no evidence that such is the case. On the contrary, the increase in the number of corporations with net income of $50,000 and over indicates that each year a considerable number have come up to this level through the notch zone, or, in some cases, especially during the war years, the notch zone may have been bypassed entirely.

This committee is fully aware that the 53 percent rate applies only to that part of the net income of each corporation with net income under the $50,000 level which is in excess of $25,000. For the record, it may be worth while to show just what part of the total net income of the companies between $25,000 and $50,000 is subject to the 53 percent rate.

On the basis of the 1946 data, the 35,645 corporations in the net income bracket $25,000–$50,000 had total net income of $1,248,324,000. Since the first $25,000 of net income for each corporation was taxed at rates ranging from 21 percent to 25 percent, this would mean that $891,125,000 of the total net income was thus taxed ($35,645×$25,000). There remained, for taxation at the notch rate, $357,199,000 of net income, which was 28.6 percent of the total. The total income tax paid by the companies in the notch area was $363,601,000, making the average rate of tax on total net income 29.1 percent.

Addendum 2

Federal Tax Program of the National Association of Manufacturers

(Approved by the board of directors on October 25, 1949, and revised June 8, 1950, on recommendation of the association's taxation committee)

I. PRINCIPLES OF TAXATION

The program for revision of the Federal tax system which is submitted in a document accompanying this statement of principles has been prepared under fiscal conditions that are alien to all commonly accepted precepts of good financial management. Despite some recession of national income and business activity from the postwar peaks established in 1948, the indicators of the state of national well-being are still above any previous levels except those attained during the war years. This is true of the Reserve Board's index of industrial production, the Department of Commerce figures of salaries and wages and the other components of personal income, consumer expenditures, and employment. Nevertheless, the expenditures that the President has demanded and the Congress has authorized in appropriation acts will exceed revenues in the current fiscal year by as much, possibly, as $4,000,000,000. The outlook for the fiscal year 1951, while presently uncertain, affords no prospect of a reversal of the deficit policy.

The present situation demonstrates, first, that a reduction of tax rates does not always result promptly in a degree of economic expansion sufficient to prevent loss of revenue and, second, that a decline of tax receipts is not always a sure way to enforce cuts in the volume of spending. Relief from excessive taxes is absolutely essential to continued economic growth, but the initial effect of the 1948 tax reduction on the revenue reveals that time is required for the results of such action to emerge.

The development of sound, consistent tax policy requires constant concern for the needs of Government, and also for the conditions essential to the maintenance of healthy economic growth. The record of our national expansion indicates that the two most fundamental factors in this expansion have been capital formation and a consumption level adequate to absorb the products of a growing industrial system. It is self-evident that these basic factors cannot have full and free play unless the people have income sufficient, after taxes, for the requisite consumption

and capital formation objectives. When Government's exactions are too great, the ability of the citizens to consume and to save for investment is encroached upon. Although the income taken in taxes is counted as part of gross national product, and is a source of income for public employees and others, such public diversion and use of private income is not as invigorating for the economy as would be its use by those who have worked, or saved and invested, to get it. It is demoralizing to effort and initiative to be obliged to surrender a substantial portion of one's income to be spent as determined by the whim or decree of someone else. This bad effect is likely to be intensified as Government branches out beyond the services which are generally recognized and accepted to be essential to national security and internal stability into areas of less general acceptability and of less definite general advantage. Since Government spending is in such large measure directed into consumption channels, it can never be an adequate substitute for those private uses of income which result in capital formation.

From these propositions there follows the first principle of taxation, which is that it must be moderate. All taxation is burdensome, which is a summary way of saying what has been explained at greater length above. Some taxation is obviously necessary, and it remains to effect the best possible adjustment of an obligatory burden. Moderation in taxation means two things: first, the total take must not encroach too heavily on the capacity of the people to consume and to save, and, second, the rates of tax must not cut too deeply into income at any point. The levy of extreme or punitive taxes, whether on incomes directly, or on commodities, business, or other objects, is an introduction of moral judgments which inevitably interferes with the primary purposes of distributing the necessary burden of taxation in such manner as to involve the least hindrance to the operation of the productive forces.

A corollary of the principle of moderation is that there must be no waste in the application of public funds, for otherwise it would soon be necessary to collect more revenue and in time the tax burden would pass the bounds of moderation. This means that public spending must be strictly controlled and every possible waste eliminated. The Nation can never be rich enough to afford public spending for unnecessary activities or in a wasteful manner.

A second principle which involves taxation although it applies broadly as a general fiscal principle, is that except in periods of grave emergency such as war or serious national disaster, the Nation should pay its way as it goes. In other words, the budget should be balanced with a reasonable surplus for debt retirement, all of which requires strict control of spending if taxation is to be moderate. Public credit is a device for postponing taxation from the present to the future, and the case for permitting the present generation to enjoy greater benefits at the expense of the next generation must always be supported by overwhelming justification. The Nation will endure for a long time, but the next generation is not present to speak or vote in its own behalf. The officers of Government are the present custodians of the future welfare, and they assume a tremendous responsibility when they decide to shift part of present costs into the future by tolerating deficits without utterly compelling reasons.

A third principle, applicable as a practical guide to policy, is that the Federal tax system should be broad in scope and flexible in operation. Breadth means, first, the use of various taxes rather than under reliance upon any one tax and, second, wide incidence of each tax by avoiding exemptions or holding them at reasonably low levels. In general, relief from overburdensome taxation should be sought by keeping tax rates down. This can best be accomplished for all citizens by maintaining broad coverage in all major Federal taxes.

Flexibility in the Federal tax system means capacity and readiness to shift the revenue emphasis from one tax to another as economic conditions change. Simplicity of language, of the structure of the tax, and of operating procedures is essential to flexibility.

The major object of this principle of breadth and flexibility is to enable the Congress to provide the revenue needed to keep the Federal budget at least in balance within the existing tax structure and under varying economic circumstances.

II. THE IMMEDIATE PROBLEM

Against the background of this outline of some principles which should be observed in shaping the kind of tax system most conducive to sustained national economic growth, there is presented a brief discussion of the taxation issues which now appear likely to be at the fore in the second session of the Eighty-first Congress. It will be necessary to consider some modifications of the present tax program in order to provide guidance for those who may be required to deal with these matters.

The excise taxes

For some time, pressure has been accumulating for repeal of some excises and for a return, in other cases, to lower rates such as were in effect prior to the war increases of 1943. It is highly probable that the Congress will be forced to acknowledge this pressure, at least by opening up the subject to hearings and possible legislative action.

The principal basis for complaint against the present Federal excise system is its selective, discriminatory character, expressed both by the range of goods taxed and by the variations in tax rates. Virtually every industry whose products are subject to tax is pressing for repeal or rate reduction. The validity of the complaint may be granted at once, for there is no sound defense of the existing hodgepodge of commodities and rates.

The issue that must be squarely faced is the best procedure for correcting these obvious and undeniable evils. The first consideration to be met is the amount of revenue loss that would be experienced and how to secure at least an equivalent revenue. In view of the current budget prospects, it should be plain that there should be no thought of an outright loss of revenue without replacement. The amount of loss would be determined by the extent of the repeal or the cut-back, but it appears inevitable that once the excises have been opened up for revision, the ensuing competition for relief would compel sweeping readjustments, and would involve a substantial amount of revenue.

At this point the contention that when given rates are reduced the sales of the taxed articles will expand sufficiently to bring in as much revenue as the existing rates now produce must be challenged.

Since excise taxes are eventually reflected in the prices paid by consumers, a reduction or repeal of tax would lead to a lower price, and in some instances to larger sales volume. The extent of the sales expansion would be influenced by the elasticity of demand for the particular classes of goods affected. It would not follow, however, that there would be, in every case of an excise-tax rate reduction, an increase of sales sufficient to produce the same amount of revenue as the higher rate had produced. Under ordinary conditions, the people spend currently a large part of their disposable income, which is the income remaining after personal taxes and nontax liabilities. A price adjustment such as would occur after the reduction of an excise tax would lead to a rearrangement of consumer buying plans. If more of the particular commodity in question were bought, there would tend to be diminished purchases of other goods, and the decrease could as well happen in the taxed field as in the untaxed field. That is, while the reduction of a particular excise tax might stimulate purchases of that article, it could very well lead to smaller purchases of some other taxed article. On the whole, it appears that the immediate revenue loss would be fairly proportionate to the amount of the excise tax rate cut-back, notwithstanding that there would be a redistribution of consumer buying in response to the price changes resulting from the cut-back.

The steadiness of the excise-tax yield in recent years indicates that consumer buying of taxed articles has continued, in the aggregate, at practically constant volume. In the fiscal years 1948 and 1949 the yield of the various major groups of excise taxes was as follows:

TABLE I.—*Excise-tax yields, fiscal years 1948 and 1949*

[Millions]

Class of tax	Amount	
	1948	1949
Liquor taxes	$2,255.3	$2,210.6
Tobacco taxes	1,300.3	1,321.9
Subtotal	3,555.6	3,532.5
Manufacturers' excise taxes	1,649.2	1,771.5
Retailers' excise taxes	469.9	449.2
Miscellaneous excises	1,655.7	1,752.8
Subtotal	3,774.8	3,973.5
Grand total	7,330.4	7,506.0

Some idea of the cost of repeal or cut-back can be had by considering the total receipts in 1949 from all taxes except those on liquors and tobacco. This total was $3,973,500,000. A general cut-back to half of the rate now levied in each case would involve a loss of around $2,000,000,000 in revenue.

The 1948 NAM position on excise taxes called, first, for a "thoroughgoing investigation of the distribution of tax burdens under the present tax system with the aim of achieving a better-balanced and more realistic structure"; and, second, for the policy that "any modification of the excise system should be carefully worked out so as to establish equity among producers of competing products and among consumers of different classes of products."

It should be clear that there is no way of achieving equity—or equality—among competing producers, or among consumers of different products except in one of two ways. The first way would be to repeal all excises, the second would be to subject all consumer goods to excise tax.

The choice between these alternatives is clear. The first method is excluded by the tremendous loss of revenue that would be involved. Replacement could not be effected by higher individual and corporate income taxes without crippling effects on the whole economy. Its adoption would be most unwise, further, because it would deprive the Federal budget of the stabilizing contribution which exercise taxes make. In fact, from this standpoint there is strong reason for increasing the proportion of total revenues provided by the indirect taxes. They are far more resistant to depression conditions than are the income taxes, and hence can become, in some circumstances, a veritable bulwark of the budget. This point is illustrated in the following table from the report of the Committee on Postwar Tax Policy.

Levels of income and changes in tax yield

[Index numbers]

Levels of gross national product	Tax yields			
	Corporation income tax	Personal income tax	Payroll tax	Excises
100 (base)	100	100	100	100
82	40	60	80	90
118	160	140	120	110

Source: R. A. Musgrave and others, Public Finance and Full Employment, Postwar Economic Studies, No. 3, December 1945. The Board of Governors of the Federal Reserve System, Washington, D. C., p. 42.

The second method would eliminate the discriminations that now exist and would put all producers on the same basis in competing for the consumers' dollars. It would at the same time equalize the situation as it involves the consumers in making their choices among different products.

It is now recommended that the Federal excises be modified to cover approval of a general manufacturers' excise tax. Such a tax would be in substitution for all of the present excises except the liquor and tobacco taxes, and should be imposed at a rate sufficient to produce the same amount of revenue, namely, $4,000,000,000 in round figures, as is now produced by the excises for which it is to be substituted. The one exemption from the proposed tax should be foods and food products. While this exemption is counter to one of the principles stated above relating to exemptions, it is nevertheless put forward in recognition of the proportion which food expenditures comprise of the small income budgets. It is estimated that a uniform rate of about 5 percent would produce the requisite receipts. Some further explanatory details follow:

First, the tax would be levied at the final point of manufacture. This point would be determined either as it is today under the existing manufacturers' excises or as it is in Canada, where a similar tax has been in effect since 1920. The present Federal practice is that the seller of materials or partly fabricated goods does not act as the tax collector if his buyer can furnish an exemption certificate. This certificate is obtainable from the Bureau of Internal Revenue on a showing that the buyer ordinarily uses the materials purchased in some further process of manufacture. Under the Canadian system all manufacturers are licensed, a formality devised solely for the control purposes of collecting the tax, and sales by one manufacturer to any licensed person are not taxable. Both in Canada and here, there comes a time when the finished article passes into the hands

of some one who has no exemption certificate, or is not licensed. At that point the last seller includes the tax.

Second, it is not feasible generally to provide that the tax be shown as a separate item and thus invoiced through the several stages of the distribution process. When it is finally imposed at the end of manufacturing, it is collected in the first instance from the wholesaler, jobber, or other middleman who first takes title to the merchandise. It is therefore, to him, part of the cost of the goods. Eventually, there will be reimbursement of this advance payment of the tax by the ultimate consumer.

The matter of pyramiding the tax as goods pass down from one layer to another of the distributive organization has been exaggerated. If this were consistently done, the practical result would be that profits at the several distribution levels would be greater than they would be if there were no such tax. And it would follow, also, that the higher the rate of tax, the greater the middleman profits would be. This view disregards the source and reason for profit, which is a return that is gained from the successful performance of a service that others are willing to pay for. In the field of merchandise distribution, this service consists essentially of supplying to consumers the kinds and qualities of goods that they want, at prices they are willing to pay. The value of this service, from the consumer standpoint, is not enhanced by the fact that the various middlemen are acting, in turn, as relays in a tax-collection process. The competition for the consumer dollar in which all of the thousands of merchants and other distributors are engaged is the effective determinant of the profit rewards which any of them will get. It is not a question of the ultimate consumer being the one from whom the tax, long since advanced to the Treasury, will be collected. Rather, it is a question of the extent to which there will be widespread, abnormal enhancement of profits at any level of the distribution process because of the tax. This is the point that has been exaggerated. Were it really true that all distributor profits would be enhanced by reason of such a tax, there should be a universal demand from these groups for a high tax rather than a low one. Actually, they know that a high tax would diminish both their sales and their profits. The advantage of a low rate across the board is that it does not discourage sales unduly, and it tends to keep the general competitive situation in a state of balance, so far as concerns all classes of goods, all producers, and all consumers.

Third, an excise tax at the retail level is in many respects the most satisfactory to administer. The principal obstacle to a Federal tax on all retail excises is the fact that some 27 States are now levying retail sales taxes. A Federal tax would be resisted as a direct encroachment upon a productive revenue source developed by and widely used in the States. It would conflict with the policy of moving toward the avoidance and elimination of duplicating and overlapping Federal and State taxes, in the greatest degree possible. A Federal excise tax at the final point of manufacture is not a direct duplication of the State sales taxes. Hence, it is probably wiser to observe the amenities of the Federal-State relationship notwithstanding certain problems and difficulties that can be found in the manufacturers' uniform excise tax.

The business interests of the country have at this time both an opportunity and a responsibility for statesmanship which should be met squarely. Action of some kind is undoubtedly to be taken on the Federal excises in 1950. The piecemeal revision which is certain to be done unless a bold, constructive, new solution is offered will include some repeals and some rate cut-backs. Inevitably, in the present state of the finances, there will be offsetting tax increases elsewhere. A uniform low rate tax that would make these other disturbing tax increases unnecessary by producing a revenue equivalent to that now received, and that would eliminate the dissention, complaint, and obvious discriminations of the present system is bold, constructive, and new. There is here an opportunity and a responsibility for industry leadership which constitute a high challenge.

The individual income tax

The central issue in the adjustment of Federal taxation to meet the need of a growing economy is the individual income tax. The burden of this tax must be reduced (1) to make possible greater personal savings for capital formation; (2) to leave more income for consumer expenditure; (3) to preserve and strengthen morale by leaving with all citizens a greater share of their incomes to be disposed of as they see fit.

The problem presented by this tax is complex and difficult. Although the following recommendations of the Hoover Commission mention no taxes specifi-

cally, it is evident that they involve a thorough review of tax policy in this field. These recommendations are:[1]

"1. We recommend that the functions and activities of Government be appraised to determine which can be most advantageously operated by the various levels of government, and which require joint policy making, financing, and administration.

"2. We recommend that our tax systems—National, State, and local—be generally revised and that, in this revision, every possible effort be made to leave to the localities and the States adequate resources from which to raise revenue to meet the duties and responsibilities of local and State governments."

These recommendations are of the greatest significance. They supply further support for the position stated above relative to the need of reducing substantially the burden of the Federal income tax on individual incomes, for it is clear that the States can acquire adequate tax resources for their own use only by an increase in the taxable capacity of their respective groups of citizens and taxpayers. A long-range problem which must be dealt with is that of effecting a proper balance between the Federal and the State drains on the current income which is the source of all taxes.

As this problem is grappled with, the many details that are involved will become apparent and must receive thorough consideration. The character of the Federal rate or rates, the policy of allowing deductions and of permitting personal exemptions and dependency credits, and many other matters must be reviewed. Pending the public discussion of these issues which must be conducted, it is consistent with the general tax principles stated above to recommend—

(1) That to the extent the current revenue requirements will permit, consideration be given to the reduction of the rate scale; and

(2) That there be no change in the personal exemptions and dependency credits as provided in the Revenue Act of 1948.

These recommendations mutually reinforce each other. An increase of exemptions, even at the most moderate additional allowances over those now provided, would result in the release of large numbers of persons from all direct tax liability and would exclude large amounts of taxable income from the Federal tax base. The effect would be to concentrate virtually all of the tax relief in the lower and moderate incomes, and thus compel the retention of such high rates upon the remaining taxable income as to limit greatly the savings that can be made for capital formation.

The taxation of corporate income, first in the hands of the corporation and second in the hands of the stockholders when disbursed in the form of dividends, is decidedly harmful in two major respects: (1) To the extent that double taxation results, the value of capital is impaired; and (2) the knowledge that double taxation does exist in substantial degree creates a barrier to the employment of individual savings through purchase of corporate equities.

III. DETAILED RECOMMENDATIONS ON TAX REVISION[2]

1. The individual income tax

(*a*) The burden of the individual income tax should be substantially reduced and, as a first step, the top rate should be reduced to no more than 50 percent.

(*b*) Personal exemptions should remain at the level established by the Revenue Act of 1948 as a means of continuing tax relief to individuals.

(*c*) Elimination of double taxation of corporate income should have high priority in the list of needed tax reforms.

2. The corporation income tax

(*a*) *Tax favoritism.*—(1) Federal taxation of all competitive enterprise should be fair and equal, and no tax favoritism should be shown any competitive group, whether it be private, corporate, cooperative, or association.

(2) In the case of corporations not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual, the Federal income-tax exemption privilege should be eliminated with respect to that part of their net income which is derived from the actual operation or management of business enterprise.

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[1] Hoover Commission Report on Federal-State Relations, p 35.

[2] Approved by the Board of Directors of the National Association of Manufacturers on recommendation of the association's Federal tax committee.

(*b*) *Rate revision.*—As part of the long-range tax-revision objective, the corporation tax rate should be reduced in order to release more funds for capital formation.

(*c*) *Rates on smaller corporate income.*—(1) The present high level of the corporation rates makes it imperative that a differential between the taxes on corporate net incomes under and over $50,000 should be continued. The Treasury recommendation "that there be explored the question of whether the tax structure with respect to corporations with incomes below $50,000 can be revised so as to substitute for the present notch rate of 53 percent on that portion of the corporate income between $25,000 and $50,000 a more desirable relationship between the lower rates on smaller incomes and the ordinary corporate rate of 38 percent" is concurred in.

(2) However, the ordinary or standard corporate rate should be retained with respect to all income of corporations with net incomes above $50,000.

(*d*) *Intercorporate dividends.*—The credit for dividends received from corporations subject to the Federal income tax should be increased from 85 percent to 100 percent.

(*e*) *Consolidated returns.*—The additional tax of 2 percent on the net income reported in consolidated returns should be eliminated.

(*f*) *Undistributed earnings* (*sec. 102*).—The policy with respect to retained earnings should be changed so as to accept the decisions of management regarding the proportion of earnings to be retained. In any event—

(1) The burden should be upon the Government to establish an improper motive as to the specific amounts retained;

(2) The tax should apply only to that part of the undistributed section 102 net income which is unreasonably accumulated;

(3) Dividends paid within 75 days after the close of its taxable year should, at the taxpayer's election, be deducted in computing section 102 net income for such year;

(4) Long-term capital gains should be excluded from section 102 net income;

(5) Corporate reserves set up out of taxed profits to reflect higher replacement costs should be excluded from section 102 net income.

(*g*) *Stock options.*—The usefulness of stock options as a means of securing and retaining executive personnel having been nullified by court decision and Treasury rulings, explicit statutory provisions should be adopted to cover the following points:

(1) An employee realizes no income from the purchase of stock or warrants from his employer or others, provided the purchase is effected or the option is granted at a price not substantially less then the fair market value of the stock.

(2) If such stock is sold by the employee 2 years or more after the option is granted, the gain from the sale should be treated as a long-term capital gain.

(3) An employer is not entitled to a deduction for compensation paid on account of his empoyee's purchase of stock under a stock-purchase or stock-option plan.

(4) The tax basis of the stock purchased by an employee is its actual cost to him.

(*h*) *Full dividend reporting.*—It is recommended that total dividend payments of more than $1 to any one shareholder in any one year be reported on form 1099 in lieu of introduction of a system of a withholding tax on dividend payments.

3. Reforms affecting all income-taxpayers

(*a*) *Business net income.*—(1) Greater recognition should be given to the results of business accounting in the determination of business net income. That is, where management is following accepted, standard accounting procedures, the results should be conclusive as to the net income. Examples of the areas in which managerial policy with respect to business accounting should be accorded greater weight than at present are: (*a*) depreciation and obsolescence, (*b*) expenditures for intangibles, (*c*) salary determination, (*d*) pension determination.

(2) There should be establishment of adequate and realistic provision for depreciation, deferred maintenance and reserves; no technicalities should be interposed to prevent taxpayer from recovering free of tax the full cost of depreciable property. The cost of depreciable property should be recoverable free of tax as rapidly as is reasonable. The depreciation claimed by the taxpayer in accordance with the computations used in his books of account should be accepted unless proved to be unreasonable.

(3) No amount of depreciation should be considered as a reasonable allowance or allowable except to the extent it would have the effect of reducing otherwise

taxable income. In other words, the "tax benefit rule" should be applied to adjustments of the tax basis of property on account of depreciation and depletion.

(*b*) *Business net losses.*—Carry-back and carry-forward of net losses should serve the purpose of equalizing tax payments of companies with highly fluctuating volumes of business.

(*c*) *Capital gains and losses.*—(1) The tax treatment of capital gains and losses, as now provided in section 117, Internal Revenue Code, should be continued, but the rates on long-term capital gains should be substantially reduced.

(2) Consideration should be given to the provision of tax relief in the case of gains realized from the sale of a bona fide residence of the taxpayer, conditioned upon a minimum period of 1 year of actual occupancy prior to sale in order to prevent speculative tax avoidance.

(3) Capital gains treatment should be extended to lump-sum distributions under a qualified pension plan as well as a qualified trust, and also to previously qualified pension plans and trusts.

4. The excises

Except for the liquor and tobacco taxes, the present system of Federal excises should be replaced by a manufacturers' uniform excise tax on all articles except foods and food products at a rate to produce the same revenue as is now received from the taxes to be repealed.

5. Estate and gift taxes

(*a*) *The ultimate goal.*—Estate and gift taxes ultimately should be returned to the jurisdiction of the States in order to support State revenues and as a step in the solution of the Federal-State tax problem.

(*b*) *Interim revisions.*—For the present, exemptions under Federal law should be increased, rates of tax reduced, and taxation on transfers between spouses completely eliminated.

(*c*) *Survivor annuities under pension plans.*—The following rules with respect to survivors' annuities under pension plans should be adopted:

(1) The value of pension benefits and any death benefits paid to a survivor-beneficiary through exercise of a joint and survivor annuity option, under any qualified or previously qualified pension plan, should not be subject to estate tax.

(2) There should be no gift tax by reason of the employee exercising his right under a qualified or previously qualified plan to choose a joint and survivor option.

IV. THE ADMINISTRATION OF THE TAX LAWS

1. The status of the Tax Court as an "independent agency in the executive branch of the Government" should be retained, and the rule that "no qualified person shall be denied admission to practice before such court because of his failure to be a member of any profession or calling" should be continued. A tax settlement board should not be established.

2. Positive steps should be taken to insure that the Treasury interpretative regulations accord with congressional purpose and intent. Such regulations should be submitted, before promulgation, to the Joint Committee on Internal Revenue Taxation for comment and criticism, in order to prevent regulations widely at variance with the spirit and purpose of the law, to give them greater weight in court, and to encourage readier acceptance of them by the taxpayers.

Mr. SLIGH. In the limited time available, I can only summarize briefly the views of NAM on the pending tax bill. I offer a more complete statement, with two addenda, and ask that they be accepted as part of the record. The major points in our statement are these:

(1) Budget balance must precede tax changes which would result in significant loss of revenue;

(2) The Federal revenue system should always include a substantial proportion of excise-tax revenue;

(3) The tax bill before you is seriously deficient because—

(*a*) it increases Federal reliance on income taxes by proposing substantial cuts in excise taxes and an increase of the corporation tax;

(*b*) it introduces full progression in the corporation tax—a revolutionary departure of gravest consequences;

(*c*) it proposes an unnecessary, cumbersome withholding tax on corporation dividends;

(*d*) it fails to resolve the excise tax problem.

(4) The existing Federal excise system is a fair target for all criticisms. I shall recommend, on behalf of the taxation committee and the board of directors of NAM that, except for the taxes on alcoholic beverages and tobacco, the entire Federal excise-tax system be eliminated and replaced by a uniform manufacturers' excise on all final products of manufacture other than foods and food products.

Senator MILLIKIN. May I ask the witness a question, please?

I notice you open your statement by saying, "Budget balance must precede tax changes which would result in significant loss of revenue." I suppose one of your tests there is whether the change would result in a significant loss of revenue?

Mr. SLIGH. That is correct.

Senator MILLIKIN. Do you feel that it is the sole function of this committee and the Congress to vote for taxes that are necessary to cover the appropriations or do you feel that this committee has some responsibility for perhaps influencing the scope of appropriations by appropriate tax legislation? I mean in your business you start from the money for your expenditures, you do not start from your expenditures to the money.

Mr. SLIGH. We believe in cutting expenditures and we believe that can be done without too much difficluty. We believe that we cannot continue running a deficit.

Senator MILLIKIN. If it is not done, you feel that we should levy the taxes to cover the appropriations?

Mr. SLIGH. We do not feel that there should be deficits continually.

Senator MILLIKIN. There is a double responsibility of reducing expenditures and of reducing taxes?

Mr. SLIGH. That is right, sir.

Senator MILLIKIN. I notice that you are proposing a sort of manufacturer's sales tax.

Mr. SLIGH. A uniform manufacturers' excise tax.

Senator MILLIKIN. As a substitute for what?

Mr. SLIGH. For the present excise-tax system.

Senator MILLIKIN. As you develop your theme here, will you point to the merits of it?

Mr. SLIGH. Yes, sir.

Senator CONNALLY. You say that we have to balance the budget before we go into the provision of tax matters. If the budget is not balanced, would you favor increasing taxes to meet the appropriation?

Mr. SLIGH. We do not feel that taxes should be increased at the present time.

Senator CONNALLY. For any reason?

Mr. SLIGH. Of course, in case of an emergency, a war emergency, or something of that kind, it might be absolutely necessary, but we do not feel that taxes should be increased in time of peace over the present level. We do feel that certain savings in expenditures are possible and should be made at the earliest possible moment.

Senator KERR. Do you point those out in your statement?

Mr. SLIGH. I do not quite understand your question.

Senator KERR. You believe that certain savings should be made in the budget?

Mr. SLIGH. Yes, sir. We have a budget; NAM has proposed a budget. However, we feel that the one already proposed by Senator Byrd of your committee is an excellent budget. We would certainly be very happy to go along with that. In the full statement that we are submitting to the committee we do have an outline of our entire tax program, which is addendum No. 2. That will give you further information.

Senator CONNALLY. Are you a candidate either for Congress or the Senate?

Mr. SLIGH. No sir; I am not. I do not aspire to that high office.

Senator CONNALLY. That is the only place you can do this. Your company's resolutions will not get very far if the Congress does not respond. You are for the Byrd plan?

Mr. SLIGH. Yes, sir.

Senator CONNALLY. Have you read it?

Mr. SLIGH. I have not read it in detail myself.

Senator CONNALLY. I did not think you had.

Mr. SLIGH. But the over-all figure is the figure I have in mind.

Senator CONNALLY. How did you get the over-all figure if you did not read the details of the figures, just lumped it off?

Mr. SLIGH. Of course our staff has made a very careful study of the entire problem, sir.

Senator CONNALLY. All right, you do not know what the details are but you are for the total.

Mr. SLIGH. I cannot recite all the details of the plan, no sir. That actually does not come under the scope of my particular committee's activities in NAM.

Senator CONNALLY. You are here testifying for your committee?

Mr. SLIGH. Yes, sir; but the budget problem comes under another committee.

Senator CONNALLY. You ought to know what you are talking about when you come here. You say you do not know anything about the Byrd details but you are for the total; is that right?

Mr. SLIGH. We are for the total of the Byrd budget.

Senator CONNALLY. If the Byrd budget was half as large as it is, you would be for that, would you not?

Mr. SLIGH. I would like to see the budget half as large as it is, sir. We have a booklet, Why Deficit Spending, that we could submit to the committee if you would like to have the detailed information.

The CHAIRMAN. This committee is not a spending committee. We are simply a raising committee.

Senator MARTIN. Do you feel that there might be a danger, if we increase taxes right now, of a diminishing return rather than a larger return?

Mr. SLIGH. We certainly do. We feel that an increase in taxes at the present time would be a very serious thing from the standpoint of the formation of venture capital and the payment of dividends to the many stockholders of this country, many of them small stockholders, widows and orphans and employees of the companies for which they work.

Senator MILLIKIN. I would like to refresh the memory of the witness that during the war we were confronted with a $50,000,000,000 deficit. We removed the excess-profits tax on corporations, and personally I think it was probably one of the wisest pieces of tax legisla-

tion that was ever passed because it enabled you gentlemen to make the replacements and make good on obsolescence, and carried you through the transition period. So, I think, there are some qualifications you have to put on your principle.

Mr. SLIGH. I proceed to a summary discussion of these points:

(1) Budget balance must precede tax changes which would result in significant loss of revenue.

We hold that spending can be reduced enough to balance the budget, and that, unless this is done, there should be no over-all tax reduction. On the other hand, we insist there should be no further increase of the Nation's tax load, which now comprises about 25 percent of national income. This load cannot, with safety, be raised further. It must be reduced if we are to continue our economic advance on a sound basis rather than on that of a disastrous inflation.

Senator MYERS. Do I understand that the paragraph means there should be no reduction in excise taxes totaling $1,000,000,000 until the budget is balanced?

Mr. SLIGH. If there is no increase in revenue from other sources, that is our belief.

Senator MYERS. But you are objecting to the features of the bill that increase revenue from other sources?

Mr. SLIGH. You will notice in this first sentence of the paragraph we say: "We hold that spending can be reduced enough to balance the budget, and that, unless this is done, there should be no over-all tax reduction."

Senator MYERS. I understand that, but, leaving out the raising of any revenue through an increase in the corporate tax, are you objecting then to the reduction of these excise taxes by $1,000,000,000 or more?

Mr. SLIGH. We do not believe that the present excise proposal under the new bill is correct. As I say, we believe in a uniform manufacturer's excise tax which will raise approximately the same figure from excise taxes but on a more equitable and fair basis.

Senator MYERS. So your objection goes to the entire House bill, the theory of the House bill?

Mr. SLIGH. Generally speaking, yes.

Senator KERR. As I understand it, you suggest that if we are going to eliminate the present unbalanced system of excise taxes, that instead of replacing that revenue with an increased corporate tax, it should be replaced with a balanced over-all manufacturer's excise tax.

Mr. SLIGH. That is correct, sir.

Senator CONNALLY. We should take it off some of them and put it on all of them?

Mr. SLIGH. That is right, sir.

Senator CONNALLY. On a manufacturer of lumber as well?

Mr. SLIGH. I was going to say it happens that I am very small manufacturer and I am in the furniture business which is not now subject to an excise tax. In other words, what I am proposing from a purely selfish and immediate interest standpoint would be to my detriment. However, I feel that I should look at the broader aspect of this matter and I think that for the good of the country as a whole it would be a fairer and more equitable plan. I outline it further in this summary.

Senator MILLIKIN. Does that not come down in its ultimate impact to a general sales tax? If you put the tax on everything you

manufacture at the source, the tax passes itself on to the ultimate purchaser, so in effect you wind up with a general tax on the consumer.

Mr. SLIGH. That in effect is true; yes. Of course we exempted food and rent under our plan, which makes up about 53 percent of the total cost of living.

Senator MILLIKIN. I am not talking about your personal business but generally in the furniture business what is the mark-up by the wholesaler from the factory?

Mr. SLIGH. Furniture, generally speaking, is not sold through a wholesaler; it is sold direct from the factory to the retailer.

Senator MILLIKIN. What is the retail mark-up?

Mr. SLIGH. It varies greatly but the initial mark-up would probably average between 85 and 100 percent on cost.

Senator MILLIKIN. Therefore, roughly speaking, the impact of your manufacturer's tax would be doubled by the time it reached the consumer.

Mr. SLIGH. We do not believe that would be true, sir. Of course the tax would be carried on the end product only and we feel that competition would soon take care of that particular problem. In other words, our business certainly has been very highly competitive. We have about 4,500 manufacturers in the field, all of them small manufacturers, and I do not think that it would be possible for the retail store to consistently mark up on the tax itself and still get the business.

Senator MILLIKIN. The retail store pays the price that you set?

Mr. SLIGH. That is correct.

Senator MILLIKIN. That price includes the tax?

Mr. SLIGH. That is right.

Senator MILLIKIN. Why should it not apply to the normal mark-up? Of course you know more about your business than I do, but the retailer does not sit down and say, "Now out of this $10 for this piece of furniture 50 cents of it is taxes, 70 cents of it is labor, and 90 cents of it is raw material," and so forth. He gets a bill from you for that $10 piece of furniture and he puts his mark-up on it, does he not?

Mr. SLIGH. That is absolutely correct, and I think that would prevail at least in the early stages of the tax, but I think eventually competition would force that mark-up on the tax itself out of the picture.

Senator MILLIKIN. As far as your end of the business is concerned, the manufacturing end, you have to pay interest to the bank. I am not talking about you, but the business has to pay interest to the bank for the tax features just as well as any other feature of its cost?

Mr. SLIGH. That is right.

Senator MILLIKIN. So that you cannot very well absorb it any more than you can absorb any other part of your cost.

Mr. SLIGH. We cannot absorb it and it is not our intention that it be absorbed at that level. Of course all taxes are ultimately paid by the consumer.

Senator MILLIKIN. The point is to keep it down as much as possible. Someone said the problems of taxation is to get the largest number of feathers with the least squawking of the fowl.

Senator MYERS. Is that not true when there are several steps between the manufacturer and retailer, where there might be three or four intermediate steps, there are constant mark-ups?

Senator MILLIKIN. He explained that in their particular business they ship directly to the retailer but in the ordinary business, to which I assume you are referring, you have a wholesaler, maybe an intermediate distributor, you have three or four steps before it hits the retailer. I am suggesting that in most instances at least there would be a mark-up all the way along the line. Frankly, I have never understood this theory of the National Association of Manufacturers. It seems to me to be very unsound.

Mr. SLIGH. I might say that a more detailed discussion of that particular point is carried on page 21 of our full statement which you have and I think it will tend to clarify that particular point.

Senator MYERS. You discuss the pyramiding in that, do you not?

Mr. SLIGH. Yes, sir.

(2) There should always be substantial reliance on Federal excises.

In 1949, the excises provided only 21.7 percent of Federal tax revenues. Income, estate, and gift taxes—the direct taxes—supplied 78.3 percent. This is a serious disproportion of the direct taxes, especially income taxes which are notoriously unstable. In contrast, excises are far more stable under adverse conditions. With a public debt of the present size, we cannot afford to carry so many eggs in the income-tax basket. We must diversify Federal revenue sources, to protect the future against debt increase, inflation, and devaluation.

Also excise taxes will make possible lower rates of income taxes. We believe that all tax rates should be moderate. Yet this requires Federal use of both income and excise taxes. Excessive rates of income tax frustrate the incentive to get income, and thus prevent capital formation, restrict production, cause unemployment, and impair economic growth. Excessive rates of excise tax interfere with consumption. To be prosperous and dynamic, there should be both production and consumption on a large scale. A tax system which includes both income and excise taxes at moderate rates will be the least impediment to both production and consumption.

3. The pending tax bill is seriously deficient because—

(*a*) It increases Federal reliance on income taxes. The statistics prepared in support of the House bill indicate, roughly, a swing of a billion dollars from excise to income taxes. Applying this to the 1949 record, it would mean that 81.2 percent of Federal taxes would come from the direct taxes, and only 18.5 percent from the excises. More eggs than ever in one basket, and at that a most uncertain and fragile basket.

(*b*) It introduces the revolutionary principle of full progression in the corporation income tax. It does this by resort to the technical, and now virtually obsolete distinction in the tax law between normal tax net income and surtax net income. The bill provides for a flat rate of 21 percent on normal tax net income and a flat rate of 20 percent on surtax net income above an exemption of $25,000. These terms, "flat rate," and "exemption" should deceive no one. For the great majority of ordinary business corporations, aside from banks and insurance companies, there is no difference of consequence between normal tax and surtax net income. Thus the bill provides for all taxpayers a first bracket rate of 21 percent on net income and a second bracket rate of 20 percent on net income above $25,000 or a total of 41 percent on all income above $25,000. This is full progression, even if the use of only two rate brackets makes it, for the present,

a "foot in the door" application. The bill removes the limit which now exists because the flat rate of 38 percent reaches back to the first dollar of income at the $50,000 income level, and so it opens the way to any third, fourth, or fifth bracket rate that a future Congress may decide to impose. In other words, H. R. 8920 converts the present limited graduation of the corporation tax rate structure to full gradution. For example, the next Congress might decide to enact that the proposed second bracket rate should apply to surtax net income from $25,000 to $100,000, and that a third rate, say, of 50 percent, should be levied on surtax net income from $100,000 upward. If American business accepts this foot-in-the-door, full progression, it will be stopped hereafter from opposing any expansion of it.

Karl Marx, father of communism, proposed heavy graduated income taxes as an effective way to communize an advanced economy.

Progressive taxation of corporation income has always been recognized as evil and dangerous. As an example: under normal competitive conditions, profit margins in business tend toward uniformity in a given industry, and the aggregate profit becomes dependent mainly on sales volume. When the corporate tax is applied to total income at progressive rates, there is an increasingly deep cut into the profit margin as sales increase. Thus a progressive tax would strike directly at management's effort to increase sales volume. If the rates become heavy enough, the distortion of the competitive situation would compel dismantlement of all large companies. This country needs many prosperous small businesses; it also needs some large businesses; and small and large business need each other. Taxation of corporation income at progressive rates would destroy the business structure which is the basis of our prosperity and national strength.

(*c*) The bill proposes a cumbersome withholding of a 10-percent tax on all dividends. This will enormously increase the volume of refunds, delay the receipt of income by many persons who should receive it promptly because they owe no tax, and complicate income-tax reporting by all persons now entitled to use the short income-tax form because they have less than $100 of income other than wage or salary. We recommend removal of the $100 limitation from the regulations pertaining to section 148 (a). The general knowledge that all dividends paid are being reported will correct the present disposition to forget, or to "chisel" on the small dividends which as is now well know, are not reported by the payor corporations.

(*d*) The bill fails to solve the excise problem. It merely reduces rates and introduces some exemptions. Our position in favor of a substantial Federal excise revenue does not involve approval of the present excise tax system. It is a fair target for all that has been said against it. It is discriminatory; illogical; and inequitable. The bill leaves it in precisely that situation.

4. There are two ways of achieving equity—or equality—in the excise system.

One is to repeal all excises, the other is to subject all consumer goods, except foods, to excise.

Repeal of all excises is excluded as a remedy for these reasons:

(*a*) The revenue loss from repeal of all excises except those on alcoholic beverages and tobacco would be tremendous—$4,000,000,000 on the basis of 1949 data—and replacement could not be effected by higher income taxes without crippling effects on the whole economy;

(*b*) It would deprive the Federal budget of the stabilizing contribution which excises make because of their resistance to depressive business conditions.

This leaves the other alternative—a comprehensive excise—as the only feasible solution, because:

(*a*) It would eliminate the excise tax discriminations that now exist;

(*b*) It would put all producers on an equal basis in competing for the consumer dollar, and it would put all consumers on an equal basis in making their choices among different products;

(*c*) It would conserve the revenues and thus preserve the salutary contribution of excises to budgetary stability. Moreover, it would keep the way open for lower income-tax rates and thus promote greater capital formation.

The NAM position is that there should always be substantial Federal excise revenue, and that it should not be obtained by scatter-gun methods. NAM, therefore, proposes a general manufacturers' excise, at a uniform, moderate rate, in substitution for all of the existing excises, except those on alcoholic beverages and tobacco. It should be levied on the final manufacturers' price of all consumer goods, other than foods, at a rate which would produce approximately the same total revenue as is now obtained from the specific taxes to be repealed. In the fiscal year 1949 this was about $4,000,000,000. Our best estimate is that a flat rate of 5 percent would produce this sum.

These points should be emphasized:

First, a manufacturers' excise is not a new form of excise taxation. We now tax at least 20 classes of goods under a manufacturers' excise, and in 1949 these excise collections alone were 1.8 billion dollars, or nearly half of the total involved in our program of substitution.

Second, the tax would be levied at the final point of manufacture. This accords with present procedure, which is administered through a system of exemption certificates to avoid duplication of tax prior to the final processing stage.

Third, it is not feasible to require that the tax be shown as a separate item and thus invoiced through the several stages of the distribution process. The intent must be to transmit the tax, eventually, to the final consumer.

In this way pyramiding will be minimized. This tendency has been exaggerated, for it implies that middleman profits are increased because of the tax. This view disregards the source and reason for profits in distribution. Competition for the consumer dollar, in which all distributors and merchants engage, is the effective determinant of profits.

The argument that such a tax is regressive can be quickly disposed of. Academically, this means that a given amount of tax is a larger proportion of a small than of a large income. Being a matter of arithmetic, this criticism can be brought against many taxes.

The fact is usually overlooked, however, is that the purchase price of a given article is itself a larger proportion of a small than of a large income. In other words, the complaint that is lodged against excise taxes, can with even greater force, be lodged against the whole system of market prices. There is no practical way of changing the whole price system, and there is no evidence that the Nation has not grown and prospered under this kind of price system.

In concluding this summary of my full statement I would like to emphasize our over-all view that the good of the Nation would be much better served without any tax revision at this time than by the enactment of H. R. 8920.

This testimony was prepared during the period of uncertainty produced by the far eastern crisis, and a final point should be emphasized. Nobody wants another war. We all want peace. But, whether there be peace or war, the Congress should put the excise part of the Federal revenue system on a sound basis.

The CHAIRMAN. Are there further questions?

If not, we thank you.

Mr. SLIGH. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. John P. Ohl Is the chairman of the committee on taxation of the New York City Bar Association present?

Since it appears Mr. Ohl is not present, we will call on Mr. William H. Quealy of the Illinois Manufacturer's Association.

All right, sir. You may identify yourself for the record, please.

STATEMENT OF WILLIAM H. QUEALY, ATTORNEY, CHICAGO, ILL., APPEARING AS COUNSEL FOR FEDERAL TAXATION COMMITTEE, ILLINOIS MANUFACTURERS' ASSOCIATION

Mr. QUEALY. My name is William H. Quealy. I am a practicing attorney of Chicago, Ill., and I am counsel for the Federal taxation committee of the Illinois Manufacturers' Association.

Our association embraces over 4,000 member firms, including large, small, and middle-sized industries of all types, the great majority of which employ less than 200 persons.

On behalf of the association, I wish first to reiterate our conviction that substantial reductions can be accomplished in Federal expenditures through the elimination of waste and extravagance, and curtailment in swollen payrolls, subsidies, loans, and grants.

Senator CONNALLY. Do you favor a cut in the appropriations for defense?

Mr. QUEALY. No, sir; I do not, but I believe that the domestic civilian expenditures for the 1951 budget are approximately $6,000,000,000 in excess of the same expenditures for the 1948 budget, and we feel that there is a basis for some reduction there.

The revenue bill of 1950, H. R. 8920, as passed by the House of Representatives contains numerous technical or corrective amendments, which are perhaps the best evidence of the careful consideration the legislation has received before the Ways and Means Committee. There are nevertheless several features in the bill which constitute a real blow to industry. The bill also fails to embody certain other much needed changes in the revenue laws which heretofore have been presented to the Congress. Within the limitations imposed by the President—that there be no loss in revenue—this result was probably inevitable. We seriously question whether tax legislation should be subjected to that limitation. Instead Federal expenditures can and should be reduced.

Before discussing the objectionable features or deficiencies in the bill, I would like to enumerate certain provisions of the bill which have heretofore been recommended by the association and which we again urge for immediate enactment. The provisions are:

(1) The elimination of the so-called notch rate of 53 percent applicable to corporate incomes between $25,000 and $50,000, as provided in section 218 of the bill.

(2) The taxation of the business and other income of certain tax-exempt organizations, as provided in section 301 of the bill.

(3) The reduction or revision in the Federal excise structure, as provided in sections 101–173 of the bill.

The immediate adoption of these provisions will encourage industry to hope for the much-needed complete revision of the Federal tax structure so as to remedy the remaining deficiencies or inequities in the law.

Unfortunately, there are also certain other provisions of the bill which, when coupled with the failure to include additional remedial legislation, more than offset the beneficial effects of the amendments I have just enumerated. The association strongly urges the committee to reject these other provisions, which are:

(1) The increase in the general corporate tax rate, as provided in section 218 of the bill.

(2) The withholding tax on dividends, as provided in section 601 of the bill.

(3) The classification as a capital loss of the loss from the sale or exchange (including abandonment) of property used in a trade or business, as provided in section 209 of the bill.

(4) The limitation of 1 year in the net operating loss carry-back, as provided in section 214 of the bill.

In addition, the bill fails to include certain proposed revisions to the revenue laws which have heretofore been recommended and of which the first three are closely related to certain of the provisions I have just enumerated. We again urge for consideration the following recommendations:

(1) The double taxation of dividends should be alleviated by allowing the individual an appropriate credit or offset against his tax for the tax paid by the corporation with respect to the income distributed as a dividend.

(2) Provision should be made for giving the taxpayer greater discretion in the determination of the rates and methods of computing the allowance for depreciation.

(3) Taxpayers should be given the option to charge all research and development expenses to current expense.

(4) The rate of interest applicable to deficiencies in tax should likewise be reduced to 3 percent.

There are undoubtedly many provisions or deficiencies in the bill, other than those I have enumerated, which may be of interest or concern to certain of our members. In limiting ourselves to these basic recommendations of general interest, we are presenting the considered opinion of our entire group. If time permits, I would like to present briefly our reasons for certain of these recommendations.

First, corporate tax revision: Section 218 of the bill provides for an increase of 3 percent in the over-all corporate rates. When combined with the $25,000 surtax exemption, the new rates result in an increase in the effective rate of $167,000 of corporate income. The report of the Ways and Means Committee states that the corporate taxpayer has fared better since the war than the individual taxpayer. From this, the committee concluded that it would be equitable to increase

the rate applicable to corporations with incomes in excess of $167,000. Such reasoning completely disregards the facts—first, that the ownership of such corporations is most often vested in a large group of individuals owning a small number of shares; and secondly, such corporations are in a better position to pass on any increase in taxes to the consumer. Thus, either the individual taxpayer or the consumer will ultimately bear the cost of the increased taxes.

In addition, the proposed increase disregards the element of double taxation in the corporate tax structure. The income of corporations is again taxed when distributed to its stockholders. For this reason corporate rates cannot be compared with the rates applicable to individuals. The Congress has been urged repeatedly to alleviate the double-taxation of dividends. Until legislation is enacted for that purpose it is believed that the corporate rates should be reduced rather than increased.

I might add, there, that we fully recognize that when such legislation is enacted, it might very well be in order to increase the rates applicable to corporations.

Section 201 of the bill provides that corporations act as withholding agents for the collection of the income tax which might be due from the stockholders on account of the payment of dividends. The method of collecting a tax on dividends is also an integral part of the over-all problem of alleviating the double taxation of corporate distributions. Action on the provisions for a withholding tax on dividends should be deferred until such time as the Congress is in a position to consider the entire problem. It is difficult to believe that there is such widespread failure on the part of stockholders to report taxable dividends received. If so, this might readily be remedied by requiring the filing of more complete information returns.

Second, property used in a trade or business: Pursuant to section 209 of the bill, the loss from the sale or exchange (including the abandonment) of property used in a trade or business is defined as a capital loss. As this committee knows, corporations may only deduct capital losses to the extent of capital gains. In most cases, where such losses are incurred, there are no offsetting capital gains. Therefore, the net effect of this amendment will be to deny to the corporate taxpayer any deduction for a loss from the sale or exchange of property used in the trade or business. In the case of individuals, the effective deduction will in most cases be limited to $1,000 in any taxable year.

We believe that this proposal is related to another recommendation which has been made many times before the Congress, namely, that management be given greater discretion in the determination of the rates and methods for computing depreciation allowances.

There are periodic drives by the Bureau of Internal Revenue to reduce the rates of depreciation used by many taxpayers. A reduction in depreciation rates might not be of such serious concern to the taxpayer if any resulting difference between the unrecovered cost of the property and its value at the time of sale or other disposition could be recovered as a charge against income. As a practical matter, it is often impossible to establish such a loss where there is no identifiable event which can be pointed out as having accelerated the Bureau's anticipated useful life of the property. Where either composite or group rates are used, the unrecovered cost is added to the basis of the remaining property. In addition, under the changes

proposed in section 209, if the remaining property is subsequently disposed of, the resulting loss can only be deducted against capital gains.

It is manifestly only equitable that taxpayers be permitted to recover as a cost the depreciation or obsolescence of property used in the trade or business. The various limitations existing either in the law or as a result of Bureau policy, when coupled with the proposed amendment, make such recovery highly doubtful.

Third, net operating loss carry-back: In section 214 of the bill the period for deducting the net operating loss carry-back is reduced from 2 years to 1 year, and the period for deducting the net operating loss carry-over is increased from 2 years to 5 years. The period for the averaging of income and losses is thus extended from 5 years to 7 years.

The association believes the retention of a net operating loss carry-back for 2 years is of greater benefit than any additional period for the carry-over of such losses. The carry-back results in the immediate recovery of a part of the loss as a refund of taxes theretofore paid. This replenishes the working capital which has been dissipated on account of the loss. On the other hand, the net operating carry-forward is of no benefit until such time as the taxpayer has income.

I might add, there, that the banks are perfectly willing to lend small taxpayers money against the certainty of a loss carry-back, but I seriously doubt whether any bank would make any loan on the gamble that the taxpayer would at some future time have income against which the loss could be carried forward.

Next we have the troublesome question of research and development expense.

A recent decision has raised serious question whether taxpayers may deduct research and development expenses, notwithstanding a consistent practice of many years duration. (Hart-Bartlett-Sturtevant Grain Co., decided by C. A., 8th, May 5, 1950.) This decision is merely a reflection of what is believed to be a changed policy on the part of the Bureau of Internal Revenue to require the capitalization of such expenses. Regardless of the merits of this policy as a matter of law, it is a serious deterrent to further development. It is doubted whether the drug industry would have incurred the expenses incident to the development of many of our recent medicines such as the sulfas, penicillin, and the like, if the industry at that time had realized that development expenses would be capitalized and any recovery deferred over an uncertain period of future operations. If future operations are profitable, there is no ultimate loss in the tax revenues from the current deduction of such expenses. If taxpayers are given that right, a source of considerable controversy in the administration of the revenue laws will be eliminated and industry will be encouraged again to undertake numerous projects which will inure to the public good.

Finally, we have the question of interest on deficiencies and refunds. I understand that the Treasury likewise has recommended that the interest rates be made the same. The association has for some time past urged that the interest rate both in the case of deficiencies and in the case of refunds be reduced from 6 percent to 3 percent.

In conclusion, the association realizes that in view of the changed international situation and the possibility that we might become involved, or actually are involved, in a conflict of ever expanding proportions, the Federal budget may exceed any existing estimates. In that event, it will, of course, be necessary to look to additional sources of revenue. Even so, we believe that the proposed recommendations should nevertheless be adopted in order to place all taxpayers on a more equitable basis. If it should develop that taxes must be increased, the Congress is then in a position to increase equitably the burden of all taxpayers.

The CHAIRMAN. Any questions?

Senator MYERS. Do I understand that the witness indicates that the provision for the increase of corporate income tax as provided in the House bill should not be accepted by the Senate and should be rejected by the entire Congress?

Mr. QUEALY. Yes; the association recommends that the increase in the corporate rates be rejected. The reason for that recommendation is——

Senator MYERS. I understand the reason. But then, in number (1) you do, however, recommend the elimination of the so called "notch" rate of 53 percent.

Mr. QUEALY. That is correct.

Senator MYERS. I understand that would mean a loss of about $250,000,000. And then, in No. (3), you speak of the reduction or revision in the Federal excise structure, as provided in sections 101–173 of the bill. Does that include all of the excise taxes?

Mr. QUEALY. That is correct.

Senator MYERS. And then do you have any recommendation as to how we may recapture some of this revenue totaling a billion dollars or more which is going to be lost?

Mr. QUEALY. We do not feel that the committee should approach the revision of the tax laws subject to a limitation that there can be no loss in revenue. We feel that there are certain revisions to the laws which should be made regardless of their effect upon the revenues. Then, having made those revisions, if, after a further review of the Federal budget, it is ascertained that additional funds will be needed, the Congress is in a better position to increase the various taxes proportionately.

Senator MYERS. Well, on the first page of your statement, you indicate that you wish to reiterate your conviction that "substantial reductions can be accomplished in Federal expenditures."

Mr. QUEALY. That is correct.

Senator MYERS. Even with those reductions that might be accomplished, you still say we should reduce our revenue another billion dollars at this moment without any additional taxes being imposed to recapture some of that loss.

Mr. QUEALY. That is correct.

Senator MYERS. That is all, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Quealy.

Mr. QUEALY. Thank you, Mr. Chairman and gentlemen.

The CHAIRMAN. Mr. Stewart? Mr. Charles Stewart?

You may identify yourself for the record, sir.

STATEMENT OF CHARLES W. STEWART, SECRETARY, MACHINERY AND ALLIED PRODUCTS INSTITUTE

Mr. STEWART. Mr. Chairman and members of the committee, my name is Charles W. Stewart. I appear in behalf of the Machinery and Allied Products Institute, of which I am secretary.

I understand from the notice received of these hearings that we have the privilege of supplementing our statement by filing a written statement for the record. With the permission of the chairman, we would like to avail ourselves of that opportunity.

The CHAIRMAN. Have you a statement now?

Mr. STEWART. I have a statement which I should like to make now, with the privilege of supplementing it for the record.

The CHAIRMAN. All right. You may do so. But you had better furnish it to the committee at an early date, so that we can get it in the record.

Mr. STEWART. Yes, sir.

The Machinery Institute represents capital-goods industries. These industries produce the facilities for production, distribution, transportation, communication, and commerce. Included in their products are the machinery, tools, and equipment which move into industrial plants in peacetime, and into arsenals, shipyards, aircraft and tank factories, during periods of national meregency.

Whether peace or war conditions exist, in our judgment anything done to retard the development and increasing productive technology of these capital goods industries for which I speak is accomplished at the Nation's peril.

As spokesmen for the institute have said to your committee many times in the past 18 years, every tax proposed must be examined in light of its impact on technological progress. For as implied by my description of the segment of industry I represent here, technological progress is the sole means of achieving national military security, attaining high levels of employment and raising living standards.

As we see it, the Nation must live for the foreseeable future with a heavy tax burden. It must also protect its military strength. Under the circumstances, there is only one sensible course for us to follow. We must collect the necessary revenue, but at the same time we must build a tax structure that will interfere as little as possible with the long-run growth and expansion of the American economy.

It is with these considerations in mind that we have examined the provisions of H. R. 8920, which is before this committee.

Based on these considerations we unreservedly oppose an increase in corporate tax rates unless overwhelming revenue needs, such as those arising in a national emergency, impel it. We do not believe that the occasion of net declines in indirect tax revenues constitutes such an imperative.

There is likely to be a tendency to inch the corporate income-tax rate upward whenever revenue requirements increase or when the more politically influential elements of the community demand tax relief. This tendency is exemplified not only in other countries but in the proposal before us to increase the top corporate rate from 38 to 41 percent under this bill.

However appealing this course may be, we believe it a grave disservice to the country at the present time. Profits constitute not

only the incentive for risk taking in the corporate sector of American industry; they constitute also its main source of funds. For it is safe to say that at least 80 to 90 percent of all corporate equity investment is financed from profits, either directly, through reinvestment, or "plowing back" by the corporations making them, or indirectly, through equity investment by stockholders from dividend income. In thus eroding at once the incentive for corporate risk taking and the supply of corporate venture capital, the taxation of profits has a doubly deterrent impact on economic expansion. We believe, therefore, that it should be applied with great restraint.

As indicated by the House report on H. R. 8920, the justification for the recommended increase in the corporate tax rate is that profits are alleged to have been so huge since the war that they can stand additional levies without serious impairment of the supply of equity funds. With this we cannot agree. As the institute has shown in a thoroughgoing analysis of the subject, entitled "Inflation and Postwar Profits," which I offer in full or in part for the record, if corporate earnings as a whole appear high in recent years, it is only because conventional accounting methods report as profit the increasing cost, during a period of inflation, of replacing the physical assets consumed in production. Corrected to exclude this element, which is not actually profit at all, postwar earnings have been low by all reasonable standards. Any tax increase proposal resting on the assumption that they have been high is, therefore, misconceived.

Moreover, the ability of corporations to pay increased tax rates is, in our judgment, not the paramount issue. Fundamentally, we must be concerned with the economic wisdom of requiring them to do so.

However, if despite our recommendations Congress decides on an increase in the corporate rate, then we urge that such an increase be provided by a special surtax which would automatically terminate on June 30, 1951, unless extended by the Congress. For if we are to have an increase, it should not be written into the tax law as a permanent feature but should require annual review and positive action by the Congress from year to year.

Another threat to technological progress contained in the bill before you is the proposal to change the treatment of capital losses realized at time of sale or abandonment of business properties. We see this issue come up again with surprise and certainly considerable regret. During the 1930's, Federal tax policy interfered so much with the development of modern equipment and plant that the error proved almost catastrophic to our national security as we entered World War II. One of the central contributing factors in this error was the treatment of capital losses on plant and equipment during the thirties. In this day of higher economic literacy, it is surprising to see a suggestion that we return to any part of that thinking which underlay the program involving the treatment of capital losses during the thirties.

The fact of the matter is that the provisions of section 117 (j) of the Internal Revenue Code were enacted in 1942, and the House report so states, to facilitate the disposition of obsolete business properties and to encourage the acquisition of new equipment needed so badly to protect our national security. These considerations were valid in 1942, they are always valid, and they are particularly compelling today. To deny these facts and to amend section 117 (j) to

provide that the losses under discussion be used for tax purposes only as offsets against capital gains is to destroy an important feature of the plan we adopted in order to eliminate great over-all loss to our economy and production. That plan was to keep our plant and equipment as modern as other oppressive tax features would permit. Supposedly designed to plug an alleged "loophole" in tax collections, the change, now incorporated in H. R. 8920, on the contrary, would constitute an unconscionable additional hindrance to programs of industrial expansion. We do not believe that the economy can afford a tax policy which slows up the pace of technological progress in this manner.

Moreover, as has been indicated by the previous witness, the proposed change would put the corporate taxpayer "in the bite," so to speak, between the present unsound Federal depreciation policy and proposed unreasonable capital loss provisions. The Treasury Department for years has been justifying its retardative policy relative to depreciation allowances by claiming that if depreciation of business property is inadequately treated during the course of its service life, such inadequate treatment can be offset at the time of disposal of the property. Such would not be possible under the proposed amendment incorporated in this bill.

If losses are realized at the time of a sale or abandonment of business property, this means that the values of such property were inadequately depreciated prior to the sale. It is obvious economic sense and patent economic justice to permit business concerns to depreciate the original cost of acquiring property by 100 percent of that cost, particularly during times of inflation. Present Treasury depreciation policy lays down a hidebound and rigid system for computing such depreciation. If the depreciation rate proves inadequate for the period of use of the equipment, the balance should obviously be recoverable at the time of disposal, at least as an offset against earnings.

On the other hand, when an industrial concern selling its used equipment realizes a profit from the sale, such a profit in these days is ordinarily attributable to price inflation. To assess a tax at the corporate rate on the earnings from such sale would be tantamount to taxing individual concerns for price inflation, while giving them no tax benefit for the same general cost and price inflation which hits them in their purchase of equipment.

We ask that this committee give particular attention to this particular provision of the House bill.

Senator MILLIKIN. Is it not true that many organizations have income but do not have capital gains?

Mr. STEWART. That is true.

Senator MILLIKIN. So that you have no fair chance to balance your capital losses against your capital gains in that kind of a company.

Mr. STEWART. I think that is true, Senator Millikin.

Senator MILLIKIN. I repeat, are there not many businesses which do not have capital gains against which to offset capital losses?

Mr. STEWART. In many businesses; and at particular times in practically all businesses.

Senator MILLIKIN. Is that not true especially in raw material producing companies?

Mr. STEWART. I should think so, although I am not as familiar with raw material producing as I am with the capital goods picture.

The level of the corporate tax and the capital loss provision change to which I have just referred are not the only factors to consider in appraising the impact of H. R. 8920 on technological progress. Also, strategically important is the structure and administration of the tax system under any revenue bill. In this connection, the Machinery Institute has certain recommendations which I should like to brief for you.

H. R. 8920 extends the period of loss carry-over from 2 years to 5. We are gratified at this extension, which is in the direction the Mcchinery Institute has been advocating for a number of years. In 1940, the institute published a study of the earnings of a sample of durable and nondurable goods manufacturers during the thirties. Our study showed conclusively that for corporations with fluctuating incomes an averaging period of 10 years is required for substantial elimination of the tax discrimination inherent in levying taxes on a year-to-year basis.

And I might say parenthetically that I believe that study was used at least as a partial basis for the Treasury recommendations with respect to the net loss carry-over.

While applauding the extension of the loss carry-over, we oppose the reduction in the loss carry-back period from 2 years to 1. Indeed, we feel that this period should be extended from 2 years to at least 3.

It should be emphasized that the loss carry-back technique has important advantages as a contracyclical device and as a protection to individual concerns suffering temporary losses. Most important, the concern suffering the loss would receive the tax benefit under a carry-back at the time it needs it most—during a period of deficit. Moreover, this is an automatic contracyclical device requiring no administrative assessment of the future cost of doing business. It should be built into the tax structure during a period of high levels of economic activity.

The revenue loss would appear to be negligible under an extension of carry-back in the fiscal year 1951. Moreover, we believe that the administrative difficulties cited by the Treasury with respect to the carry-back are grossly exaggerated.

In order to stimulate technological advance so necessary to our economic well being and national security, MAPI urges that H. R. 8920 be amended to include a provision for reform of depreciation policy. Our reasoning has been expressed in Institute Bulletin 2243, which is just four pages in length, and I should like to have it incorporated as an appendix to this statement.

The CHAIRMAN. All right. You may do so.

Mr. STEWART. Briefly, to summarize that bulletin, we have two recommendations: First, we believe corporations should be permitted to write off unamortized portions of original cost over two-thirds of the estimated remaining service life of the equipment. Second, we think the burden of proof that depreciation policies adopted by industrial concerns are unreasonable should be placed squarely on the Bureau of Internal Revenue, where it rested prior to 1934. In general, we believe that reasonable discretion in this matter should be restored to business management.

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As I indicated, present tax policy with regard to depreciation allowances was adopted in 1934. It came in a period of depressed levels of national income, and it sprang from the rather peculiar notion that the way to increase total national income was to reduce a significant part of it, namely, business income. We believe that the present depreciation policy as written in the law and as administered by the Bureau of Internal Revenue is a tax on technological progress.

One brief word on the proposed change in interest rates on refunds. I will not discuss it in detail. We agree with Secretary Snyder that the proposal "cannot be construed as an improvement in the tax structure or an administrative reform, and is an inequitable method of meeting our revenue requirements." It is particularly inequitable in those situations where a taxpayer receives refunds and pays deficiencies at the same time, which occurs inevitably under cases of section 722 of the Internal Revenue Code.

I should like to leave one thought with the committee beyond these specific recommendations. Tax policy in the United States has been approached from a tangential angle for many years. We believe that this is entirely understandable, and we sympathize with the problems that confront this committee. We have been through a long and devastating war. The tax system necessarily was tuned to that war, and if we have another one, necessarily the new war will require further adjustments. The postwar period has been unique in our history. For reasons of security and international relations we have borne the cost of many programs which have tested the financial strength of the United States. Now we are confronted with another crisis, which we can but hope will be temporary.

In any case, it appears that we cannot count on any easy return-to-normal period which will enable us to overhaul the tax system in a leisurely manner. Overhaul of the tax system is a long-range job and must be undertaken in spite of obstacles. It is a task which requires penetrating analysis of the economic issues involved. Each "opportunistic adjustment" in the tax system makes the major task that much more difficult.

We submit that the combination net excise tax cut and corporate tax increase in the bill before this committee is a perfect example of what I call opportunistic adjustment. Unless substantially revised from its present state, we urge the rejection of H. R. 8920.

In summary, we believe that: (1) There should be no net increase in corporate tax rates at this time, in the absence of a national emergency; (2) there should be no change in the treatment of gains and losses arising from the sale of plant and equipment; (3) the carry-back of losses should be extended to 3 years, not reduced to 1; (4) Federal depreciation policy should be reformed to restore to business management reasonable discretion in this field; and (5) the proposed change in interest rates on refunds should be rejected.

The CHAIRMAN. Are there any questions of the witness?

Senator MYERS. May I ask the witness what his view is on the excise tax feature of the bill?

You have rejected the corporate income tax, and you have commented on other features of the bill. What is your view as to the reduction of excise taxes in the bill?

Mr. STEWART. This bill was proposed and passed by the House in rather quick order, and our taxation committee and executive com-

mittee have not had full opportunity to give consideration to all of the problems which are raised in the bill. As I indicated, we oppose a net increase in the corporate tax rate to offset or compensate for an excise tax increase. We recognize that there may be certain inequities, and probably are, in the excise-tax structure at the present time; that certain industries probably are feeling unjust and discriminatory excise-tax provisions, many of which were enacted into law at a time when the objective was not altogether to raise revenue, but to discourage consumption of certain items.

We believe that attention should certainly be given to removal of those inequities. We believe at the same time that the committee should consider—and on this we do not have a specific recommendation, but we are merely recommending it for purposes of study—broadening the excise tax base. How that could be accomplished, at the same time maintaining equity, minimizing the impact on individual consumers, and so on, we are not prepared to recommend.

Senator MYERS. Then you are reserving judgment on the excise tax feature of the bill?

Mr. STEWART. That is correct.

Senator MILLIKIN. Has your organization taken a position on a general manufacturers' sales tax?

Mr. STEWART. We do not have a position on that, and I would rather not give you a personal opinion on it, Senator. We do believe, however, that the committee should consider alternative sources of revenue to periodic increases in the corporate tax rate.

The CHAIRMAN. We thank you, sir, for your appearance.

(The supplementary material referred to by Mr. Stewart follows:)

APPENDIX A

SUMMARY OF RECOMMENDATIONS FOR TAX REFORM PRESENTED BY THE MACHINERY AND ALLIED PRODUCTS INSTITUTE TO THE COMMITTEE ON WAYS AND MEANS OF THE HOUSE OF REPRESENTATIVES ON MARCH 1, 1950

1. The Congress should hold the corporate rate against further increase and should look toward an early reduction.

2. The Congress should reform Federal tax treatment of depreciation allowances to restore to business management a reasonable degree of discretion in this field. This should be accomplished by:

(*a*) Permitting business concerns to depreciate the full original cost of plant and equipment over two-thirds of its estimated service life.

(*b*) Accepting as reasonable for tax purposes any depreciation policy adopted and consistently followed by a business concern unless the Treasury can prove the contrary by a clear preponderance of the evidence.

3. The period for carry-back and carry-over of losses should be extended to 3 years and 6 years, respectively.

4. A start should be made on abolishing the double taxation of dividends by granting taxpayers a credit against the personal income tax equal to 10 percent of dividend income.

5. Present provisions relating to the undue accumulation of corporate surplus (sec. 102) should be modified by shifting the burden of proof from the taxpayer to the Treasury. Further, any penalty assessed should fall only on improper accumulation, not on all undistributed income of the taxable year or years concerned.

6. The capital gains tax should be reduced, and full deduction of losses should be permitted.

7. Business concerns should have the clear option of either capitalizing or expensing research and development costs.

8. Personal income-tax rates should be regraduated to a maximum of 50 percent.

9. The tax treatment of income earned abroad should be improved.

10. The budget should be balanced by a reduction of expenditures, or if necessary by a shift of the tax load to a broader excise base, but in any case a beginning on tax reform in the interest of economic progress should be made immediately.

APPENDIX C

[Machinery and Allied Products Institute Bulletin, No. 2243, Washington 6, D. C., June 25, 1950]

THE NEED FOR SOUND FEDERAL TAX POLICY ON DEPRECIATION ALLOWANCES

The fundamental objective of a sound tax policy is to provide for raising necessary revenue through a tax structure that interferes as little as possible with the long-run growth and expansion of the economy. Such a structure must protect both the incentives to enterprise and the supply of risk capital to finance it.

Summary of MAPI recommendations

Central to a tax policy appropriate to a dynamic economy are legislative and administrative provisions permitting more rapid capital recovery through adequate depreciation allowances. MAPI's recommendations for legislative reform in tax depreciation allowances can be summarized as follows:

To restore to business management a reasonable measure of discretion in the determination of depreciation policy.

To permit complete write-off over two-thirds of the estimated service life of the equipment.

To put the burden of proof relative to the reasonableness of depreciation practices back where it belongs—on the Bureau of Internal Revenue.

Reason for depreciation reform

A sound policy governing tax allowances for depreciation will stimulate private investment in productive facilities. Earlier recovery of capital through depreciation allowances would give industrial concerns additional funds for investment, would reduce the risk of investment in new facilities and diminish resistance to the replacement of old facilities. The resulting stimulus to technological progress would lead to higher levels of production and employment, improved products, lower prices, and even less burdensome conditions of work.

These considerations are particularly important at a time when the general price level has increased as drastically as it has in recent years, thereby aggravating the inadequacy of belated recovery of original cost. This issue is discussed in MAPI studies, Depreciation Policy and the Postwar Price Level and Inflation and Postwar Profits.

United States policy lags behind other countries

The hide-bound rigidity of our present tax-depreciation policy is in marked contrast to former policy in the United States and to present policy in other leading countries. In Sweden corporations may write off the cost of new productive equipment at once if they so elect. In Great Britain and Australia they may write off roughly one-half of equipment cost in the year of acquisition. In western Germany 50 percent of the cost of replacement equipment may be written off over the first 2 years. In Canada corporations can depreciate approximately one-half the cost of most types of industrial equipment over the first 3 years. In France, also, the administration of depreciation rates for tax purposes is much more liberal than here. We are in the unenviable position of having the most unenlightened tax-depreciation policy of any major industrial country in the world.

Depreciation policy changed in 1934

Prior to the midthirties the Bureau of Internal Revenue followed a fairly reasonable policy in the allowance of tax deductions for the depreciation of assets. For the most part, the decision on rates of depreciation rested with business management and the burden of proof was on the Treasury.

In 1934 a new Treasury policy was announced in Treasury Decision 4422 and Mimeograph 4170. This required taxpayers to review their property accounts, to estimate the remaining useful lives of the assets therein, and to revise their depreciation rates so as to write off undepreciated balances over these estimated remaining lives. Further, it reversed the burden of proof, placing squarely on the taxpayer the responsibility for justifying whatever rates of depreciation are claimed either as a result of this special review of property accounts or in the future.

Treasury policy is arbitrary

In administering this policy, the Treasury has required business firms to determine the prospective useful lives of depreciable assets with exactitude. Where the taxpayer's available records have been insufficient to establish satis-

factorily the probable service lives of assets in use, the Treasury has frequently imposed lower depreciation rates arbitrarily. In these cases reference is made either to a manual (Bulletin F) purporting to reflect average experience, or to the rates allowed other taxpayers in the same line of business, or to some other criterion. The entire procedure is inequitable, time consuming, and tedious.

Stright-line write-offs unscientific

If the rates of depreciation now insisted on by the Treasury reflected in any scientific sense the "true" depreciation of the assets concerned, they would have something to recommend them. But they do not. Revenue agents are scrupulous in attempting to determine the probable life expectancies of assets, but having made a finding they use it ordinarily for the computation of rates for application by the straight-line method, a notoriously unscientific, though practically convenient, expedient.

It is readily demonstrable that straight-line depreciation typically understates the consumption of capital goods in the early years of their lives and overstates it during the later years. The result is not only a serious maldistribution of depreciation charges over the life span; the cumulated sum of such charges typically lags behind the cumulated capital consumption throughout. To be as meticulous as the Treasury is in estimating the service life of assets, while relying on the straight-line method of distributing depreciation over that life, is therefore completely incongruous.

DISCUSSION OF MAPI RECOMMENDATIONS

First step in reform

A variety of legislative proposals for liberalizing tax depreciation have been offered, ranging from "free" or fully discretionary depreciation, 5-year amortization, and special initial write-offs, down to suggestions much more modest and conventional. Whatever the merits and demerits of the more extreme forms of acceleration—which we do not undertake to assess here—they involve such heavy losses of tax revenue over the first few years as to make them of doubtful immediate practicability in view of the state of the budget and current Government expenditures. MAPI has recommended that before we introduce special write-offs and amortizations we should first reform our normal depreciation procedure. Certainly that is logical as a first step.

Policy should be flexible

The problem cannot be solved to the best advantage by the prescription of standard rates of allowable depreciation on various categories of capital assets. The factors affecting the life expectancy of capital goods are too numerous, and too diverse from one situation to another, to permit standard rates to have any realistic application. American income tax practice has been based from the beginning on the principle that depreciation rates should be tailored to the needs of each taxpayer, a principle that the institute has consistently advocated.

Since administrative discretion if arbitrarily exercised will destroy the very flexibility it is designed to permit, the principle of individual treatment of depreciation practices should be written into the law, insofar as practicable. This will give better direction to a broad-minded and reasonable attitude on the part of revenue authorities—an attitude which is an essential element in proper administration.

Restore discretion to business management

It is essential to get away from the excessive rigidity and the literal-mindedness of Treasury policy since 1934. By legislative enactment we must restore to business management a reasonable measure of discretion in the determination of depreciation policy. After all, regardless of the method of computing depreciation, no asset can be depreciated more than 100 percent of its original cost, so that the only point at issue is the timing of the accrual. The responsible executives of a business are better judges of its needs than the revenue agent who audits its tax return.

Liberalize by two-thirds rule

Prior to the Treasury campaign for the reduction of depreciation charges, it was the practice of many business enterprises to apply the straight-line write-off over a period somewhat shorter than the full life expectancy of the assets concerned. Thus, machinery kept in service an average of 15 years would be depreciated over 10 years. This was a crude compensation for the tendency of the straight-line write-off to lag behind capital consumption (including obsolescence), but nevertheless it did serve as a partial corrective. Granted that the straight-line method

cannot be correct theoretically, however applied, it certainly comes nearer to reflecting the typical course of capital consumption when applied over say two-thirds of the full life of an asset than when applied, according to Treasury requirements over the entire life span.

To permit restoration of something like the earlier latitude in fixing rates, MAPI has recommended that Congress expressly authorize the depreciation of productive facilities, by the customary straight-line method or its equivalent, over a period not less than two-thirds of the estimated service life.

Place burden of proof on BIR

As an additional reform MAPI has recommended that the burden of proof with reference to depreciation deductions be placed where it belongs, and where it reposed, in practice at least, before Treasury Decision 4422—on the Bureau of Internal Revenue. Subject to the basic requirement that the taxpayer must follow consistently whatever method of depreciation he elects to use (save for changes approved by the Commissioner), his judgment should stand except where the Bureau is able to prove his method an unreasonable one. This shift of the onus of proof from the taxpayer to the Bureau should be accomplished by statute, in unequivocal language.

The CHAIRMAN. The next witness is Mr. Donald E. Chafey, of the Commerce and Industry Association of New York.

STATEMENT OF DONALD E. CHAFEY, COMMERCE AND INDUSTRY ASSOCIATION OF NEW YORK, INC., NEW YORK, N. Y.

Mr. CHAFEY. Mr. Chairman, my name is Donald E. Chafey. I am from the Commerce and Industry Association of New York, of which I am a staff member. I am speaking in the absence of one of the committee.

The CHAIRMAN. You may be seated, sir.

Mr. CHAFEY. The Commerce and Industry Association of New York, Inc., the largest chamber of commerce on the east coast and representing some 4,000 New York City businesses of all types and sizes, is opposed to this new tax bill for the following reasons:

1. Action on taxes should be deferred until the world situation is clarified.

Senator MILLIKIN. Mr. Chairman, may I ask a question?

You say that you represent 4,000 New York City businesses of all types and sizes. What is the preponderant type of business that you represent?

Mr. CHAFEY. It is widely scattered, including practically every type of business you can think of.

Senator MILLIKIN. What percentage, for example, represents retail establishments?

Mr. CHAFEY. I am new with the association, but I suspect it is in the neighborhood of 50 percent or more. In fact, I suspect it of being higher than that.

Senator MILLIKIN. And your retailers do not wish to get rid of the excise tax?

Mr. CHAFEY. There are qualifications here on our point of view that I hope will clarify that.

Although the association consistently has advocated elimination or reduction of excise taxes, it realizes that if full-scale war should break out in Korea or other troubled areas an increase in taxes will be required. In time of war the tax burden must be broadly spread over the entire population. Increases in military expenditures might require restoration of excise-tax cuts.

Excise reductions are accompanied in this bill by an increase in corporation rates. Such an increase would be harmful to the economy, a deterrent to investment, and unjustified in time of peace. On the other hand, if this country approaches a war situation, an excess-profits tax on corporations is probably inevitable. With this possibility facing us, it is certainly unwise to increase the basic rate of corporate tax.

2. The bill is hastily and badly drafted, which will lead to inequities and uncertainties.

Many provisions should be studied carefully before enactment. Some of the so-called loopholes sought to be eliminated by this bill represent the taking away of legitimate tax deductions. (Some particularly objectionable features of the bill are outlined subsequently in this statement.)

3. Excise reduction is offered at too great a sacrifice.

As we and other organizations interested in efficient and economical government long have contended, wasteful expenditures should be cut—and cut now. Then the increase in corporate rates would not have to accompany excise-tax reductions.

Comment on specific provisions of bill: If Congress decides to proceed with a tax bill at this time, the Commerce and Industry Association wishes to register the following comments on particular sections of H. R. 8920:

Sections 101 to 173—Excise taxes: Because of time limitations Congress will be unable to revise its proposed cuts of excise taxes. However, there is serious question that tax relief has been allocated fairly. Expediency appears to have been a major factor.

Section 205—Corporate earnings and profits accumulated prior to March 1913: The taxing principle of removing special treatment of prior-to-1913 earnings is not objectionable. To enact this provision 30 years later is unwise as a matter of practicality. The corporate records on which computations would have to be based no longer are available, so the accounting burden would be almost impossible. By this time there is little revenue and much bother in store for the Bureau of Internal Revenue. If this provision is to be adopted, it should be redrafted to permit an allowance for losses on the same basis as gains.

Section 206—Distributions in liquidation of a foreign subsidiary: On the one hand, President Truman is sponsoring the point 4 program to encourage foreign investments, while directly contrary is this provision that would discourage foreign investments by restricting the possibilities of realizing a reasonable return. The provision largely ignores the fact that a foreign subsidiary pays full foreign taxes. Furthermore, with the Commissioner's present powers and policy of restricting liquidations, this proposal is unnecessary.

Section 207—Treatment of certain redemptions of stock as dividends: The first situation covered by this amendment is not objectionable. The second case, involving the purchase of one corporation by another corporation where both are controlled by the same interests is highly restrictive and interferes with legitimate corporate operations. The definition of "control" should be revised upward from 50 percent to 80 percent to make it conform to other sections of the code.

Section 208—Redemption of stock to pay death taxes: Although a worth-while attempt has been made to give relief from the unfor-

tunate situation where closely held corporations must be liquidated to pay estate taxes, this section may aggravate other cases not specifically covered. Careful study should be given before adopting this proposal.

Section 209—Capital gains and losses: The Ways and Means Committee report claims that an inconsistency is removed by treating losses from the sale of property as capital losses. If the present practice is inconsistent, it now would be accentuated even further, since capital losses can be charged only against capital gains. Losses from disposal of property are an ordinary and legitimate cost of carrying on a business and should be so treated.

The proposed treatment of abandonment is particularly bad. Modernization of industry often requires abandonment of equipment before it has been depreciated. Now it is proposed to so limit industry that it would be unable to recoup many such losses and thereby discourage the introduction of new equipment and methods.

Section 210—Short sales of capital assets: Approved.

Section 211—Treatment of gain to shareholders of collapsible corporations: Evasions through use of collapsible corporations can be reached under the present law, and legislation is unnecessary. Bad drafting is particularly apparent here in the use of a subjective definition of what constitutes a collapsible corporation.

Senator MILLIKIN. Mr. Chairman, may I ask Mr. Kirby whether in his opinion we can reach the collapsible corporations under present law?

Mr. KIRBY. Mr. Chairman, that is a debatable question. We are doing our best administratively to reach that type of device.

Senator MILLIKIN. Have you reached any of them?

Mr. KIRBY. We have not had any court decision on the question. We are holding up many of them, preparing to litigate the cases. We are in the process of litigating.

Mr. CHAFEY. Section 214—Net operating loss deduction: We heartily support the extension of the carry-forward to 5 years. In reducing the carry-back, we recommend that the effective date of this provision be set so that corporations already planning to utilize the 2-year carry-back on current operations can do so and will have due warning that only a 1-year carry-back will be allowed on future operations.

In revising carry-backs we recommend that the definition be redrafted to eliminate technicalities so that the gains and losses of different years would be treated as if they occurred in a single taxable period.

Sections 301 to 332—Treatment of income of tax-exempt organizations: Although agreeing that it is undesirable to permit tax-exempt businesses to operate in competition with taxpaying corporations, we feel that action should be delayed until a careful study of these sections and their effects can be made.

Section 501—Estate taxes—Transfers in contemplation of death: We support the proposal to make transfers more than 3 years before death absolutely not in contemplation of death. Equity would dictate that this provision also should apply to tax cases that are still open covering previous years.

Section 601—Collection of income tax at source on dividends: If Congress is convinced that substantial revenue is lost by nonreporting

of dividends, a withholding may be in order. Without taking any stand on this proposal, we urge that careful consideration be given to the administrative difficulties which may be imposed on small companies. Generally speaking, large corporations could handle this burden by mechanized methods. The same may not be true of small companies.

Section 602—Reduction of rate of interest on overpayments: This proposal to reduce the rate of interest is inequitable since the Government collects one rate of interest and would refund at a lower rate. Furthermore, it is self-defeating, since taxpayers henceforth would be careful not to overpay taxes but wait until an assessment is levied.

Section 603—Payment of income tax by installment payments: The principle of having corporations pay taxes on a current basis is sound. However, it is unfortunate that this proposal is introduced as a revenue-raising measure.

The CHAIRMAN. Any questions?

If not, we thank you for your appearance.

Mr. CHAFEY. Thank you, Senator.

The CHAIRMAN. Mr. Heyl? You may identify yourself for the record, sir.

STATEMENT OF LOUIS H. HEYL, VICE PRESIDENT AND GENERAL MANAGER, THE WYODAK CHEMICAL CO., CLEVELAND, OHIO

Mr. HEYL. My name is Louis H. Heyl, and I am vice president and general manager of the Wyodak Chemical Co. of Cleveland, Ohio, and Upton and Colony, Wyo. My business address is 4600 East Seventy-first Street, Cleveland, Ohio.

We are miners and processors of bentonite clay. Under section 114 (b) of the Internal Revenue Code, the mining and processing of bentonite clay is granted certain exemptions in the form of percentage depletion along with several other mineral products.

Bentonite clay is unlike any other mineral as to its physical characteristics or as to its formation in the ground. It is widely scattered, in very small deposits, and therefore should be considered differently than any other minerals covered by this section.

I would therefore strongly urge that amendment 204 (c) to H. R. 8920, which would amend section 114 (b) (4) (B) of the Internal Revenue Code, be deleted as it pertains to bentonite.

That amendment, if permitted to stand, would add at the end of the second sentence thereof the following:

but such term shall in no cases include transportation beyond the property.

In order that a clear understanding may be had of the bentonite industry and the peculiar and unusual problems attendant thereto, I would like to give a brief geology of bentonite.

Senator TAFT. Is it my understanding that you want the percentage depletion entirely eliminated as far as bentonite is concerned?

Mr. HEYL. No, sir.

Senator TAFT. Only this one sentence eliminated?

Senator MILLIKIN. He wants it to include transportation.

Mr. HEYL. Transportation beyond the property. That is one of the proposals. There are two presented here.

This mineral is of volcanic-ash origin, deposited in scattered locations around the Black Hills. It is said to have fallen upon the surface

of what was then a salt-water sea which occupied much of the country surrounding the Black Hills of Wyoming and South Dakota and to have floated upon the surface of that sea until prevailing winds carried and eventually deposited it on various portions of the earth that rose above the sea, probably as islands at that time; now just small knolls surrounding the Black Hills. During the subsequent glacial period the water was forced from that sea, the volcanic ash was covered with overburden, compressed, and during the ages became what is now named "bentonite," a highly colloidal clay with certain properties known to no other mineral.

Because of that peculiar geological origin, bentonite appears in small widely scattered patches over a wide area, in veins ranging from zero to approximately 30 inches in thickness and covered with seldom over 20 feet of overburden making strip mining possible.

The proposed amendment 204 (c) would be discriminatory against the bentonite industry. The Bureau of Internal Revenue records will clearly reveal that in the administration of the Revenue Code as now written, transportation beyond the property, that is, from strip mines to processing plants, has been consistently allowed in the case of strip coal mines in past years. Section 204 (a) (4) (ii) of H. R. 8920 would adequately compensate the coal industry for the proposed loss of such transportation costs beyond the property by doubling their percentage depletion allowance from 5 percent to 10 percent but no percentage depletion allowance increase is proposed for the bentonite industry.

Senator TAFT. How much do they have already?

Mr. HEYL. Bentonite? Fifteen percent.

As part of my testimony, I am submitting attached to each copy thereof a sketch, drawn to scale, indicating the widely scattered small bentonite deposits and the distances bentonite must be trucked to nearest railroad points where, of necessity, the processing plants must be located. Since hauling must be by truck, we have designated approximate road-miles rather than the airline-miles on the sketch. You will note that the deposits designated as "Oshoto" varies from 25 miles to 30 miles to Moorcroft, Wyo., which is the nearest rail point which is on the Chicago, Burlington & Quincy Railroad; also that the deposits designated as "Ingalls" are from 50 to 60 road-miles to the same point and that other properties near the Wyoming-Montana boundary line are 50 to 60 road-miles to the nearest rail point, Colony, Wyo., which is on the Chicago & Northwestern Railway. Your attention is also directed to deposits bearing the numeral one, (1), from which bentonite must be trucked 20 to 25 road-miles to our processing plant near Upton, Wyo., on the Chicago, Burlington & Quincy Railroad.

It is therefore a definitely established fact that trucking bentonite to the processing plants where it must be dried, granulated, or ground, is a vital portion of the processing steps necessary to develop it to its "first commercially marketable product" stage; that is, in dried, ground, or granulated form and packed in bags.

Senator MILLIKIN. Your first step does not change the character of the deposit in any way?

Mr. HEYL. None whatever; it just reduces the moisture.

Senator MILLIKIN. That is, cleaning it up, drying it, and putting it into a certain form?

Mr. HEYL. That is correct.

The proposed amendment section 204 (c), if enacted, would therefore definitely discriminate against the bentonite mining industry, since the bentonite deposits are small—widely scattered and very distant from rail lines and possible processing locations. In the case of all other minerals, the deposits are not so scattered and are of thicker vein. Generally speaking, therefore, plants processing such other minerals can be and are located on the property and require very little trucking from the pits to the plant.

The second purpose of this testimony pertains to clarification of section 114 (b) of the Internal Revenue Code which section defines the term "Gross income from the property" and gives four specific definitions of allowable "ordinary treatment processes."

Senator MILLIKIN. Mr. Chairman, may I ask a question, please?

With what other deposits or minerals is your product in competition?

Mr. HEYL. It is not in competition with anything; except, in a general way, with other clays.

Senator TAFT. What is it used for?

Mr. HEYL. Bentonite clay is used primarily as a base for a rotary drilling mud in oil-well drilling, and also for rebonding burned molding sands used in foundries, and so on; and as a binder in core sands in foundries; and also, somewhat, in the general chemical trade. It being highly colloidal, it lends itself especially to suspension of other minerals in aqueous solutions. That is its principal use in rotary mud: for oil-well drilling. It holds the barium sulfates and other heavy materials in suspension so that they may be pumped and followed through without loss of circulation, and so forth.

None of these existing definitions cover, nor can they be applied to the methods used to produce commercially marketable bentonite. The bentonite processing industry is a comparatively small business conducted by the following companies: The American Colloid Co., Baroid Sales Co., the Black Hills Bentonite Co., the Eastern Clay Products Co., and ourselves, the Wyodak Chemical Co.

We have letters from the four other producers stating that their sales of bentonite, pulverized and in bags, amounted to from 93 to 99 percent of their total sales; that granulated bentonite in bags accounted for from 1 to 2 percent of their total and that the small remainder consists entirely of crushed and dried bentonite shipped to commercial grinders for further processing.

In our individual case, 98¼ percent of our total production sold is pulverized and packed in bags and 1½ percent is granulated and packed in bags while the remainder, about one-quarter of 1 percent, is crushed and dried and is sold to others for final processing.

Since the five producers listed above make up the entire bentonite industry and since such a small percentage is sold other than pulverized and packed in bags, or granulated and packed in bags, it is our logical contention that "the first marketable product" is bentonite, so processed and so packed.

Senator MILLIKIN. Mr. Chairman, may I ask a question, please?

What further things are done by your bentonite to make, for example, mud in rotary drilling?

Mr. HEYL. Simply to mix it with water, made into a pumpable solution, if I might use that term, so that it can be pumped down through the drill system and out the drill and back through the hole;

and where it brings the cuttings and borings from a drill many thousands of feet below the ground surface.

Senator MILLIKIN. You do not add any other chemicals?

Mr. HEYL. We don't.

Senator MILLIKIN. When the product reaches the oil well, or the well you hope will be an oil well, what else is added to the product to make it usable at that point?

Mr. HEYL. Just water.

Senator MILLIKIN. So that from the time it leaves your processing plant you do not add anything to it?

Mr. HEYL. No, sir.

Senator MILLIKIN. But it would be useless unless you did process it in the way that you mention?

Mr. HEYL. Yes. That is true. But I believe we bear that out by proving that about 98¼ percent of the sales are the pulverized or granulated bentonite. Some prefer to have it granulated. It takes water a little more readily.

Senator MILLIKIN. Could the driller of an oil well use your product if it were not processed?

Mr. HEYL. No; they could not. They have tried it, but can't use it until it is pulverized or granulated.

Since the presently defined ordinary treatment processes do not cover the bentonite industry adequately and clearly, we respectfully suggest and sincerely urge your approval of a fifth definition of "ordinary treatment processes" in section 114 (b) of the Internal Revenue Code to read as follows:

(v) in the case of bentonite, trucking from mines to processing plant, crushing, drying, pulverizing or granulating, bagging, and loading for shipment.

Senator TAFT. That covers both of your points, does it not? That amendment?

Mr. HEYL. Yes, that covers both points.

Senator MILLIKIN. Does the purchaser of your bentonite pay you from the processing plant? Or does he pay you from the mine?

Mr. HEYL. He pays for the material as finally processed, either pulverized or granulated.

The CHAIRMAN. It is not marketable until you do that?

Mr. HEYL. No, sir, it is not.

If I might just amplify that slightly, we go through actually three processes. We crush the material so that it can be put through rotary kilns and then dried. We sell up to 1 percent—it varies in different years—of that crushed and dried material to others, who then grind it with other materials in perhaps a chemical manufacturing plant, so that these other minerals may be just mixed with water and then held in suspension when they are mixed.

Senator MILLIKIN. Are you asking for transportation to that kind of a plant?

Mr. HEYL. Oh, no. Just transportation from these pits, which are shown on the yellow copy attached at the end of my statement, to the processing plant. And, as I have pointed out, the processing plant must be at a railroad. Now, we merely ask for the trucking to the processing plant; because obviously these deposits will have, perhaps—oh, in a large deposit, 50 to 60 thousand tons of bentonite. You can't go way out in the country and build a processing plant at

that little pit. So we have to gather up all these deposits and put them in our general mining picture, scattered 50 to 60 miles from the processing plant, so that the material may be trucked to the processing plant, where it is then crushed and dried and pulverized, granulated, and so on, and put in bags for shipment.

Senator BUTLER. Are these five different companies that you mentioned all operating in this area that you show in your sketch?

Mr. HEYL. They are all in the Black Hills area. There are two plants at Belle Fourche, S. Dak., which is about 8 miles into South Dakota, east of the Wyoming line, which runs north and south. Then the Baroid Sales Co. has a plant approximately 15 miles into Crook County, Wyo., which is the northeastern corner of Wyoming.

Senator BUTLER. This illustrates your own operations?

Mr. HEYL. This merely illustrates our own operations.

Senator BUTLER. But the others are in that general area?

Mr. HEYL. They are all in that area, yes. We are at Upton. They are at Osage, Wyo. There is one at Moorcroft and one at Colony, Wyo., and we are proposing to build a plant at Colony later, and then there are two at Belle Fourche, S. Dak. Does that answer the question?

Senator BUTLER. Yes.

Mr. HEYL. In conclusion, I, as a representative of a typical small American business, producing a natural resource of this country, a material that is vitally necessary to our economic growth, request your earnest consideration of this testimony and the arguments contained therein, and urge the adoption of the foregoing suggestions for the sake of clarity and equity.

I want to sincerely thank each member of this committee for making it possible for me to bring this story to you on behalf of our industry.

The CHAIRMAN. We thank you for your appearance.

Mr. HEYL. Thank you, sir.

(The following telegram was received for the record:)

MOORCROFT, WYO., *July 10, 1950.*

HON. LESTER C. HUNT,
Senate Office Building:

Please accept this telegram as our approval of statement being given Finance Committee today by Louis Heyl, of Wyodak Chemical Co., pertaining to bentonite hauling and processing. We have to truck haul bentonite from 13 to 25 miles from scattered deposits to plant at Moorcroft. Hope you will consider such hauling and the subsequent steps at plant of crushing, drying, grinding, bagging, and loading as "ordinary treatment processes."

BLACK HILLS BENTONITE, INC.
A. C. HARDING.
HARRY T. THORSON.

The CHAIRMAN. Mr. Seidman? Will you please identify yourself for the record, sir?

STATEMENT OF M. L. SEIDMAN, CHAIRMAN, TAXATION COMMITTEE, NEW YORK BOARD OF TRADE, INC.

Mr. SEIDMAN. Mr. Chairman and gentlemen, I am M. L. Seidman, chairman of the taxation committee of the New York Board of Trade.

The New York Board of Trade represents a cross section of business in the city and State of New York. Its membership is made up of almost every conceivable size and class of business in manufacture,

commerce, and finance. It thus appears here neither for big business nor small. I want to say this at the very outset to make it perfectly clear that I speak for business as a whole and not for any particular class, size, or kind of business.

Let me also make it clear at the outset that I am directing my remarks to a peacetime tax bill. We will recognize that international developments may require entirely different tax considerations that are now before us. Speaking of this bill as a peacetime measure, our able Secretary of the Treasury, in his appearance before you gentlemen the other day, said that this bill goes a long way toward meeting the objectives set by the President. I wish I could say that it goes even a short way toward meeting the objectives set by business. It definitely does not.

The bill has been labeled by responsible Members of Congress as a "phony." Perhaps it might better be characterized as a "political smoothy." According to its sponsors, everybody is going to be better off under it—and nobody is going to be hurt much. The bill tries to accomplish this with mirrors. It converts taxes that are plainly seen and deeply resented by those who pay them, to a similar amount of taxes that are neatly concealed and therefore not likely to raise the same amount of squawk—even if paid by many more taxpayers.

The bill would remove about a billion dollars in excise taxes. To offset the loss of revenue about half of that amount would be raised by closing various so-called loopholes in our present income-tax laws. The other half would be raised by increasing taxes only on "big" corporations and by accelerating tax collections from all corporations.

To the uninitiated it is not easy to discover just where the rabbit is hidden. The billion-dollar reduction in excise taxes represents almost entirely those taxes imposed during the war with the specific understanding that they will be removed 6 months after the war. By one pretense or another, these taxes have been continued to the present day. No one, therefore, can quarrel with the justification of removing them now. All the same, these taxes have at least one virtue—we all know who has to pay them, and those who are paying them have been yelling so loudly that Congress has had to finally do something about redeeming its pledge to repeal them.

As for closing the loopholes in our tax laws, no one can quarrel with that either. The higher tax rates are and the more inducement there is to escape them the more necessary it is to have the tax collection chamber airtight so that none can escape. Otherwise, the tax that should be paid by the fellow who escapes will have to be borne by the rest of us. Understandably, therefore, the closing of loopholes is a popular pastime, and to the extent that this bill does that it is enthusiastically supported by all but those who are hurt in the process.

I must point out, however, that many of these provisions will not represent the closing of loopholes, but merely a tougher attitude on the part of Government against business. Thus, for instance, to mention only a few, the amendment to section 117 (j) regarding capital assets used in trade or business will deprive many a business of legitimate loss deductions. The collection at the source of income tax on dividends will make business the Government's collection agency free of charge. The reduction of the interest rates on tax overpayments to 3 percent while retaining the 6-percent interest

charge on innocent underpayments can only go to emphasize the one-sided approach which this tax bill makes to the entire problem of promoting equity and fairness in our tax laws.

Finally there is the increase in corporation taxes. Here the "smoothie" touch is at its best. The plan limits the tax increase to the very big corporations—in fact, gives the others a slight reduction—but, in consideration of letting so many of them get by, requires all of them to pay up a little earlier than usual. Earlier collection in turn creates the illusion of a smaller budget deficit than would actually be the case if the present tax collection plan were continued. It is very much like the case of a fellow living way beyond his means who attempts to overcome his difficulties by collecting his salary a little earlier in the month.

I am firmly convinced, gentlemen, that many of the Congressmen who voted to send this bill to you here did so with tongue in cheek. It may be a long time before we can get the majority of our people to understand the effect of business taxes on the cost of living but certainly most Congressmen know it. All of us here, I am sure, understand that no business can exist without making a profit over and above all of its costs and expenses—including taxes. Any tax that a corporation pays must necessarily be included in its cost of doing business and passed on to the consumer. As a result, you and I and all of us pay every dollar of business taxes. When Congress shifts hundreds of millions of dollars of excise taxes imposed directly and knowingly on specific consumers to business taxes imposed indirectly on all consumers, it would seem to be resorting to political expediency rather than to good statesmanship.

Contrary to the general impression that this is a short and simple tax bill merely eliminating some of the excise taxes and increasing other taxes, it is in fact a voluminous and extremely intricate bill treating with numerous extremely complicated subjects. One cannot help wonder therefore why, if Congress has the time to devote itself to this kind of a bill, it cannot also find the time to correct at least some of the major inequities in our present tax laws which mitigate against business and against the preservation of our private enterprise system.

I see nothing in this bill to remove the gross inequity of double taxation on corporate earnings and dividends. I see nothing in this bill to correct the gross unfairness of taxing all capital gains but carefully limiting the deductibility of capital losses. I see nothing in this bill that will bring down tax rates on incomes and inheritances to a point where enterprise and thrift will be encouraged. These and many other such basic items should, in all fairness and equity, be considered in any legislation which undertakes to treat with inequities and loopholes in our present tax laws.

The background for our revenue needs is now, as always, Government spending, and that is the real problem today. Here we are at the highest point of prosperity in our history, operating our Government at a deficit of billions of dollars a year and no provision made for the systematic reduction of our huge national debt. Senator Harry Byrd, venerable member of this honorable body, hits the nail on the head when, in comparing civilian Government expenditures this year with those of only 2 years ago, he points to an increase of more than $5,000,000,000 in these items alone. He thus exposed the

claim that our swollen budgetary deficits are due to war expenditures. Obviously if our civilian Government expenditures were held down to what they were only 2 years ago, our budget would now be balanced. If war expenditures must unfortunately be continued or even be increased, then all the more reason why civilian Government expenditures should be cut to the bone.

I want to repeat that I am directing my remarks, here, to a peacetime tax bill. That is the kind of a tax bill which the House had in mind when it sent this here to you. As such, instead of shuffling taxes about and ending up with a total tax bill at its present height, we should now be reducing taxes substantially all along the line and imposing upon outselves the compelling need of cutting expenditures. The most effective way in which out people can have their Government spend less is to give the Government less to spend. As individuals, our spending is curbed by the limit of our income, and we must learn to live within our income or go broke. In Government, we spend without any seeming regard to where the money is coming from. That sort of thing can't go on indefinitely. Sooner or later there must be a breaking point. Here, I am afraid it is later than we think. Inflation and the cost of living is already taking its toll on the hard-pressed taxpayer. The trend continues upward and can get out of hand if we fail to clamp down on Government spending and deficit financing. If we cannot manage to balance our budget in years of highest prosperity and full employment, what hope is there to arrest the rising cost of living and to stop the depreciation of our dollar?

You gentlemen, as members of this powerful committee of the Senate, have great influence in formulating the financial policies of our Government. The New York Board of Trade appeals to you to use your influence in relentlessly cutting down Government costs and to insist upon a balanced budget. The tax bill you have before you accomplishes nothing in that direction. Actually, it does the opposite—lulls the taxpayer to sleep by converting direct taxes into indirect and unconsciously paid taxes. Under present circumstances our most valuable asset in curbing inflation is a keen consciousness on the part of the people on how much of the cost of living is due to taxes.

The New York Board of Trade believes that taxes are entirely too high all along the line. It believes that we cannot have a stable economy until taxes and Government costs are substantially reduced all along the line. It believes that tax consciousness for all of us is an indispensable requisite toward that objective. And, finally, it believes that our tax laws should be deliberately designed to promote tax consciousness on the part of our people as the best insurance against inflation and against indifference about Government spending.

The CHAIRMAN. We thank you for your appearance.

Mr. SEIDMAN. I think you, Mr. Chairman and gentlemen, for the privilege of appearing before you.

The CHAIRMAN. We will now call upon Mr. Russell Brown.

Mr. Brown, will you please be seated and identify yourself for the record.

STATEMENT OF RUSSELL B. BROWN, GENERAL COUNSEL, INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA

Mr. BROWN. My name is Russell B. Brown. I am general counsel of the Independent Petroleum Association of America. The membership of our association is engaged in all branches of the domestic oil industry, but our primary interest is in the production of oil and gas.

I appear at this time to discuss one item of H. R. 8920 and that is the proposal set forth as section 209 (d). In view of limitations my comments will be brief and general in nature. We request, however, the opportunity to supplement my appearance with a more detailed and technical analysis to be filed with the committee, if that is agreeable.

The CHAIRMAN. It is agreeable.

Mr. BROWN. We will try to do that within the next 2 days.

The CHAIRMAN. All right, sir.

Mr. BROWN. The proposed change embodied in section 209 (d) is a matter of grave concern because of the effect it would have upon the Nation's oil supply. It would involve a fundamental change in a long-established tax policy. It would alter a tax provision that has proven to be both necessary and successful in providing the Nation with adequate supplies of petroleum and its products.

The practical effect of this proposed change in the tax law would be an immediate and drastic curtailment in leasing and exploratory activities. This would mean fewer new oil fields found, less reserves of oil, and less productive capacity. In view of the present world situation and the essentiality of oil to our national welfare and safety we urge your committee to give this proposal your most careful consideration.

Section 209 (d), appearing on pages 64 and 65 of H. R. 8920, is as follows:

(d) ABANDONMENT OF CAPITAL ASSETS AND CERTAIN PROPERTY USED IN THE TRADE OR BUSINESS.—Section 117 (relating to capital gains and losses) is hereby amended by adding at the end thereof the following new subsection:

(1) ABANDONMENT OF CAPITAL ASSETS, ETC.—For the purposes of this chapter, the abandonment of a capital asset or of property used in the trade or business (as defined in subsection (j) without regard to the last sentence of paragraph (l) thereof) shall be considered as a sale or exchange of such asset or property.

This proposed change would treat abandonments as sales or exchanges, permitting write-offs of abandonment losses only against capital gains and being subject to the limitations applicable to capital losses. It would prevent write-offs of abandonments as an ordinary business loss against income. Businessmen do not abandon valuable business assets for the purpose of obtaining a tax advantage. Therefore the provision is not necessary to correct tax inequities, at least so far as we are concerned. In fact this provision would violate the fundamental philosophy of net income taxation. Although the proposed provision would permit abandonment losses to be charged off against capital gains the effect of its application to oil and gas exploration and development would be to deny any deduction. Large recurring losses are the normal essential result of exploratory activity whereas capital gains are infrequent. The effect of such a provision would tend to force undesirable liquidation.

The nature and character of the oil-producing industry must be recognized in order to fully understand the effects of the proposed tax change.

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Senator MILLIKIN. Mr. Brown, is it not a fact that a great part of our oil reserves have been turned up by shoestring operators, who make a venture, and who have no capital gain?

Mr. BROWN. That is quite true, Senator. As a matter of fact, I think the record rather clearly shows, from general examination, that between 72 and 75 percent of our wildcat fields are discovered by the independent operators, who rarely have capital gains. Does that answer your question, Senator?

Senator MILLIKIN. Yes. Oftentimes the drilling of a wildcat well is a single venture all to itself; is that not correct?

Mr. BROWN. Quite correct.

Senator MILLIKIN. A group of fellows will pass the hat.

Mr. BROWN. For that one experiment; yes.

Senator MILLIKIN. And that is the end of it.

Mr. BROWN. That is correct, Senator.

Oil exploration and development involves the continual risking of large sums at great hazards with substantial losses resulting continuously. The search for new oil reserves and new oil fields must never cease. As oil is produced and consumed, more oil must be discovered and developed in order to maintain the Nation's productive capacity and to increase this capacity as consumer demands for oil products grow larger each year.

In the oil industry, the finding and developing of new oil reserves to replace those consumed is the normal and the major activity. This can be continued only if there is adequate provision for the losses that are necessary and unavoidable in this activity.

The oil-producing industry in the United States reinvests or "puts back into the ground" billions of dollars each year. These huge sums are expended for geophysical and geological surveys; for the payment of lease rentals and bonuses to the owners of millions of acres of land; for preliminary scientific testing of unknown areas; for drilling and equipping the thousands of exploratory and development wells; and for the countless operations related to these activities. The extent of risk and losses suffered in these activities is demonstrated by the losses involved in the leasing of land in areas that may be geologically favorable but have not been proven to be productive of oil or gas. The magnitude of this activity is not generally recognized.

Table I, attached, is enlightening on this point. It shows that more than 200,000,000 acres of nonproductive land were estimated to be under lease for oil and gas in 32 States at the beginning of 1950, which was more than 10 times the 16,000,000 acres of proven production. It is interesting to note that in six States—Georgia, Idaho, North Carolina, North Dakota, South Carolina, and South Dakota—where there is not yet commercial oil or gas production, a total of 18,100,000 acres are under lease.

Senator MARTIN. Mr. Chairman, might I ask a question?

Mr. Brown, is it not true that particularly in the Eastern States there has been rental enough paid on certain land to have bought it outright?

Mr. BROWN. Many, many times that. For instance, if I may illustrate, I had a case called to my attention Friday, where it is an entirely new effort, and they said the effort to clear up the title and to take care of the leases cost them more than the original purchase of the land outright. And that is true in many cases.

It is estimated that between 40,000,000 and 50,000,000 acres, or about 20 percent of the total under lease in the United States, are surrendered or abandoned each year at a loss to the oil operators. This does not mean that total leasing declines. The acreage surrendered or abandoned is offset by additional leasing. Because of the unknowns and the differing opinions as to oil possibilities, a tract of land abandoned by one operator may be leased by another. The constant turn-over and retesting of these leases, with the accompanying exploration expenditures, is the foundation of the industry's program to find and develop productive capacity. Many of our greatest oil fields have been found in areas, previously condemned, because some wildcatter was willing to risk additional capital. The cost of abandoning leases has always been recognized as a proper current expense in determining taxable income. It is elementary that the proposed change in this tax provision could have but one result—less money available for oil exploration.

The extent of the losses involved is further indicated by the fact that the oil industry has drilled approximately 640,000 wells in the United States during the past 25 years. Of these wells 170,000 failed to produce oil or gas and involved the abandonment of leases as a complete loss to the investor. A large part of the billions invested is lost each year. The total number of wells drilled and the total number of failures does not fully reflect the element of risk in searching for oil deposits. Many wells are drilled in proven areas to develop and make available a new source of oil after it has been discovered. A better measure of the hazards is found in the record of exploratory or "wildcat" wells. One of the most authoritative sources for this information is the annual survey by Frederic H. Lahee, chairman of the American Association of Petroleum Geologists' Committee on Statistics of Exploratory Drilling. The latest of these surveys shows the following results from drilling for new fields in areas never before productive.

	Wildcat wells drilled in search for new fields		
	1947	1948	1949
Number of wells:			
Productive	394	501	506
Dry or failures	3,086	3,795	3,943
Total	3,480	4,296	4,449
Percentage:			
Productive	11.3	11.7	11 4
Dry or failures	88.7	88.3	88 6

Senator MILLIKIN. I suggest to you that those kinds of statistics can also be very misleading. That is an average statistic; whereas the individual enterpriser can drill a hundred dry wells, one after another. I have had personal knowledge of that kind of experience. One right after the other.

Mr. BROWN. I am glad you called my attention to that. This is misleading, because it is taking in the industry as a whole. And any number of people that I know of have drilled as high as 50 before they have found one. They would have been in pretty bad shape if they had nothing to charge it against.

Senator MARTIN. Is it not also true, Mr. Brown, that even in so-called proven fields, particularly in the eastern part of the United States, we also drill many dry holes?

Mr. BROWN. Many dry holes, yes; right in areas that we think are productive.

Senator MARTIN. That is right.

Mr. BROWN. That is constantly happening, as to approximately a third of the wells even in those areas.

As shown by these figures, almost 9 out of every 10 wells drilled in the search for new oil fields are unsuccessful. This is the normal expectancy. It is a normal and necessary undertaking, without which the Nation's productive capacity would soon decline. It is the means by which a producer maintains his production and continues in business. The high ratio of dry holes shown by these figures indicates the extent of abandonment losses in oil exploration.

Present world conditions demand that the primary consideration in evaluating this proposed tax change is its effect on national security. At the beginning of World War II the domestic oil industry had a reserve producing capacity of about 1,000,000 barrels per day. This represented a reserve of about 20 percent available for emergency use. The wartime restrictions on normal expansion absorbed this reserve. Since the war, however, the industry has rebuilt until today it again has a reserve capacity in the order of 1,000,000 barrels per day. Prudence dictates that this reserve must be maintained and increased to the maximum extent possible.

The oil industry represents one of the strongest elements in our Armed Forces. Our enemies would be greatly comforted by realization that this soldier was being reduced to inefficiency by unwise action at home. This is no time to tamper with our national security.

Senator MILLIKIN. Do you not think our enemies are greatly heartened by the fact that we are depending on 700,000 to 800,000 barrels of imported oil a day?

Mr. BROWN. Their enthusiasm would be increased by their ability to cut that off.

Senator MILLIKIN. And is there any doubt that in a major engagement that is one of the first things that will be cut off?

Mr. BROWN. I think in all plans that is contemplated.

Senator MILLIKIN. But we are told that we do not need to worry about that, because a lot of these fellows think that you can just push a button or turn a knob of some kind and have all the oil you want domestically produced.

Mr. BROWN. You can't do that if you cut off the incentive.

Senator MILLIKIN. We have been through that twice, now. We were through it in World War I, and we were through it in World War II. And the skulls of some of these fellows seem so thick that they are completely impenetrable to the lessons of experience.

Mr. BROWN. Quite true. And because of the limitations of my time here, I am discussing only section 209, but I would like to call the attention of this committee to the fact that there is pending before this committee an effort to correct that. But, because full hearings were held before this committee a year ago in connection with the trade-agreements extension—and I may say that since then that situation has gotten worse—and since that time the Neely subcommittee has gone into this investigation rather completely, and at least one

member of this committee was a member of that group, we did not at this time but we hope to file, with the permission of this committee, some further comment bringing down to date the previous hearings that we have had on that question. If we may do that, I will not attempt to go into that question further at this time, because you do have available full hearings on it.

The CHAIRMAN. You may do that, Mr. Brown.

But answer, if you can, at the moment: What are the imports at the present time?

Mr. BROWN. A little under 800,000 a day.

For the first 6 months they have run about 800,000; and the prospect is for almost the same amount through the rest of the year.

I think at the time we appeared before you a year ago, it was a little less than 600,000; about 500,000. So it has continued to get worse.

Senator MARTIN. Mr. Brown, how much will it average for 1950, so far? Do you have any figures on that?

Mr. BROWN. I have the exact figures. I am told that for the first 6 months it was about 790,000.

Senator MILLIKIN. What is our daily domestic production?

Mr. BROWN. About 5,450,000, right at the present time.

Senator MILLIKIN. And how much oil have we shut in at the present time?

Mr. BROWN. About a million barrels.

Senator MILLIKIN. So we import 800,000 and shut in a million of our own?

Mr. BROWN. That is right.

Senator MILLIKIN. We will never get rich that way.

The CHAIRMAN. Thank you very much Mr. Brown.

Mr. BROWN. Thank you, Mr. Chairman.

(The following supplemental statement was later submitted by Mr. Brown:)

SUPPLEMENT TO STATEMENT OF RUSSELL B. BROWN, GENERAL COUNSEL, INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA

During my testimony before your committee on July 10, 1950, the question of petroleum imports was raised by a member of the committee. In furtherance of the permission granted me to supplement my oral testimony on this matter I submit the following summary statement regarding imports, with the request that it be incorporated in the record of the committee's hearings.

The problem of excessive oil imports is not a new one. It has been a recurring one and the recent rapid development of oil reserves outside the United States confronts us with the clear likelihood that foreign oil will continue through the years to present a problem of national concern. The present unstable world conditions may temporarily remove the urgency of the problem but for the long range the import issue should be met by the establishment of proper national policy. Because we did not have an established policy guide, since World War II excessive imports have prevented the domestic industry from reaching as strong a position as it could have attained. We as a Nation should prepare now to avoid the recurrence of this result.

From both a short- and long-range viewpoint, our Nation must maintain the maximum internal strength of its basic industries. No basic industry is more essential to our security than petroleum. Two World Wars have proved that we cannot rely on foreign oil for the protection of our own borders. In the case of all-out war, Middle East oil would be unavailable to us and, in fact, if not destroyed might be available to Russia. The rapid development of the Middle East oil fields since World War II may prove to be more harmful than helpful to national security. Oil shipments from South America were disrupted by the German submarines in World War II and with the improved submarines now in use we

certainly cannot afford to become dependent upon foreign oil from these sources. We must remember that in World War II the United States supplied, from the oil wells within its own borders, over 80 percent of all the oil used by ourselves and our allies to win the war.

We must build up, within the borders of the United States, as large an excess productive capacity as possible. Prior to World War II we had at least 1,000,000 barrels per day excess capacity over and above national requirements at that time. Because of lack of materials and manpower, and the fixing of crude-oil prices at subnormal levels, the industry was unable to maintain this excess capacity throughout the war. The necessary exploratory and development wells could not be drilled and our reserve strength was absorbed. The lesson from that experience must not be forgotten.

During the postwar years the domestic petroleum industry recovered much of the ground lost, in the face of progressively increasing consumer demands. Since the close of World War II we have not only met the demand but we have increased our proved reserves by approximately 7,500,000,000 barrels over and above that produced during the period. This accomplishment is encouraging and reassuring, but provided no basis for complacency. Unlimited supplies of oil are not available "at the turn of a valve." Productive capacity is the result of time, adequate materials, experienced manpower, and sufficiency money to finance a continuous exploratory and development program involving great hazards and large recurring losses. The vigor of the industry yesterday and today determines its reserve capacity in the months and years ahead.

For an extended period of time since December 1948, the vigor of the domestic industry was impaired by sharply increasing imports of foreign oil, coupled with declining exports. This fact was recognized throughout the industry. In January of this year, the National Petroleum Council (an industry group composed of representatives from all branches of the oil industry, advisory to the Interior Department) stated that:

"1. The sharp increase in imports of crude oil and its products coupled with the continuing decline in exports of crude oil and its products has hurt the domestic oil industry.

"2. If imports continue to increase without regard to the principle of only supplementing the domestic production of crude and products, they will seriously damage the oil industry and thus adversely affect the national economy and the national security."

This was recognition of injury to the domestic industry resulting from the lack of an established proper policy on imports—injury that unfortunately meant a loss of time and an adverse effect upon future productive capacity that can never be regained. Exploratory effort, as reflected by geophysical activity and leasing, suffered a set-back that the Nation can ill afford under today's circumstances. As a result at sometime in the future we will have a domestic industry which is less vigorous than it could have been.

The difficulties resulting from imports grew out of a basic change that had been taking place in the world oil situation. Historically the world outside the United States, and without respect to Russia, had been short of oil. The United States supplied that shortage. With the development of a world oil surplus, this situation was reversed. In the 3 years from 1946 through 1949, foreign production excluding Russia increased by more than 60 percent, which was a faster rate than could be consumed in foreign markets. As a result, imports into the United States increased and exports declined. This country became a net importer of oil to an increasing extent as shown by the following figures:

United States petroleum imports versus exports

[Barrels daily]

	Imports of crude and products	Exports of crude and products	Net exports
Average (1935–39)	153,000	447,000	294,000
Year 1946	377,000	419,000	42,000
Year 1947	437,000	450,000	13,000
Year 1948	513,000	368,000	[1] 145,000
Year 1949	642,000	327,000	[1] 315,000
First 6 months 1950	800,000	285,000	[1] 515,000

[1] Net imports.

These increasing imports, coupled with the steady decline in exports, resulted in the domestic industry supplying a decreasing percentage of United States oil requirements as shown below:

Total United States petroleum supply required

	Domestic production, crude and natural gasoline		Imports, crude and products	
	Barrels daily	Percent of total supply	Barrels daily	Percent of total supply
Average (1935-39)	3,341,000	95.6	153,000	4.4
Year 1946	5,073,000	93.1	377,000	6.9
Year 1947	5,452,000	92.6	436,000	7.4
Year 1948	5,922,000	92.0	514,000	8.0
Year 1949	5,470,000	89.5	641,000	10.5
First 6 months 1950	5,510,000	87.3	800,000	12.7

These definite trends toward (1) increasing imports, (2) decreasing exports, and (3) a relatively smaller share of the market supplied by the domestic industry are properly matters of national concern. As a Nation, this is a course that can only lead to dependency on foreign oil.

The security aspect of the import problem is all important. The aim must be the assurance of adequate and available supplies of petroleum and its products at all times. To this end, our national policies on oil should be directed by certain basic objectives of which the most important is a program of vigorous exploration and development of the petroleum resources of this country commensurate with increasing national requirements.

This must be the primary objective which is best served by full activity that provides both the incentives and the funds required in oil exploration and development. To the extent that foreign oil can be used without interference with this primary objective, obviously this would be in the Nation's interest under present international conditions.

The CHAIRMAN. We have two other witnesses who were listed but who were not able to appear this morning.

Mr. Guy H. Woodward?

Mr. Woodward, you may be seated, and identify yourself, please, for the record.

STATEMENT OF GUY H. WOODWARD, ATTORNEY FOR MID-CONTINENT OIL & GAS ASSOCIATION, WASHINGTON, D. C.

Mr. WOODWARD. Mr. Chairman, gentlemen of the committee; my name is Guy H. Woodward. I appear for Mid-Continent Oil & Gas Association, a trade organization with approximately 5,500 members, representing all branches of the oil and gas industry throughout the midcontinent area. We have attempted, in this statement, to summarize our objections to section 209 (d) of H. R. 8920. However, we request the opportunity to file for the record a more detailed analysis of the proposed amendment.

I would like to say, Mr. Chairman, in that connection, that we expect to join with Mr. Brown and the American Petroleum Institute in a consolidated statement for the use of the committee.

The CHAIRMAN. Yes, sir. We will be glad to have you do so.

Mr. WOODWARD. The oil and gas industry is most seriously concerned with the effect of proposed section 209 (d) of the bill you now have under consideration, because, coupled with the amendment of 117 (j), its application would classify property used in trade or business

as capital assets and thus would prevent charge-offs of abandonment losses for tax purposes except to the extent of capital gains, if any.

As a necessary incident to the production of oil and gas, abandonment losses continuously occur, while capital gains are seldom realized. A going oil and gas business requires the day-to-day purchase of new-lease acreage and the day-to-day abandonment of dry or condemned leases. A vast majority of those in the oil industry who are successful in finding profitable productive properties continue to produce the properties to exhaustion. Occasionally sales are made which result in capital gains, but such is not the usual and ordinary practice of a going concern in the oil industry.

I know of one organization, with a book value of over half a billion dollars, that had less than $2,000 capital gains last year, yet this organization suffered losses to the extent of several million dollars through dry and abandoned leases. I am familiar with another organization, of comparatively small size in the oil industry, that had losses resulting from dry and abandoned leases of nearly $20,000,000 in 3 years, with no capital gains to absorb any part of these losses.

The oil and gas industry, by its very nature, must spend large sums for oil and gas lease acreage. Unlike capital expenditures in most industries, where depreciation reserves may be set up for foreseeable wear and tear and normal obsolescence, a very substantial portion of an oil company's lease acreage is eventually abandoned as dry or condemned acreage. If this type of loss cannot be deducted from ordinary gross income, then it is obvious that there will be little, if any, incentive to make investments in the extremely hazardous business of exploring for oil and gas.

Senator MILLIKIN. You could not stay in business, could you?

Mr. WOODWARD. It would be impossible to go forward with an exploration program unless you knew that in the event that you had a failure you could charge it against any ordinary income that you had. That is true, Senator.

Certainly no such impediment to the discovery of additional oil and gas reserves—which are so vital to our national security and our domestic economy—should be created. This is emphasized by the present critical international situation. The application of section 209 (d) might readily result in the payment of taxes on income that did not, in fact, exist. Assume a corporation buys lease acreage and drills an exploratory well in which it has invested a million dollars, but the venture proves dry and is abandoned. That is not out of the ordinary.

Senator MILLIKIN. A fellow was in my office within the last 2 months, and he told me he knew of eight holes costing a million dollars apiece, and they did not get a smell of oil in any of them; and it was in an area which was thought to be very encouraging.

Mr. WOODWARD. Senator, on the Gulf coast, many, many such wells have been drilled where the cost was in excess of a million dollars for each well.

In addition to that, you may have large blocks of acreage on which geological or geophysical work has to be done in advance.

Assume that this corporation has a million dollars net income from other properties. Unless the million-dollar loss may be charged against the million dollar ordinary income, the result would be to collect from this business enterprise $410,000 income tax, as provided

by the proposed bill, on theoretical income; less, of course, the lower rate on the first $25,000. Actually this business enterprise made no money with which it could pay the tax.

Oil and gas lease acreage is the raw material from which the oil industry eventually produces gasoline and other petroleum products. The dry and abandoned leases are the culls and have no value. It would certainly be unreasonable and unrealistic to treat the abandonment of worthless property as a sale or exchange. Only 2 or 3 percent of all the leases purchased prove profitable. The profit that accrues from the small percentage of the leases that prove productive must necessarily pay the operating expenses, pay the taxes and absorb the losses from worthless properties which are abandoned in the ordinary course of business.

Section 209 (d), in our opinion, will severely curtail leasing activities, substantially reduce the bonus and rental payments to landowners in nearly every section of the United States, reduce oil industry employment and close the door to venture capital which is essential to the continued exploration for oil and gas. Experienced oilmen believe, so far as the oil industry is concerned, that the proposed amendment will, in fact, be self-defeating because of the resulting reduced national income. Under such paralyzing treatment our dependency upon foreign oil, which may or may not be available in times of emergency, might well soon be a reality.

Equally alarming is the prospect of great damage to programs for research, experimentation, scientific development and geological and geophysical exploration. Responsible business executives cannot be expected to risk great expenditures of investors' money for pioneer ventures if faced with the fact that the cost of unsuccessful work will not be deductible from gross income in computing tax liability. Such ventures require great optimism and business courage even under favorable conditions.

The proposed amendment, in the case of the petroleum industry, certainly is not a technical correction of any tax inequity but strikes directly as a levy against the capital used normally in oil exploration. The proposed change would be a reversal of one of the basic concepts of income taxation which has been in the law since its inception and would be a vicious blow to many business enterprises and particularly to petroleum exploration which is so vital to our national security and economy.

We respectfully suggest to the committee that the proposed section 209 (d) be stricken from the bill.

Now, Mr. Chairman, there is one other item I would like to mention at this time. I won't take the time of the committee to go into the matter, other than to ask the opportunity of filing a short statement on it. That is with respect to section 203 of the bill, which amends the present law which permits dividends paid in kind by one corporation to another corporation to receive a credit of 85 percent. The present amendment would deny that credit to dividends paid in kind to the recipient corporation.

The amendment is retroactive for the current taxable year.

Dividends have been declared in kind since January 1, 1950, relying upon the law as it was then on the books; that is, the existing status of the law at that time. It would work a hardship on those people who have acted on the law as it was then on the books. And

we suggest, in that connection, that the retroactive feature of the section be eliminated, so that it would be effective only as to future taxable years.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you very much for your appearance.

(The supplementary statement with regard to sec. 203 is as follows:)

SUPPLEMENTARY STATEMENT OF GUY H. WOODWARD, ATTORNEY FOR MID-CONTINENT OIL AND GAS ASSOCIATION

There is one other section of H. R. 8920 that I would like to comment on. Section 203 of the bill[1] would deny the 85-percent dividends received credit[2] to that portion of the value of dividends in kind received by corporations that is in excess of the original cost or other basis of the property to the paying corporation.

My protest does not relate to the principle involved in this proposed revision, but to the effective date of the amendment. As written, it would become effective as to dividends received during taxable years ending after December 31, 1949, if the dividends were received after that date. Consequently, it would take away from some corporations the dividends received credit that they were entitled to by existing law on dividends already received during 1950.

It is unfair and inequitable to make such retroactive application to dividends that were declared in good faith and in reliance on the law as it existed at the time of the declaration. Generally, legislative enactments which effect substantive changes in the law are not made effective prior to the final passage of the legislation. Therefore, in the interest of fairness, section 203 of H. R. 8920 should not be made effective as to dividends received before the date H. R. 8920 is enacted into law.

The CHAIRMAN. That completes the list of witnesses for the morning.

The committe will recess until 10 o'clock tomorrow.

(The following material was submitted for the record:)

A STATEMENT BY ALBERT S. GOSS, MASTER OF THE NATIONAL GRANGE, ON ESSENTIALS OF A SOUND TAX POLICY

1. The problem of taxation is so intricate and involved that it requires far more study and research than our organization is able to give to the preparation of any comprehensive statement. We are not tax experts. There are a few basic principles, however, that we wish to bring to the attention of your committee for we are greatly disturbed to find the tax totals going up and the deficit increasing in these peacetime years of unprecedented prosperity.

2. First, we want to call the attention of the committee to the fact that America's outstanding prosperity is basically due to the fact that we have the largest percent of middle-class citizens of any nation on earth. In turn, this is due to the fact that we have maintained an effective competitive or free-enterprise system which has resulted in passing on to the ultimate consumer, within a reasonable time, the largest part of the benefits of our inventive genius and technological improvements so that the cost of the essential items entering into the cost of living has taken a smaller percent of the consumer's income than in any other nation on earth. In other words, we have held the cost of living down

[1] Sec 203 of H. R. 8920 reads as follows:

"SEC. 203. DIVIDENDS RECEIVED CREDIT—(a) DIVIDENDS RECEIVED IN PROPERTY.—Section 26 (b) (relating to credits allowed corporations with respect to dividends received) is hereby amended by striking out the first sentence and inserting in lieu thereof, the following '85 per centum of the amount received as dividends from a domestic corporation which is subject to taxation under this chapter. For the purpose of the preceding sentence, if the whole or any part of a dividend is received in property other than money, then, with respect to such property the shareholder shall not be considered to have received as a dividend an amount in excess of the adjusted basis of such property in the hands of the distributing corporation at the time of distribution increased in the amount of gain or decreased in the amount of loss recognized to the distributing corporation by reason of such distribution. In no event shall the credit allowed by this subsection exceed 85 per centum of the adjusted net income.'

"(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall be applicable to taxable years ending after December 31, 1949, but shall apply only with respect to dividends received after such date."

[2] Under present law, if the recipient of a dividend is a corporation, it is required to include in taxable income only 15 percent of dividends received from other corporations, the other 85 percent being a credit allowed by sec. 26 (b) of the Internal Revenue Code. This is true whether the dividend is in money or in property. If in property, the market value is the basis for computing the dividend income and the credit.

so that the people in the low- and middle-income brackets could have more to spend for nonessentials and thereby we have not only improved their standards of living, but in so doing we have kept industry active, men employed, and maintained a very high rate of national income. This has been the secret of America's economic growth and prosperity. Continued growth and prosperity depend upon holding the cost of the essentials which enter into the cost of living to a low percent of our national income.

3. When our Federal tax totals reach nearly 20 percent of our total national income the incidence of such taxes has a tremendous effect upon the stability of our national welfare. The impression is all too common that most of the Federal taxes are paid by the wealthy, and that because of this it is possible to secure a substantial measure of equalizing the economic status of our citizens by taxing the wealthy and giving special benefits to those with less income. Because a man of low income pays little or no direct Federal income tax, he often feels that he is benefited by relatively high income taxes paid by others, the proceeds of which are used for various forms of subsidies such as free medicine, cheap food, and unemployment benefits.

4. This is a dangerous school of thought because it is based on an entirely wrong assumption. A very large portion of our Federal taxes are passed on directly to the consumer, and they are pyramided and compounded as they are passed on, so that every dollar the Government collects in some kinds of taxes is probably reflected in a dollar or more paid by the consumer in increased living costs. Every tax dollar passed on to the consumer reduces his purchasing power by the exact amount of the tax passed on. This strikes most heavily at those in the low-income and middle-income brackets. With a Federal tax bill nearly one-fifth of our national income, we therefore should examine most carefully what portion of our taxes is passed on to the consumer and consider the effect on our total economy of the increase it effects in the cost of living, particularly among the great mass of our people in the middle- and low-income brackets whose purchasing power is so badly needed to keep our industries going.

5. Of recent years approximately 17½ percent of our Federal income has been derived from excise taxes, 32½ percent from corporation income taxes, and 50 percent from personal income taxes. Practically every dollar of the excise taxes has been passed on to the consumer, and because of pyramiding the consumer has paid far more than the Government has collected. Although there are some differences of opinion, I am convinced that practically all the corporation income tax is also passed on to the consumer. There would be no net income left for the corporation if it did not pass on to its customers the amount of the Federal tax in the form of increased prices for its products and its services. Here, too, the consumers often pay far more than the taxes the Government receives.

6. Even in the field of personal income taxes a considerable portion is passed on to the consumers. Partnerships and proprietorships, just like corporations, add to their selling prices to meet the tax, and what lawyer, doctor, or other professional man has not increased his fees to meet the heavy increase in income taxes? So it is altogether probable that the consumers pay in higher costs of living substantially more than the amount the Federal Government collects in taxes.

7. One cannot escape the fact that it is impossible to give a lot of benefits to the consumers through all kinds of socialistic subsidies without taking away from them in the form of higher cost of living practically everything that is given to them and, in some cases, even more, even though they may pay no direct income tax. This leads to our first conclusion that the first approach to the tax problem lies in cutting down all unnecessary expenditures and developing the highest possible efficiency and economy in Government operation.

8. Our next approach is to examine the kind of taxes the Federal Government levies to endeavor to eliminate those which have the greatest impact upon the essential cost of living. We start with our excise taxes. They are nearly all passed on. Some of them like the taxes on liquor and tobacco do not affect the essential cost of living and since they are collected through stamp taxes there is little compounding. Other taxes like the tax on freight rates go through a terrific process of compounding and affect practically everything the consumer buys. We therefore reach the conclusion that the first reduction in taxation should be on those items which are passed on to the consumer with the most compounding effect.

9. The next approach is to examine into the possibility of shifting the taxes which are passed on with the most pyramiding effect to some other form which could not be passed on. Aside from inheritance taxes, the tax which is most

difficult to pass on is the personal income tax. Taxes on income from some sources such as interest, and dividends, cannot be passed on at all. We must recognize, however, that all taxation cannot be loaded at this one spot, for we must protect capital accrual in order to maintain an expanding economy. However, we must also recognize that we have had a tremendous expansion in industrial development during the last 7 years, an expansion equal to about 35 years of normal development, and that there is not the same need for expansion of industrial plants at this time that there is normally.

10. An increase in corporation income tax has been suggested. This has a very popular appeal, not only because it is an easy place to get the money, but also because people generally have no particular love for corporations, especially big ones—the ones that pay the taxes. However, we should examine carefully the effect such an increase would have on our total economy. Not only is most of this tax passed on, but we find that in many instances there is a tendency of the corporation to withhold dividends because it can get by with a 38 percent corporation tax while many of the stockholders in active control would have to pay far more than a 38 percent tax if they received their dividends in cash. We also find there is a substantial injustice in corporation taxation, in that the corporation pays a tax on the earnings and the stockholders pay a second tax on the balance of the earnings when they are received as dividends. Here, it would seem, would be an opportunity for considerable tax reform through eliminating double taxation. Let us suppose, for example, that the income tax on corporations was abolished, and there was some way to make the corporations distribute their earnings, beyond their capital needs, in the form either of reduced prices for their goods and services, or increased dividends. If the prices were reduced, the cost of living would be reduced, purchasing power enhanced, industry would be expanded, more wealth created, and a wider tax base established. While there might be a lag in Federal income, this would be the desirable course to pursue if the reductions were so passed on to the consumers' benefit, for an expanded economy a high national income and additional tax revenue would be the result. If the tax savings were not passed on to the consumers but were passed on to the stockholders in the form of dividends, it would increase the purchasing power of the stockholders, although this is not as important a field as might be expected because most stockholders are in a class whose purchasing power is already fairly well balanced with their needs. The important point is that the dividends would increase the rate of taxation of many stockholders, and in many cases would bring a far greater return to the Government than if taxed at the corporation rate of 38 percent, and held in corporation reserves.

11. At this point we believe the Congress could well consider abolishing all corporation taxes on profits distributed as dividends, but substantially increasing the rate of taxation on the profits retained in the corporation. It may be argued that this would prevent the accumulation of the necessary working capital on the part of the corporation. The answer is quite simple. If more working capital is needed, the corporation could increase its working capital by distributing its earnings in the form of stock dividends. All earnings so distributed should not be taxed in the hands of the corporation, but should be taxed in the hands of the recipient.

12. We are not informed as to how much such a program would affect the actual cash receipts of the Government, but if the tax on earnings retained was substantially increased, and if the Government would restore the differential in taxing earned income and unearned income, so that the unearned income would carry a substantially heavier share, we dare say that the income to the Government might be maintained or even increased. Earnings would begin to circulate at a much higher velocity, and the chances are that competition would soon result in substantial decreases in prices to the consumer.

13. Probably this cannot all be done at once, but it seems to us that this is the general trend the Congress should endeavor to develop through its tax policies. Certainly an increase in corporation taxation is going in the wrong direction, for it will result in an increase in the cost of living with a corresponding reduction in purchasing power, resulting in slowing down industry at the very time when we need to increase employment and speed up industry.

14. In viewing this whole tax problem, we believe we should recognize that the development of our great middle class society is the direct result of holding down the cost of living, and we should direct not only our tax policies but our expenditure policies to attain that end. Frankly we are much alarmed at the tendency to follow the other course of trying to increase the purchasing power of the people in the low and middle income brackets by many social experiments such as have

brought distress to so many other nations who have tried them unsuccessfully. We think the course to pursue is to follow the very course which has made America predominantly prosperous, and not go go off into these strange fields. We feel that the question of taxation is probably the most important single factor in determining the course we should follow, and that the first principle to strive to attain is maximum economy and efficiency. The second principle is so to levy our taxes as to pass the least amount possible on to the consumer, with the least compounding.

A STATEMENT ON WITHHOLDING TAX ON STOCK DIVIDENDS AND PATRONAGE REFUNDS OF COOPERATIVES, BY J. T. SANDERS, LEGISLATIVE COUNSEL, THE NATIONAL GRANGE

1. H. R. 8920 places a 10 percent withholding tax on stock dividends and patronage refunds of cooperatives. The main reason for this action is presumably based on the belief that many taxpayers are not now including their dividends and patronage refunds in their income-tax returns.

2. We have studied the practicability of this withholding tax provision from the standpoint of both the farmer cooperatives and the Treasury. The patronage refund earnings of cooperative members, which are based on extent of patronage rather than amount of stock owned, are paid to their members in relatively small amounts.

3. The statement filed by the North Carolina State Grange Master H. B. Caldwell showed that for three cooperatives that issued 237,000 patronage and dividend checks, less than 6 percent of the checks were over $10 in amount, and around two-thirds were less than $1 in amount. It appears that the withholding phases of this bill are simply not worth the total cost and worry that the provision would incur.

4. These facts indicate the extent of the burden of compliance which would fall upon cooperatives should the withholding tax be enacted.

5. The burden upon the Treasury would also be great. A sizable percentage of farmers do not have taxable income. Those who have no taxable income and who file for refunds will place a considerable expense upon the Treasury with no offsetting gain to the Treasury.

6. We believe that the objective of collecting taxes where due could be accomplished at much less cost to the Treasury and expense to the taxpayer by providing that all corporations including cooperative associations report the names of all individuals who receive $50 or more in stock dividends or patronage refunds and by requiring the taxpayers to list on his income tax return the amount of each such dividend and refund and the source.

7. We object to subjecting patronage refunds of cooperatives to a withholding tax unless similar refunds, discounts, and rebates of proprietary business concerns are so treated. It should also be recognized that patronage refunds represent final settlement in a business transaction. It is hard to see why the final transaction should be subjected to taxation any more than the first advances.

8. If the withholding provisions are to be retained, we suggest that the patronage refunds, trade discounts, rebates of all corporations or associations of more than $50 be subjected to the withholding provisions. It would also be necessary to provide that only patronage refunds to individuals be subjected to the withholding tax in order to prevent the tax from being cumulative in case of federated cooperatives.

AMERICAN FARM BUREAU FEDERATION,
Washington, D. C., July 13, 1950.

HON. WALTER F. GEORGE,
Chairman, Committee on Finance,
United States Senate, Washington, D. C.

DEAR CHAIRMAN GEORGE: We understand that the Ways and Means Committee gave consideration in H. R. 8920 to a revision of section 117 (j) (1) of the Internal Revenue Code as it applies to the tax treatment of income received from the sale of animals culled from breeding herds. The action taken, however, does not meet the issue presented by rulings of the Bureau of Internal Revenue.

At a recent meeting, the board of directors of the American Farm Bureau Federation unanimously agreed to request an amendment in line with recent court decisions in which it has been held that income from the sale of animals culled from a dairy or breeding herd may be treated as capital gains under section 117 (j) (1), provided such animals have been held for at least 6 months.

We can see no basis for the contention of the Bureau of Internal Revenue that livestock held for the production of milk or offspring are not capital assets. In order to remove the possibility that recent court findings in this matter may be overturned by later decisions, we recommend that there be added to section 117 (j) (1) a provision clearly stating that income from the sale of animals culled from a dairy or breeding herd is to be considered a capital gain under this section.

We respectfully request that this letter be made part of the official hearings.

Sincerely yours,

ROGER FLEMING, *Secretary-Treasurer.*

RECOMMENDATIONS OF SPECIAL COMMITTEE ADOPTED BY BOARD OF DIRECTORS, COLORADO STATE CHAMBER OF COMMERCE, JULY 7, 1950

The committee recommends two technical changes in Federal income-tax laws, as follows:

1. That the interest rate on overpayment or deficiencies in tax payments be reduced from 6 percent to 3 percent, and interest on deficiencies limited to the periods of the statute of limitations. Present basis was established when interest rates generally were at much higher levels. Neither the taxpayer, or the Government, should be penalized by the payment of interest at rates far above prevailing rates. Payment of interest by the taxpayer beyond the period of the statute of limitations constitutes a penalty occasioned by the inability of the Bureau to audit his tax account promptly, which is beyond the control of the taxpayer.

2. The employers be reimbursed for out of pocket expense incurred in collection of social security and withholding taxes of employees, by means of a small percentage allowance deductible from the returns. The withholding system has greatly improved collections and reduced expenses to the Government. At the same time real expense has been added to the cost of doing business of every employer. Since the basic right of the Government to impose upon one citizen the responsibility of collecting the taxes of another is so subject to doubt, it seems only fair to reimburse incurred expense, as a matter of elemental principle. Many States have recognized this principle in the collection of sales taxes.

RUTGERS UNIVERSITY,
New Brunswick, N. J., June 28, 1950.

Senator H. ALEXANDER SMITH,
Senate Office Building,
Washington, D. C.

MY DEAR SENATOR: Dean Meder of our staff, whom you will recall, I am sure, has written me as follows:

"According to Circular Letter No. 35 of the Association of Land-Grant Colleges and Universities the Ways and Means Committee of the House of Representatives has announced approval of the following proposal:

" '(3) Imposing a tax on accumulated investment income of charitable trusts and foundations (interest, rents, and royalties) where the funds are not spent on designated purposes within the taxable year or within 2½ months after the close of the year. No tax would be applicable where the accumulations in trust are for a period of not more than 5 years if the trust instrument designates that the funds be turned over to the tax-exempt organizations, and the trust would be permitted to accumulate tax-free 1 year's earnings equal to its highest annual income during the preceding 5 years, and also accumulate tax-free earnings for 25 years where the trust is established by will.' "

As I read the above, it would directly affect us in connection with numerous funds received and to be received by gift, by trust indenture, and by will. We have funds, the income on which is restricted for certain purposes, which purposes become obsolete with the passage of time. In these cases, we continue to accrue the income until ways and means could be worked out, possibly by application to the appropriate court, for the use of said income for some substantially similar purpose; or in other cases adding cumulative income to the principal and then applying for permission to use the income for some substantially similar purpose.

If I read the proposal correctly, I hope that you and Senator Hendrickson will do your best to defeat this proposal.

Best regards to you. We hope the weather is not too severe in Washington, especially with the burdensome and all-important problems facing you folks in Congress constantly and especially currently.

Sincerely yours,

A. S. JOHNSON, *Comptroller.*

STATEMENT SUBMITTED BY JOSEPH A. SCHAFER, CERTIFIED PUBLIC ACCOUNTANT

The provisions of H. R. 8920 pertaining to the adjustment of excise taxes merit emphatic disapproval for the following reasons:

1. Adjustments in rates or exemptions to correct apparent inequities, or to afford special relief, cannot overcome the fact that the system will continue to discriminate, disrupt, and interfere with the purchasing, production, and selling of the goods, or the furnishing of the services, that are selected under the excise system.
2. The excise tax system will continue to discriminate against the small taxpayer whose tax payments are out of porportion to the established income tax schedule of rates based on ability to pay.
3. The excise taxes create a system of double taxation by which a high-bracket taxpayer must pay more than 100 percent tax on the portion of his income that is subject to both income tax and excise tax.
4. The bill retains a system for the collection of excise taxes levied during the past war, the only war measure that remains without a specific termination date.
5. It continues to demand that businessmen, manufacturers, and operators of other commercial enterprises pursue the duties of a tax collector for the Government.
6. By continuing the system with reduced rates, millions of dollars of expense will continue to be incurred by business concerns and the Government to maintain that collection system.
7. If the system is to function properly, the various rate changes, exceptions and exemptions will require more attention and assistance because of the complications and the difficulty in administration.

CONSEQUENCES

Choosing certain items for special treatment in preference to other items is extremely difficult, and can lead only to confusion for all parties concerned. If one article is taxed and another is exempt, the customer will be utterly confused unless every item to which tax applies is plainly marked. The customer cannot hope to have a knowledge of what items are subject to tax, and he therefore pays whatever the sales clerk demands when a purchase is made, which will make it easy for dishonest sales clerks to cheat the customer.

In some cases the dishonest sales clerk will deliberately collect tax from an uninformed customer and pocket the amount because the tax does not apply. If the tax charge is questioned, it will be a simple matter to say that a mistake was made. In other cases an inexperienced sales clerk through oversight will charge a tax on exempt merchandise. Either inadvertently or intentionally, such situations exist even with the present schedule of tax rates. It will be the poor uneducated people who will be taken advantage of by the cheats and chiselers.

Storekeepers likewise will be confused by an extremely complicated schedule of excises. Instead of relieving business in this collection task, the annoyance and bother and work will become more aggravated. If some articles are subject to tax and others are not, the businessman will have to carefully segregate sales, and he will have more trouble in recording and accounting for the tax funds and preparing reports to the Government.

The Government itself will lose an enormous amount of revenue because of the difficulty in administering a tax which applies indiscriminately to certain items and not to others. Businessmen first of all will have difficulty in segregating their sales properly and accounting for the correct tax. In some cases it will be easy to cheat the Government by recording a sale as exempt and retaining the tax collected from the customer. The unscrupulous businessman will evade payment of the tax by recording a minimum of sales as being subject to tax. Evasion will become more widespread than it is at present. That situation cannot be controlled even under the present system. Proper administration will be impossible unless many more agents are assigned to the investigation and examination of returns.

The absence of free choice of goods by the customers will cause them to purchase an exempt item from one counter in preference to a taxed item on the next counter. It seems certain, therefore, that the proposed changes in excises will interfere with production in the factories because workers will be shifted from taxed items to exempt goods. There is no logical reason to compel manufacturers to divert production to exempt articles, or to advertise or label items in such a way that they can qualify for exemption from tax.

INDISCRIMINATE SELECTION

Toilet preparations for babies are to be exempt from tax, but it no longer will be permissible to indicate on the package that they are also for the use of adults. Such products are used by adults at the present time, and it is certain that they will not volunteer to pay the tax even if they use baby powders and lotions in the future. If the tax can be avoided merely by purchasing items that carry an exempt title, sales of such items will increase and sales of unfavored items will decrease. It will be a simple matter to produce goods that carry the proper label, but such tinkering with production serves no useful purpose.

Some items used in the kitchen will be exempt from tax but other items will be taxable. Electric, gas, or oil appliances used for cooking are taxable, but household cooking stoves or ranges are exempt. Electric mixers will be taxable, but electric irons or toasters will be exempt. Household electric direct motor-driven fans will be taxable, but the nonhousehold type will be exempt. No tax will apply to any item if it is primarily designed for use as a baby bottle warmer. With these fine distinctions it will be a miracle if the businessman escapes the insane asylum.

In the jewelry line, exemption is granted to watches selling at a price of $65 or less. If that is the case then manufacturers will not produce watches priced over $65 because it probably would not be worth while for a customer to purchase a watch priced at $80, the additional tax charge of $8 being out of proportion to the $15 increase in the value of the watch. Practically all the watches that are sold will be relieved from tax by this exemption, under the pretext that inexpensive watches are a necessity and a tax thereon would be burdensome. Similar language granting a $65 exemption was not used for fur articles, although the Senate Finance Committee in 1943 stated that fur articles were necessary items of apparel in some parts of the country.

And why should there not be a $65 exemption on all luggage? A $65 exemption should also apply to railroad tickets that are now subject to a transportation tax. However, provision was made for the exemption of certain small articles of leather goods, such as wallets and handbags. But the tax was retained on the 10- and 25-cent pieces of jewelry purchased for little children. And a tax also was retained on the creams and lotions costing 10, 25, 50 cents, or $1, which items are vitally important in the care and preservation of the skin and body. It might be stated here that creams and lotions for babies were considered necessities, but the same preparations are not necessities if used by adults. It is these various arbitrary selections and preferences that make it impossible for the businessman and taxpayers to comprehend the type of excise system under consideration.

COMPARISON OF TAXES AND BUSINESS, TABLE 1

The comparison of excise tax collections shown in the accompanying table 1 supports the contention that if relief is granted to one line, then it is mandatory that equal treatment be given to the other industries. Greater declines have occurred in furs and cabarets than in jewelry and the other trades. Collections during the Christmas season of 3 months (December 1949, and January and February 1950) included in the current fiscal year, in comparison with the corresponding period in the 1947 fiscal year, show the following results:

Furs, collections decreased 51.7 percent; a business loss of 113 million dollars.

Jewelry, collections decreased 21.8 percent; a business loss of 97.5 million dollars.

Luggage, collections decreased 9.9 percent; a business loss of 14 million dollars.

Toilet preparations, collections decreased 14 percent; a business loss of 23.5 million dollars.

Total retailers' excises, collections decreased 25.5 percent; a business loss of 249 million dollars.

Collections for the 9 months' period ended March 31, 1950, in comparison with the corresponding period in the 1947 fiscal year (July 1, 1946, to March 31, 1947), show the following results:

Furs, collections decreased 65.8 percent; a business loss of 225.5 million dollars.

Jewelry, collections decreased 21 percent; a business loss of 199.5 million dollars.

Luggage, collections decreased 11.3 percent; a business loss of 37.5 million dollars.

Toilet preparations, collections decreased 5 percent; a business loss of 19 million dollars.

Total retailers' excises, collections decreased 23.2 percent; a business loss of 481.5 million dollars.

Collections of admissions taxes for the same 9 months' periods show the following results:

Cabarets, collections decreased 36.7 percent; a business loss of 90.5 million dollars.

Theaters, collections decreased 5.1 percent; a business loss of 76 million dollars.

Combining the four retailers' lines and the two admissions items for the same 9 months' periods, the 1950 period in comparison with the 1947 period shows a decrease in tax collections of 17 percent, representing an aggregate loss of potential business of $648,000,000 (for only 9 months).

It also should be reported that tax collections for transportation of persons for the 9 months' period ended March 31, 1950, in comparison with the corresponding period in 1947, show a decrease of 5.8 percent in collections, representing loss of travel business of $74,000,000 for 9 months. Comparing the current 9 months' period with the same period in the preceding year (1949), tax collections show a decrease of 10.3 percent (19.5 million dollars), representing loss of travel business of $130,000,000. (This section is not included in table 1.)

BURDEN ON CHILDREN

No admissions tax has ever been applied to the recreational activities of men and women who engage in the sports of bowling, golf, tennis, and horseback riding. Now further relief is proposed for men by excusing them from the transportation tax when they go on a fishing trip. On the other hand, an admissions tax has been demanded from the boys and girls when they go roller skating, and they will continue to pay tax at a reduced rate. It should be considered that when boys and girls go roller skating they are personally participating in a wholesome and healthful recreational activity which will make them strong and healthy citizens. They do not engage in this physical exercise for the purpose of being entertained by others or to see a show.

The same thing applies to swimming, which is a favorite sport for boys and girls during their summer vacation. If they are fortunate to find a suitable swimming pool operated by the State or municipality, they will not have to pay a tax, but if they must go to a privately operated pool they will have to pay an extra tax charge for the privilege of engaging in that physical activity. Such discrimination is unfair to the children as well as to those who have furnished the facilities by investing their capital in a private enterprise.

Likewise unfair to children is the continuation of an admissions tax to theaters, even at a reduced rate. Although the price of admission may be only 40 or 50 cents, many children are required to earn the money that will enable them to go to the movies, or swimming or roller skating. It is inconsiderate to take their pennies for tax, but it is particularly severe for the children of low income families. Operators of skating rinks, swimming pools, and theaters would rather pay income taxes on their profits than restrict attendance of the children because of an admissions tax.

BUSINESS EXCISES

No tax will apply to cameras and photographic film and equipment used in business. In that case employees will conspire to purchase those items through their companies on the pretext that the article has a business use and is therefore exempt. Many companies now furnish athletic equipment of various kinds for the amusement of workers, so now it can be expected that company recreational programs will include photography. Only the poor helpless individuals who do not have contacts will be at a disadvantage because they cannot avail themselves of such methods to avoid tax. This is one more loophole that will lead to greater avoidance and evasion.

Although certain items will have an exemption because they are "used in business," tax is retained on many other items of an essential nature in the conduct of business. There should be no inconsistencies in the treatment of goods and services used in business. If certain photographic items are to be exempt, it seems just as important to exempt the following items that are of vital necessity in business:

Luggage and leather goods.

Telephone and telegraph services (a higher tax rate is proposed for business than for residential service).

Transportation of property, coal, and oil.

Transportation of salesmen, employees, and executives.

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Admissions to theaters and cabarets for business entertainment.
Business machines and equipment.
Automobiles and trucks.
Gasoline, oil, and tires.
Electrical energy.

Secretary of the Treasury John W. Snyder, in his appearance before the Ways and Means Committee, stated: "Excise taxes on business costs tend to be pyramided successive markups by those handling goods in the various stages of production and distribution. The cost of living of all consumers is increased out of proportion to the tax imposed."

It apparently was for that reason that elimination of the transportation tax on property was recommended, the tax being compounded by three or four applications from the raw material stage to the finished product in a store. In the same manner duplication of the tax on communications occurs time and again in the transaction of business from the original source of material to the final consumer. It was testified that transportation and communication services are used widely and predominantly by business.

The enormous amount of direct and indirect excise taxes which falls upon business is included in the cost of production either as cost of purchases or in the tax or expense accounts. Consequently, all such tax expenditures must be reimbursed by the customers through the sales price of goods. The resumption is clear that all taxes are passed on to the consumers, and that it would be cheaper if the latter could pay all taxes directly in the first place instead of half of them being paid indirectly by additions to prices.

Every business, trade and industry has complained about the inequities in the excise tax system. To restore tax equality it would be necessary to revert to the 1941 status of excises. The suggestion of the National Association of Manufacturers to end inequities against certain industries by spreading the tax over all goods and products, instead of a tax on only certain selected lines, is unsatisfactory because it would in effect be a sales tax to be passed along in the price of goods to all levels of customers.

REPLACING EXCISE TAXES

Most of the excise taxes should be eliminated because they are in the nature of nuisances, which include the following:

All retailers' excise taxes on sales.
All excise taxes on facilities (transportation and communication).
All admissions taxes on theaters, cabarets, etc.
Half of the manufacturers' excise taxes.

To accomplish the repeal or adjustment of the excise taxes to the status existing in 1941, the lesser evil and the only logical solution is to increase corporation income taxes. Although such procedure may not conform to proper principles of taxation, it seems safe to predict that the satisfactory results of such a switch would make possible lower taxes within 1 year. The ability of a corporation to pay income taxes depends upon the profitable results of operation, so that no corporation will suffer if they do more business and make more profits and pay income taxes instead of excise taxes.

If it is assumed that $2,000,000,000 of excise taxes now included in business costs be eliminated, then it would be fair to substitute therefor $2,000,000,000 of corporation income tax as an offset. Prices to consumers would remain the same, because the price paid would reimburse the corporation for income taxes instead of the excise taxes in costs. Actually, the effect would be more favorable for the Government as shown by the following figures:

[In millions]

	Before repealing excises	After repealing excises	Increase
Aggregate corporation taxable net income:			
With excise taxes in costs	$30,000		
With excise taxes excluded		$32,000	
Increase in net income			$2,000
Corporation income taxes (at average effective rate, assumed to be 33⅓ percent)	10,000	10,666	666
Balance of corporation income	20,000	21,334	1,334

The above figures show that if costs are reduced $2;000,000,000, raising taxable net income by an equivalent amount, the result would be $666,000,000 of additional corporation income tax just by reason of the change in the method of taxation. Therefore, merely $1,334,000,000 of additional revenue would be required to replace $2,000,000,000 of business excise taxes. That $1,334,000,000 would represent the funds corporations have not paid out as direct excise taxes, so they would be in the same position if they are required to turn over that much to the Government in the form of increased income taxes. Every corporation is affected by the excise taxes so it would not be a hardship to them if the income tax is substituted, especially since profits must be earned before any income tax is payable.

SAVINGS EFFECT

Collection of the entire $2,000,000,000 of substituted revenue through corporation income tax will make it possible to save millions of dollars in expenses for the business concerns as well as for the Government. Whether an income tax return shows the amount to be due as $1,000 or $10,000, not 1 cent of additional administrative expense is incurred to collect the higher amount. The same income tax report must be prepared, the only changes being in the amounts of the various items, the calculation of tax by an increased rate instead of the former rate, and a check of greater amount to be paid by the corporation and received by the tax collector.

Corporations now affected by manufacturers' and other excise taxes would save the expense of having clerks apply excise taxes to invoices, sales tickets, and merchandise on the counters; the collection and segregation of the excise tax funds in the accounts and records; the reporting and payment of such funds to the Government; and the auditing services related thereto. How much of a nuisance this type of tax collection is may be understood if it is realized that sales clerks in a store such as Woolworth's are required to collect as little as 2 cents tax (or 1 cent as now proposed) on innumerable transactions of 10, 25, 50 cents, etc., and that all day long they must keep track of those items.

The same thing applies to the Government's procedure in connection with the collection, recording, accounting, and examination of excise taxes. Just as many persons will be needed to collect a tax of 1 cent on a 10-cent sale in Woolworth's instead of 2, or to collect 1 cent per 1,000 matches instead of 2 cents, or to collect 1½-percent tax on transportation of property instead of 3 percent. Not 1 cent of expense will be saved by merely adusting rates of these nuisance taxes.

If complications are added to the system because of exemptions and exceptions, in all probability more assistance will be required because of greater difficulty and confusion in administration. A manufacturers' sales tax on all goods and products also would require additional employees in business and Government for collection and administration purposes. Reduction in personnel can occur only if many of the excise taxes are eliminated entirely, and that should include half of the manufacturers' excises.

WAR EFFECT

The saving of manpower should be welcomed at any time, but during a war emergency the extravagant squandering of manpower is dangerous and should not be tolerated. The unnecessary wastage of paper, an essential war material, for the many tax forms and other administrative records and reports for an improper tax collection system also is a matter of vital concern to the country. It must be emphasized that excise taxes should not be levied as a special source of revenue in the event of war when an income-tax system has been established for the purpose of obtaining revenue. The duplication of tax-collection systems is unwarranted any time.

Taxes should not be availed of for extraneous purposes or to solve certain problems created by a war situation. If it becomes necessary to restrain inflationary tendencies, then the Federal Reserve System should be charged with that task. If it becomes necessary to curtail consumption in order to conserve vital materials, allocations, and controls should be employed. If there is a scarcity of any article or commodity, then such items should be distributed according to a practical ration system. If it is desired to eliminate nonessential travel, then a system of priority should control the flow of rail and air traffic.

TERMINATION DATE

It should be noted that the changes in the excises in 1941 were understood to be only on account of the war situation, and that every authority considered such levies to be imposed only because of the emergency which existed. At that time Congress insisted that such special taxes were only for the duration of the war by providing a specific termination date, which was later designated to be July 1, 1947. The continuation of the war excises, even in modified form, is the only war measure that has been extended without a specific termination date.

DIVIDEND WITHHOLDING

A further reason for discarding the wartime excise taxes is the proposal to withhold 10 percent of the dividends paid by corporations to be applied against the personal income taxes of stockholders. This new procedure will require additional personnel by the corporations and the Government, again for the recording, accounting, reporting, and payment and collection of the withheld funds. If it is not possible to transfer employees now engaged in excise-tax work to the new tasks demanded by the dividend withholding system, additional millions of dollars of expense will be required for still more employees, and for another set of forms, storage, transportation, and all other related activity involved in another withholding system.

CONSUMER EXCISES

In addition to the $2,000,000,000 of reduction in business excise taxes, an additional $1,000,000,000 of excise taxes that are imposed directly on the consumers should be eliminated. As a consequence $1,000,000,000 of additional purchasing power would be available for spending by the customers. It is certain that those funds would be channeled into every field of business enterprise with the result that all trades and industries would benefit by increased sales, production, and profit. Such increased business and profits would offset to a great extent any additional corporation income taxes.

A further consequence of such increased business and production would be the reemployment of many workers who are now on the unemployment or relief rolls. Perhaps 1,000,000 of the unemployed could return to the factories and shops within a short period of time. The earning power of 1,000,000 additional men, based on an average annual income of $2,500 for each worker, would aggregate 2½ billion dollars. At an average personal income tax rate of 20 percent, the Government would collect additional income taxes totaling $500,000,000. The balance of take-home pay of $2,000,000,000 would be available to the reemployed workers as additional purchasing power to be poured into the economic stream.

The above $500,000,000 of additional income tax from individuals would be supplemented by still more income tax revenue collected from both individuals and corporations by further increases in business and employment resulting from the turnover of the available $2,000,000,000 fund. The $1,000,000,000 of eliminated excise-tax revenue would be further offset by savings to the Government in unemployment compensation and relief payments and in related administrative expenses.

BURDEN ON SMALL TAXPAYERS

The most important consideration for the repeal of most of the excises is illustrated in the accompanying table 2, which shows the combined effect of income and excise taxes at the different levels of taxable net income. It is proper to combine these tax payments because excise taxes are income taxes in another form; both are collected for revenue purposes, and they must be paid out of other income.

The illustration is based on the assumption that $250 of excise taxes are paid in connection with the expenditure of $1,000 during the year, which applies to all levels of income since the wants and desires of two persons are the same even though they may vary in particular categories. Any average person can smoke only a certain number of cigarettes, or drink a certain quantity of liquor, or attend theatres a certain number of times, and so on for the different excise items, but perhaps with variations between items.

The conditions shown by the effective tax rates in table 2 may be summarized as follows:

The small taxpayer pays a much higher excise tax rate: 10 percent for a $2,500 taxpayer; one-fourth of 1 percent for a $100,000 taxpayer; 5 percent for a $5,000

taxpayer; one-half of 1 percent for a $50,000 taxpayer; 2½ percent for a $10,000 taxpayer; 1 percent for a $25,000 taxpayer.

The combined tax rate becomes progressively higher on incomes from $5,000 down to $2,500: 23.78 percent at $6,000; 23.96 percent at $5,000; 24.23 percent at $4,000; 25.85 percent at $3,000; 27.15 percent at $2,500.

The $2,500 taxpayer pays a higher combined tax rate (27.15 percent) than those having incomes from $3,000 (25.85 percent) up to $12,000 (26.85 percent).

The $3,000 taxpayer pays a higher combined tax rate (25.85 percent) than those having incomes from $4,000 (24.23 percent) up to $10,000 (25.53 percent).

The $4,000 taxpayer pays a higher combined tax rate (24.23 percent) than those having incomes of $5,000 (23.96 percent) or $6,000 (23.78 percent).

If the proposed reductions in tax rates reduce the excise tax payments during the year to $125 on an expenditure of $1,000, the conditions shown by the effective tax rates shown in table 2 will be as follows:

The small taxpayer will still pay a higher excise tax rate: 5 percent for a $2,500 taxpayer; one-eighth of 1 percent for a $100,000 taxpayer, 2½ percent for a $5,000 taxpayer; one-fourth of 1 percent for a $50,000 taxpayer; 1¼ percent for a $10,000 taxpayer; one-half of 1 percent for a $25,000 taxpayer.

The combined tax rate becomes progressively higher on incomes from $3,000 down to $2,500: 21.11 percent at $4,000; 21.69 percent at $3,000, 22.15 percent at $2,500.

The $2,500 taxpayer will pay a higher combined tax rate (22.15 percent) than those having incomes from $3,000 (21.69 percent) up to $6,000 (21.69 percent).

The $3,000 taxpayer will pay a higher combined tax rate (21.69 percent) than those having incomes from $4,000 (21.11 percent) up to $5,000 (21.46 percent), and the same rate as the $6,000 taxpayer.

This analysis proves that the established system of collecting revenue from the taxpayers according to the ability to pay by means of progressive rates as income rises has been ignored. The income-tax method based on ability to pay is the accepted form of taxation in this country and any special levies which have the effect of violating that principle should be discontinued without further delay. It is highly objectionable that the Government by a two-pronged system extracts from the pockets of the lower-income groups a higher tax rate than is obtained from higher-income groups. Such a system is entirely discriminatory, unfair, and inequitable.

DOUBLE TAXATION—TABLE 3

Table 3 discloses the effects of the system of double taxation created by application of an income tax on earnings, and in addition an excise tax when those same earnings are spent, whether for the purchase of goods or for services. The assumption is that $250 of excise taxes are paid in connection with the expenditure of $1,000 during the year, which portion of income is subject to the highest income-tax rate.

In the extreme case, a $100,000 taxpayer pays a combined tax rate of 101.56 percent for income and excise taxes on the $1,000 portion of his income which was subject to both taxes. In order to spend $1,000 of his income he must earn an additional $1,015 60 for income and excise taxes, which certainly is a paradoxical situation.

The double taxation conditions shown in table 3 may be summarized as follows:

The double taxation rate in comparison with the basic income-tax rate becomes progressively less on incomes from $40,000 to $100,000: 1.04 percent less at $40,000 (42.34 percent instead of 43.38 percent); 9.60 percent less at $60,000 (40.70 percent instead of 50.30 percent); 16.88 percent less at $100,000 (42.34 percent instead of 59.22 percent).

The excess of the double taxation rate on $1,000 expenditure subject to excise taxes, in comparison with the basic income-tax rate, is greater on incomes from $2,500 to $15,000: 8.40 percent to 9.96 percent excess for the incomes from $2,500 to $12,000; 11.14 percent excess at $15.000; 2.14 percent excess at $30,000; minus 5.96 percent at $50,000; minus 16.88 percent at $100,000.

Superimposing of excise taxes in addition to income tax on earnings has an unequal effect at the various levels of income: A $15,000 taxpayer pays 11.14 percent more than his basic rate (27.61 percent); a $5,000 taxpayer pays 9.96 percent more than his basic rate (18.96 percent); a $2,500 taxpayer pays 8.68 percent more than his basic rate (17.15 percent); an $80,000 taxpayer pays 14.16 percent less than his basic rate (55.22 percent); a $100,000 taxpayer pays 16.88 percent less than his basic rate (59.22 percent).

If the proposed reductions in tax rates reduce the excise-tax payments during the year to $125 on an expenditure of $1,000, the double-taxation conditions shown in table 3 will be as follows:

In comparison with the basic income tax rate, the reduction of the double-taxation rate is lower on incomes from $2,500 to $15,000 than on incomes from $20,000 to $100,000: 1.36 percent lower rate at $15,000; 2.54 percent lower rate at $5,000; 4.10 percent lower rate at $4,000; 4.54 percent lower rate at $20,000; 22.10 percent lower rate at $60,000; 29.38 percent lower rate at $100,000.

The effect at various levels of income will be unequal: A $15,000 taxpayer will pay 1.36 percent less than his basic rate (27.61 percent); a $3,000 taxpayer will pay 3.18 percent less than his basic rate (17.52 percent); a $2,500 taxpayer will pay 3.82 percent less than his basic rate (17.15 percent); an $80,000 taxpayer will pay 26.66 percent less than his basic rate (55.22 percent); a $100,000 taxpayer will pay 29.38 percent less than his basic rate (59.22 percent).

REQUIREMENTS

Tax justice at all levels of income requires complete elimination of most of the excises and reliance on the income-tax method of collecting tax revenue. Tax equality will not exist unless revenue is obtained only according to ability to pay with true progressive rates from the lowest income group to the highest income group.

In order to relieve business, to safeguard the interests of the consumers and taxpayers, and to protect the Federal revenues, it is obvious that the revenue bill of 1950 should provide for the following:

(1) Termination of the policy that requires storekeepers, manufacturers, railroads, theater owners, and operators of other business establishments to act in the capacity of tax collectors.

(2) Elimination of the bother and work involved in tax collection, which now costs business and the Government millions of dollars for clerical tasks and other related administrative expenses.

(3) Removal of the annoyance and irritation inflicted upon customers by the extraction of taxes through a selective system of excises, by which they are prevented from having a free choice of goods, or by which they are restricted in their enjoyment of other activities.

(4) The maintenance of a free-enterprise system by permitting manufacturers to engage in full and unhindered production of all kinds of goods and products irrespective of values.

(5) Reliance upon the income-tax system for increased revenues demanded by national or world conditions, because only that method is based upon the ability to pay and recognizes the principle that tax rates should be progressive as the income levels increase.

Fulfillment of the above requirements would result in stimulation of buying, full production, greater employment, larger profits, and additional income taxes from both individuals and business concerns. More than that, it would do justice to the small taxpayers who would then not be required to pay more than their share of taxes in relation to their respective incomes.

TABLE 1.—*Comparison of excise-tax collections for periods in fiscal years June 30, 1947, to June 30, 1950*

CHRISTMAS SEASON

[In millions of dollars]

	3 months, Dec. 1 to Feb. 28—				Percent decrease	Loss in business
	1947	1948	1949	1950		
Furs:						
Tax collected	43.7	37.8	29.1	21.1		
Decrease from preceding year		5.9	8.7	8.0		
Decrease from 1947 period				22.6	51.7	113.0
Jewelry:						
Tax collected	89.5	81.4	78.5	70.0		
Decrease from preceding year		8.1	2.9	8.5		
Decrease from 1947 period				19.5	21.8	97.5
Luggage:						
Tax collected	28.2	27.6	27.6	25.4		
Decrease from preceding year		.6		2.2		
Decrease from 1947 period				2.8	9.9	14.0
Toilet preparations:						
Tax collected	33.5	31.2	30.7	28.8		
Decrease from preceding year		2.3	.5	1.9		
Decrease from 1947 period				4.7	14.0	23.5
Total retailers:						
Tax collected	195.0	178.0	166.0	145.2		
Decrease from preceding year		17.0	12.0	20.8		
Decrease from 1947 period				49.8	25.5	249.0

9 MONTHS' PERIOD

	July 1 to March 31—				Percent decrease	Loss in business
	1947	1948	1949	1950		
Furs:						
Tax collected	83.7	68.5	53.4	38.6		
Decrease from preceding year		15.2	15.1	14.8		
Decrease from 1947 period				45.1	65.8	225.5
Jewelry:						
Tax collected	190.0	173.1	168.7	150.1		
Decrease from preceding year		16.9	4.4	18.6		
Decrease from 1947 period				39.9	21.0	199.5
Luggage:						
Tax collected	66.1	61.7	63.4	58.6		
Decrease from preceding year		4.4	[1]1.7	4.8		
Decrease from 1947 period				7.5	11.3	37.5
Toilet preparations:						
Tax collected	75.4	71.5	72.4	71.6		
Decrease from preceding year		3.9	[1].9	.8		
Decrease from 1947 period				3.8	5.0	19.0
Total retailers:						
Tax collected	415.2	374.8	357.9	318.9		
Decrease from preceding year		40.4	16.9	39.0		
Decrease from 1947 period				96.3	23.2	481.5
Admissions—Theaters, etc.:						
Tax collected	299.8	293.6	298.1	284.6		
Decrease from preceding year		6.2	[1]4.5	13.5		
Decrease from 1947 period				15.2	5.1	76.0
Admissions—Cabarets, etc.:						
Tax collected	49.3	40.7	37.7	31.2		
Decrease from preceding year		8.6	3.0	6.5		
Decrease from 1947 period				18.1	36.7	90.5
Total retailers and admissions:						
Tax collected	764.3	709.1	693.7	634.7		
Decrease from preceding year		55.2	15.4	59.0		
Decrease from 1947 period				129.6	17.0	648.0

[1] Increase.

TABLE 2.—*Schedule of income and excise taxes paid and effective tax rates based on taxable net income*

ASSUMPTION: $250 EXCISE TAXES PAID ON $1,000 EXPENDITURE

[Cents omitted]

Taxable net income	Excise taxes		Income taxes		Combined taxes	
	Amount paid	Effective tax rate	Amount paid	Effective tax rate	Total paid	Effective tax rate
		Percent		*Percent*		*Percent*
$2,500	$250	10.00	$428	17.15	$678	27 15
$3,000	250	8 33	525	17.52	775	25.85
$4,000	250	6.25	719	17.98	969	24 23
$5,000	250	5.00	948	18.96	1,198	23.96
$6,000	250	4.17	1,176	19.61	1,426	23.78
$8,000	250	3.13	1,704	21.31	1,954	24.44
$10,000	250	2.50	2,303	23.03	2,553	25.53
$12,000	250	2.08	2,972	24.77	3,222	26.85
$15,000	250	1.67	4,142	27.61	4,392	29.28
$20,000	250	1.25	6,368	31.84	6,618	33.09
$25,000	250	1.00	8,912	35.65	9,162	36.65
$30,000	250	.83	11,613	38.71	11,683	39.54
$40,000	250	.62	17,351	43.38	17,601	44.00
$50,000	250	.50	23,581	47.16	23,831	47.66
$60,000	250	.42	30,181	50.30	30,431	50.72
$80,000	250	.31	44,173	55.22	44,423	55.53
$100,000	250	.25	59,221	59.22	59,471	59.47
ASSUMPTION: REDUCTION TO $125 EXCISE TAXES PAID ON $1,000 EXPENDITURE						
$2,500	$125	5.00	$428	17.15	$553	22.15
$3,000	125	4.17	525	17.52	650	21.69
$4,000	125	3.13	719	17 98	844	21.11
$5,000	125	2 50	948	18 96	1,073	21.46
$6,000	125	2.08	1,176	19.61	1,301	21.69
$8,000	125	1.56	1,704	21 31	1,829	22 87
$10,000	125	1.25	2,303	23 03	2,428	24.28
$12,000	125	1.04	2,972	24.77	3,097	25.81
$15,000	125	.83	4,142	27.61	4,267	28.44
$20,000	125	.63	6,368	31.84	6,493	32.47
$25,000	125	.50	8,912	35.65	9,037	36.15
$30,000	125	.42	11,613	38.71	11,738	39.13
$40,000	125	.31	17,351	43.38	17,476	43.69
$50,000	125	.25	23,581	47.16	23,706	47.41
$60,000	125	.21	30,181	50.30	30,306	50.51
$80,000	125	.15	44,173	55.22	44,298	55.37
$100,000	125	.13	59,221	59.22	59,346	59.35

NOTE.—Taxable net income of $2,500 for a single person would represent adjusted net income of $3,444, less 10 percent standard deduction of $344, less personal exemption of $600.

TABLE 3.—*Double taxation element in combined taxes paid on $1,000 expenditure subject to both income taxes and excise taxes*

ASSUMPTION. $250 EXCISE TAXES PAID ON $1,000 EXPENDITURE

Taxable net income	Excise taxes paid	Income taxes paid [1]	Combined taxes paid [1]	Effective tax rate	Basic income tax rate	Double taxation rate	Over or under basic rate
				Percent	*Percent*	*Percent*	*Percent*
$2,500	$250	$179	$429	42.98	17.15	25.83	8.68
$3,000	250	193	443	44.36	17.52	26.84	9.32
$4,000	250	193	443	44.36	17.98	26.38	8.40
$5,000	250	228	478	47.88	18.96	28.92	9.96
$6,000	250	228	478	47.88	19.61	28.27	8.66
$8,000	250	264	514	51.40	21.31	30.09	8.78
$10,000	250	299	549	54.92	23.03	31.89	8.86
$12,000	250	334	584	58.44	24.77	33.67	8.90
$15,000	250	413	663	66.36	27.61	38.75	11.14
$20,000	250	466	716	71.64	31.84	39.80	7.96
$25,000	250	519	769	76.92	35.65	41.27	5.62
$30,000	250	545	795	79.56	38.71	40.85	2.14
$40,000	250	607	857	85.72	43.38	42.34	(1.04)
$50,000	250	633	883	88.36	47.16	41.20	(5.96)
$60,000	250	660	910	91.00	50.30	40.70	(9.60)
$80,000	250	712	962	96.28	55.22	41.06	(14.16)
$100,000	250	765	1,015	101.56	59.22	42.34	(16.88)

ASSUMPTION. REDUCTION TO $125 EXCISE TAXES PAID ON $1,000 EXPENDITURE

Taxable net income	Excise taxes paid	Income taxes paid [1]	Combined taxes paid [1]	Effective tax rate	Basic income tax rate	Double taxation rate	Over or under basic rate
$2,500	$125	$179	$304	30.48	17.15	13.33	(3.82)
$3,000	125	193	318	31.86	17.52	14.34	(3.18)
$4,000	125	193	318	31.86	17.98	13.88	(4.10)
$5,000	125	228	353	35.38	18.96	16.42	(2.54)
$6,000	125	228	353	35.38	19.61	15.77	(3.84)
$8,000	125	264	389	38.90	21.31	17.59	(3.72)
$10,000	125	299	424	42.42	23.03	19.39	(3.64)
$12,000	125	334	459	45.94	24.77	21.17	(3.60)
$15,000	125	413	538	53.86	27.61	26.25	(1.36)
$20,000	125	466	591	59.14	31.84	27.30	(4.54)
$25,000	125	519	644	64.42	35.65	28.77	(6.88)
$30,000	125	545	670	67.06	38.71	28.35	(10.36)
$40,000	125	607	732	73.22	43.38	29.84	(13.54)
$50,000	125	633	758	75.86	47.16	28.70	(18.46)
$60,000	125	660	785	78.50	50.30	28.20	(22.10)
$80,000	125	712	837	83.78	55.22	28.56	(26.66)
$100,000	125	765	890	89.06	59.22	29.84	(29.38)

[1] Basis. Income and excise taxes on the $1,000 expenditure are paid at the highest tax rates. Cents omitted.

Supplementary Statement Presented by American Federation of Labor

INCREASE YIELD ON ESTATE AND GIFT TAXES

The American Federation of Labor urges the revision of the estate and gift tax laws to provide for (1) integration, (2) lowering of exemptions, and (3) more effective rates.

Evidence presented to the House Ways and Means Committee showed clearly that with little hardship to the living and no hardship on the dead the revenue yield from estate and gift taxes could be increased by in excess of $400,000,000 annually.

H. R. 8920 contains no provision for securing this much-needed revenue. More than that, it includes a provision that would remove from the scope of the contemplation-of-death clause all transfers made more than 3 years prior to the date of death. It would seem that the House of Representatives is thus further committing itself to a perpetuation of the present hogde-podge, ineffective, discriminatory estate and gift tax set-up. Real concern at discrimination would seem to argue for integration of the estate and gift tax laws that would once and for all eliminate further occasion for tax-avoidance in this field.

We trust that the Senate will see fit to make amendments to H. R. 8920 that will insure that estate and gift tax laws will be the effective revenue producers that studies over the years have shown they should and can be.

SPECIAL DEPLETION ALLOWANCES

Evidence presented to the House Ways and Means Committee again showed clearly that the combination of provision for percentage depletion and the expensing of development costs provides a mechanism for pyramiding extensive holdings of oil and mineral assets with payment of little or no income tax. The annual revenue loss as estimated in the Treasury statement was placed at between 400 to 500 million dollars. The House failed to act on recommendations that were presented to it proposing the elimination of a substantial part of this revenue loss in a manner that would not discourage incentives for development of new properties.

It is also our understanding that H. R. 8920 contains changes that would increase percentage-depletion allowance by $35,000,000 yearly on the ground that certain additional minerals should be covered since they are at a "competitive disadvantage." This seems to constitute added proof that the initial mistake was the granting of preferential treatment to any producers.

We trust that your committee will see fit to reexamine the entire problem with a view to eliminating special tax privilege now enjoyed by certain types of business through the special depletion allowance provision.

REDUCTION OF HOLDING PERIOD FROM 6 TO 3 MONTHS TO QUALIFY FOR CAPITAL GAINS RATE

A careful perusal of the section holding period in the case of capital assets, page 60, Report No. 2319 to accompany H. R. 8920 fails to reveal that the Committee on Ways and Means advanced even one valid reason for its recommendation that the holding period to qualify for the capital gains rate be reduced from 6 to 3 months.

At one point the statement is made that "the holding period requirement is the test by which the 'investor' is distinguished from the 'speculator' whose individual ventures in the markets for capital assets tend to be of comparatively short duration."

This statement would seem to recognize what has generally been assumed by all tax economists without question, namely: The only qualification for a lower tax rate on capital gains than on ordinary income is that the appreciation in value of a capital asset accrues over more than 1 year.

However, again quoting from page 60, Report No. 2319, the following statement appears: "A long holding period has a disturbing effect on prices in the markets forc apital assets, which is most unfortunate * * * your committee's action * * * will reduce this tendency thus contributing to the stabilization of the security markets which is highly desirable * * *."

In effect, the committee now says that the holding period requirement which was the basic justification for the capital gains rate in the first place on the theory that it would prevent "bunching up" of gains, has a "disturbing effect on prices." Further it proposes that this theory underlying special treatment for capital gains

which is now being largely disregarded under the 6 months' holding period provision should be further disregarded by cutting the holding period in half under pretext of "stabilizing the market."

If the committee is correct in its conclusion that "a long holding period has a disturbing effect on prices in the market for capital assets" logic would seem to suggest that it should recommend the complete abolition of the preferential rate on capital gains. Certainly, the reduction of the holding period from 6 months to 3 months argues very strongly that speculators will be the principal beneficiaries of this section of H. R. 8920.

Rather than consider a decrease in the holding period may we urge that if the 25 percent rate is to stand, the holding period be increased to 18 months or more. This certainly would not be excessive in view of prevailing surtax rates.

Capital gains provisions should help long-term investors, not short-term speculators; and considerations of equity would seem to demand that short-term speculators should not fare better tax-wise than those who pay at the full-schedule income tax rate on their earnings.

Statement of American Federation of Labor Before House Ways and Means Committee on Proposed Amendments to Federal Tax Laws

The American Federation of Labor is in agreement with economists, Congressmen, and public administrators who urge the importance of making only such changes in the tax laws at this time as will serve to eliminate inequities without decreasing revenues to a point where prospective Federal deficits will be further increased. It is our considered opinion that this is the only businesslike position to take. The current and prospective defense program expenditures as well as the extensive commitments for European aid were undertaken with full knowledge of their cost. To refuse to meet these costs and other necessary expenses of government through a pay-as-you-go tax policy in a period of high income such as the present would, in our opinion, be nothing short of economic folly.

Moreover, we would point out that the deficit for the past fiscal year as well as prospective deficits for the current year and next year will be the direct result of premature and ill-advised tax reductions approved by the Eightieth Congress. These tax reductions, concentrated in the income, gift, and estate tax fields, resulted in the bulk of the tax savings accruing to those in the upper income groups.

The American Federation of Labor in 1947, 1948, and 1949 went emphatically on record as being opposed to the nature and extent of the tax reductions which were eventually approved by Congress. It was our opinion, which has not changed in the light of events, that if and when budgetary conditions and the over-all health of the national economy would permit, first priority should be given to the reduction and eventual elimination of wartime-imposed excise taxes.

The view of our members on this subject was expressed at our most recent convention in St. Paul, Minn., in October when, after having gone on record as being very much concerned at the fact that a "smaller and smaller percentage of an increasing amount of tax revenue at all levels of government is being collected from taxes based on the ability to pay", delegates expressed themselves on the subject of excise taxes as follows:

"During the past year large sections of the membership of organized labor have registered protests against Federal excise taxes. These taxes imposed during the war on amusements, transportation, telephone, cosmetics, leather goods, jewelry, etc., have undoubtedly contributed to unemployment of our members, because of curtailed demand for goods and services to which they apply. When enacted, Congress referred to these excise taxes as temporary war emergency measures; its continued failure to reduce or modify them constitutes a breach of faith with the American people."

Members of your committee will appreciate, in the light of the record here presented, that the American Federation of Labor is wholly in accord with the recommendations of President Truman that reductions in excise taxes should be made at this time. We hope that these reductions will be substantial and apply to all commodities and services enumerated by the President as well as to amusements, leather goods, and any and all goods and services that have been subject to war emergency imposed taxes. Current argument regarding which excise taxes should or should not be reduced in our opinion is pointless. In an economy where there is neither shortage of manpower nor material, taxation of the 20

cent, 40 cent, and $1 movie ticket or any type of legitimate entertainment cannot be justified any more than the taxation of telephone, toilet goods, freight, leather goods, or any other type of commodity or service can be justified. All wartime imposed emergency taxes should be reduced and eliminated as speedily as possible.

REPLACING REVENUE LOSS

Much as we would like to have all emergency excise taxes completely eliminated immediately, we recognize the soundness of the position of those who propose that any and all reductions in revenue should be made up by additional revenue from other sources.

CLOSING OF TAX LOOPHOLES

In general, we are thoroughly in accord with the proposal for closing up loopholes in existing tax laws. Any and all exemptions or loopholes that confer special privileges or benefits on certain groups of citizens or organizations should be eliminated. Tax exemption for nonprofit, educational, charitable, fraternal, religious, or labor organizations should not extend to income or property not employed by such organizations in the carrying out of their primary functions. Income from property or business owned by any and all such organizations and not directly related to the conduct of their affairs, therefore, in ou ropinion should be regarded as ordinary income and so taxed.

NEW SOURCES OF REVENUE

Since the coordination of tax adjustments with the requirements of continued prosperity is essential, it is our considered opinion that the proposal to revise and improve existing estate and gift tax laws should be given the very highest priority. Over the years estate and gift tax revenues have fallen far short of yielding the revenue that should be derived from them. Furthermore, admittedly defective and ineffective laws were still further weakened by the 1948 amendments which resulted in revenue loss of $300,000,000 annually, with the result that estate and gift taxes which by our conservative estimate should yield revenue of 2 to 2½ billion dollars are now yielding considerably less than $1,000,000,000 yearly. Failure to further exploit these sources of tax revenue and continued opposition of business interests to their exploitation can only serve to invite counter pressure for tax measures of a severe nature that such interests may later regret. In our opinion it ill-becomes the groups which are perpetually clamoring for reduction of taxes on corporate income, elimination of taxes on dividends, and/or more generous treatment of capital gains to oppose taxes on estates and gifts which would operate to prevent the concentration of economic power and wealth that are implicit in the type of tax legislation they support. We sincerely trust that your committee will recommend that all existing loopholes in estate and gift tax laws should be eliminated; that the rates should be increased; that inequities be eliminated; all with a view to accomplishing the original intent of Congress that a "larger proportion of our necessary revenues" should be collected from the "inheritances of those deriving most protection from the Government" in line with the President's recommendation on this subject. It is our considered opinion that through proper revision of estate and gift tax legislation all additional revenue requested by President Truman would be realized.

LONG-TERM POLICY AND COORDINATION ESSENTIAL

In appearing before your committee we recognize that you are confronted with the problem of devising revenue measures that will be most appropriate in meeting immediate needs. However, we in the American Federation of Labor consider it no less important that increased consideration be given to practical ways of developing over-all long-term policy.

Unfortunately up to this point postwar tax policy has not been determined by sound economic considerations but has been too largely dictated by selfish interests which bitterly opposed proposals for more rigorous tax policy during the war, yet with the conclusion of hostilities, "whooped it up" for the ending of controls and the immediate reduction of taxes.

Many of these same interests, while now supporting reduction or elimination of a particular excise tax, are at the present time urging the adoption of a general manufacturers' tax at the Federal level or supporting additional taxes on consumption at the State or local level. We would respectfully point out to members of your committee that if the Federal Congress reduces, or in a large measure

eliminates, oppressive excise taxes there may be positive loss rather than benefit to the over-all economy if such reductions are more than exceeded by revenue from additional taxes on sales, indiscriminate payroll taxes, excise taxes, and other taxes on consumption enacted by States and local units of Government.

We are persuaded that the remedy for this situation lies in coordination through integration of tax-collection machinery. It is our opinion that financial problems of many cities and poorer States will remain acute with resultant dislocation of our entire economy until and unless present overlapping, competition, and uneconomic duplication in the tax field are eliminated. The Federal Government with the major power in the tax field should assume the major responsibility for eliminating duplication and confusion.

STATEMENT OF THE INVESTORS LEAGUE, INC., PRESENTED TO THE SENATE FINANCE COMMITTEE

I am William Jackman, executive vice president of the Investors League, Inc., with headquarters at 175 Fifth Avenue, New York 10, N. Y. The league I represent is the oldest and most successful organization of investors with thousands of members residing in every State of the Union. It is an organization of investors, both small and large, who make up the backbone of our private-enterprise system which is in turn the backbone of our national economy.

As the recognized representative of and official spokesman for investors of the United States, the Investors League respectfully submits this statement to the Finance Committee of the United States Senate for its consideration in connection with the bill H. R. 8920 (a bill to reduce excise taxes, and for other purposes).

1. Bearing in mind the emergencies which have been created in recent years by the so-called cold war and by the outbreak of actual hostilities in Korea the Investors League believes this is hardly the time to think in terms of large-scale tax reductions. In fact, the league believes that whatever funds are needed for this Nation's protection should be made available by the American people. We must, of course, have ample funds to meet other Federal expenses, too. While the league believes that an appreciable reduction in total Federal expenses could be achieved by more general adoption of the provisions in the Hoover report, this statement will be confined to the proposals of H. R. 8920.

2. Being a league of investors, the Investors League is directly concerned with tax laws "as they affect investors" which is equivalent to saying "as they affect the continuance and growth of American business" since it is the investor, as a group, who supplies the capital for American business. Expansion of American business is the only way to provide for the expansion of employment necessitated by our ever-increasing population and by the increasing life expectancy in America. Therefore, any position which the Investors League takes is based directly on these considerations and not on any selfish benefit to investors as a preferred class. Our position is that what is good for the economy of the Nation under our private-enterprise system is good for the investor and vice versa.

3. Title I of the bill proposes reductions, and some eliminations, of the excise taxes imposed during wartime and for the express purpose of revenue for war use. As an emergency tax it was imposed under circumstances where the Nation's total effort was directed toward one objective—victory in arms. Under such circumstances the national economy is secondary, however essential it may be. Now, five years after achievement of our victory in arms, the preservation and advancement of our industry is paramount not only to the United States of America, but to the entire world, and most emphatically is it paramount to the democracies of the world.

Reduction or elimination of these taxes will undoubtedly stimulate business and industry and thus contribute to the Nation's present objective. Whether or not this stimulation may be sufficient to increase revenue from corporation income and other taxes in sufficient amounts to offset the loss in revenue from excise taxes is a matter of conjecture. The possibility is real, however, and should not be overlooked. Certainly the proposals of title I appear to have more advantages than disadvantages.

4. Title II of the bill will, in general, contribute to the over-all best interests of the investor and hence to business and industry as well as to the Nation's economy. The proposed change in section 209 (e) reducing the "holding period" from 6 to 3 months is perhaps the feature of this title which will contribute most to the stimulation of business and indirectly the encouragement of the investor.

5. Title III deals with matter not directly related to the investor. In fairness to all taxpayers, loopholes in our tax structure should be closed as far as possible.

6. Title IV, in effect, seems to be a technical change in the present law to achieve the original intent of that law and is of little direct interest to the investor. It merely closes another loophole.

7. Title V has no direct relation to investors as such, but only as to individuals.

8. Title VI deals, in section 601, with the collection ("withholding") of income tax at the source on dividends.

The Investors League is in complete accord with the principle that taxes due should be paid and collected. Collection, at the source, of taxes on dividends will, however, include many cases in which no tax is due. More than 47 percent of stockholders have incomes of less than $5,000 per annum. The withholding of 10 percent of dividends will, in these cases, work hardships, severe in some instances. Even though refunds may, in time, be made, the stockholder will not have the use of this portion of his income during the calendar year 1951 and such part of 1952 as elapses until receipt of such refund as may be due to him. Thereafter the period will be approximately 12 months. This is, therefore, a vicious principle and, moreover, unduly burdensome on the low-income investor.

Furthermore, its actual benefit is doubtful. Both the withholding agent and the Government will undoubtedly be put to additional expense. The total gain in revenue is estimated at only $170,000,000. When the withholding agent has reduced his tax liability by credit for the additional business expense, when the Government has deducted its expense plus refunds, the net will, it is believed, be far below $170,000,000 if it does not vanish altogether.

Such a provision as this withholding of dividends is equivalent to saying to the stockholder "We will collect the tax and then give you the opportunity to prove you do not owe it." That is a police state procedure. Furthermore, it is penalizing the majority for the few—even more a police state method.

The League believes such a withholding procedure will prove a deterrent to the purchase or holding of stock and therefore will discourage the flow of capital to business and industry from which more jobs and hence more tax revenue are created. The circle is vicious and may result in its own dissipation.

The objective of collecting tax on dividends due and not paid can be accomplished far more economically, particularly as to the Government but also as to the withholding agent, by requiring the payor (the withholding agent) to file with the Commissioner of Internal Revenue a statement (similar to the current statement as to taxes withheld from employees) of the dividends paid to each stockholder, two copies of the statement to be supplied the stockholder. In turn, require the stockholder to file with his income tax return one copy of the two furnished him, retaining the second for file. The new section 1314 of the new chapter 8A of the Internal Revenue Code appears to accomplish this purpose but in addition to the withholding of the tax.

Such a procedure would eliminate the expense of refunds by the government incident to the proposals as now written in the bill and would relieve the corporations of some of the burden of bookkeeping certain to be necessary by the same proposal.

9. An important feature not covered in H. R. 8920 is the matter of the double taxation of dividends, first as corporate earnings and second as income to the stockholder. This situation is now aggravated by an increase, in title II, section 218 of the bill, in the taxes on corporation earnings.

This double taxation was inaugurated in the hysteria of finding new revenue to offset rising Government expenditures. It is prima facie that the imposition of this tax is in fact taxation of a class, and unfortunately, it is the very class which supplies the lifeblood of business and industry, the flow of investment capital. The disaster inherent in the extension of the principle to other classes or groups is obvious and yet this double tax remains. Correction of this inequity is not merely a popular slogan—it is a necessary step toward the maintenance and necessary expansion of industry without which we as a Nation, and now in turn other nations so dependent upon us, cannot prosper.

Respectully submitted for consideration.

LION OIL CO.,
El Dorado, Ark., July 5, 1950.

Hon. WILLIAM FULBRIGHT,
Senate Office Building, Washington 25, D. C.

DEAR BILL: When in Washington last week, I contacted your office and found you away. I was hopeful I might get to see you while there and have a little visit.

Bill, I see the House has passed a tax bill (H. R. 8920). While there are a number of provisions in it, including the increase in the corporate rate of tax, which do not appear practical, there is one provision in particular which seems to be rather unfair when its effect is fully considered. The provision is contained in section 209 (d) of House bill 8920 adding section 117 (L) to the Internal Revenue Code.

We find our search for oil is becoming more difficult and expensive. It is necessary to expend large sums for geophysical work in locating structures and larger amounts to acquire leasehold interests. Unfortunately, all of the areas explored do not reveal possible structures and all the lease interests which we purchase are not productive of oil or gas. In such instances, it is necessary that we abandon the projects or properties when the leases expire or are forfeited and we determine there are no structures in the area explored.

The above amendment would restrict the amount allowed as a deduction for such losses to the amount of capital gains derived from the sale or exchange of property. As a rule, in the ordinary course of business operations capital gains are unusual, but abandonment losses of the nature described are customary and usually expected to a certain extent. The amendment would have the practical effect of preventing the recovery of losses of this nature as tax deductions and, as a consequence, many companies and individuals, particularly the small oilman, would have net losses from the conduct of a business, but be faced with heavy and unjust income taxes if such losses are not allowed as a deduction.

For these reasons, Bill, I would consider it a favor if you would use your influence to have section 209 (d) of H. R. 8920 deleted from that bill.

With good wishes and very best regards, I am

Sincerely,

BARTON.

STATEMENT OF DANIEL J. O'BRIEN BEFORE SENATE FINANCE COMMITTEE ON H. R. 8920

Mr. Chairman, and gentlemen of the committee, I am Daniel J. O'Brien, president, the Commodore-Perry Co., Toledo, Ohio. We own and operate three hotels in Toledo. I am addressing you as a member of the Governmental Affairs Committee for the American Hotel Association, representing the great majority of all hotel rooms in the country.

We have studied carefully the House version of this bill, together with the report. We feel that the House has acted wisely in proposing reductions in a number of wartime excise taxes which have become extremely burdensome to business, imperiling full employment, and jeopardizing the financial stability of affected industry. Included among recommended reductions, in which this industry is interested, are those governing transportation of persons and property, telephone and telegraph, sterling silverware and hollow-ware and cabaret. We feel, too, that the House has acted wisely in proposing to subject to Federal corporate income tax, the unrelated business activities of tax-exempt institutions, where those activities are directly competitive with tax-paying groups. We also believe the House acted wisely in eliminating the Notch provision of the corporate tax schedule, correcting the long-standing inequity which has placed an unfair burden on small corporations, with earnings between $25,000 and $50,000. We agree with the House proposal to assess a 10 percent withholding tax on patronage dividends of cooperatives. Inasmuch as the House proposes to assess a 10 percent withholding tax on dividends of private corporations, this bill marks the first time that Congress has specifically bracketed patronage dividends with other dividends, clarifying the present uncertain status of the former, removing the inequity to private business which has heretofore existed in the revenue code. Also, the House bill does provide some degree of cushion to an industry with widely fluctuating volumes of business in different years by extending the carry-forward provision whereby business losses may be carried forward for 5 years as compared to 2 years, as the law now stands. All of the above named provisions are in line

with recommendations given by Glenwood J. Sherrard and Ray Smith, representing the American Hotel Association, when they appeared before the Ways and Means Committee.

Permit us to point out, however, a number of inequities which we believe will continue until or unless the House bill is substantially amended by your committee.

We do feel that a reduction of the transportation tax from 15 percent to 10 percent is inadequate to furnish the needed stimulus to increased patronage of domestic carriers. A reduction of only one-third in this domestic tax can scarcely be defended in the light of the fact that Congress in 1947 terminated the 15 percent transportation tax on foreign travel. Is it the intent of Congress to stimulate travel outside of continental United States at the expense of travel within this Nation? The reduction proposed is not great enough to reverse the downward trend of patronage which our people are affording public carriers in America, upon which the hotel industry, and many other domestic industries, are largely dependent.

We fail to understand the reasoning of the House, which has declined to approve any reduction in the 10 percent tax on commercial oil, gas and electrical appliances and on commercial air-conditioning and refrigeration units, which are essential to the operation of hotels. How can you rationalize reductions in photographic apparatus, films, business and store machines, and other manufacturers' tax items, while passing over entirely this important type of industrial and commercial equipment? Hotels, restaurants and other service establishments require this equipment as part of their working tools. How can it be deemed fair to tax some working tools, or equipment, and exempt others?

We are at a loss to understand the action of the House in twice reversing itself on the reduction of the cabaret tax, concluding with the recommendation that this present levy of 20 percent merely be reduced to 15 percent. None of the wartime excises has shown a greater reduced yield to the Treasury than has the cabaret tax which shows a reduction of approximately 39 percent for the calendar year of 1949, as compared to 1946. This downward trend continues, with the Treasury's own figures revealing approximately a 15 percent reduction for the 11 months ending May 31, 1950, over the preceding 11 months. This tax has literally driven hundreds of hotel dining rooms to either close their doors or to terminate the entertainment which made the room subject to tax. We feel that it is highly unfair to exempt like entertainment in private clubs and in business clubs, as well as all additional and charitable institutions, and to continue to impose this burdensome tax upon refined and well-policed entertainment rooms in the Nation's hotels. To maintain this inequity is to drive additional thousands of entertainers, waiters and waitresses and other employees out of employment. The House has approved reduction from 20 percent to 15 percent, and it is estimated that such a cut will cost the Treasury $6,000,000 for the remaining portion of fiscal 1951. At an additional cost of only $6,000,000 to the Federal Treasury for the fiscal year 1951, the Congress could lower this cabaret tax to 10 percent, bringing it in line with admissions taxes generally. To do otherwise is to single out the cabaret tax from the other admissions taxes for discriminatory treatment. The Treasury's own figures reveal forcibly the mounting guest resistance to this tax which has lowered Federal revenues from a peak of $72,000,000 in the fiscal year of 1946, to an estimated total of $41,000,000 for fiscal year 1951.

We feel that the House has overlooked with business taxpayers in failing to provide for floor stock tax refunds on those commodities upon which reductions are recommended in H. R. 8920. It has been assumed through the years, based upon reassurance given business by congressional sources, that whenever these wartime taxes were rolled back, business would be protected against any reduction in tax on current inventories. This would be a grave factor to the hotel industry, when and if desired reductions were afforded in the field of alcoholic beverages, beer, and wine.

We feel rather strongly that the greatest equity to all concerned could be achieved when and if the Congress affected a proportionate reduction on all wartime excise taxes. This would include alcoholic beverages, beer, and wine and other levies which are afforded no prospective relief in the House bill. Only eighteen out of thirty industries which are currently burdened with wartime excise taxes, will stand to benefit from the provisions of the House bill. How can it be regarded as fair and proper that the other twelve industries should be denied comparable relief?

It seems to us that the House has given much greater weight to potential loss to the Treasury from individual excise tax reductions than to the equity in each case. We feel that this is an eminently unfair premise upon which to write tax

legislation. Rather, the Congress should compute the Federal Government's income requirements, and then if relief can be afforded, allocate that relief evenly among the 30 affected industries.

Mr. Chairman and gentlemen of the committee, the hotel industry asks no special dispensation, nor relief not accorded other segments of American industry. We have never appeared before congressional committees and asked specifically for reductions in corporate taxes, excess profits taxes, or other levies made against business as a whole. But we have sought to point out those instances where existing or proposed levies would afford an excessive and discriminatory burden upon the hotels of the Nation. In this light, may we recite hardships which our industry is currently experiencing under existing wartime levies.

First, it is conservatively estimated that 10 to 25 percent of the time of the clerical staff in certain departments of a hotel is required for the handling of the records covering taxes on individual guest's accounts, and for billing. An illuminating illustration of the great volume of clerical work involved is provided by one hotel in Washington, D. C.

During the calendar year of 1949, there were 91,748 computations involving the excise tax on communications. In each one of these instances, any clerical error, or any mechanical error which resulted in this tax not being assessed against the guest meant that the hotel was forced to pay the tax. Also, with reference to the cabaret tax, there were 3,455 guest checks upon which that tax was applicable for the month of November 1949. Using that as an average month, and extending that figure over the entire calendar year, it would mean a total of 41,460 tax computations. These figures reveal quite clearly the administrative burden imposed upon a hotel in computing, collecting, and record-keeping, where excise taxes are concerned.

Incidentally, this local hotel has another computation which very well illustrates our point that total taxes, local, State and Federal, equal a substantial percentage of the gross income of a hotel. Throughout the chain of hotels in seven cities, including the local establishment, this particular hotel organization reports that in 1949, local, State and Federal taxes accounted for total levies equivalent to $578.17 per room per year. This does not include liquor licenses, excise taxes, or local or State sales or use taxes. This means a tax overhead of $1.58 per guest room per day, regardless of whether the room was occupied or empty.

The administrative routine to which business is subjected under an increasing list of local, State and Federal taxes, is constantly mounting. One of my friends said to me recently, somewhat in jest, although I know exactly what he meant, that the bookkeeping and record-keeping involved in the social security—or payroll tax—is so extensive that he figures it cost almost $100 to compute a $25 tax. Without any question, the wiping out of some of these excise taxes would appreciably reduce this administrative burden within our industry.

Second, the presence of a tax on any commodity increases appreciably the record-keeping requirements of an individual business establishment. For instance, the hotel is obliged to keep all records of individual long distance phone calls, upon which a tax is computed, all individual guest checks upon which a 20 percent cabaret tax is involved, etc. We must keep these bulky records for 3 years or more, just in case there is some reason why the Treasury Department might later wish to come in and check our records. The bare storage space needed for these extensive records makes this a costly requirement.

Third, a long list of employees in hotels work on records which include tax calculations. We are constantly afraid that some innocent error may occur on the part of some one employee, which would mean a tax liability upon the hotel. We know that whenever an error occurs in the computing of a tax on a guest's telephone and telegraph bill, which is not rendered to the guest at the time he checks out, the hotel is unable to collect.

Also, some uncertainty occasionally surrounds the regulations and interpretations of the Bureau of Internal Revenue, with the ever present possibility that retroactive assessments going back as long as 3 years are sometimes imposed when it is found that the hotel has innocently been in violation of some Federal regulation covering the collection of excise taxes. This situation develops, for example, in connection with the enforcement of the cabaret tax regulations. In fact, the situation becomes almost ludicrous sometimes. For instance, if the guests in one of our dining rooms should spontaneously decide to sing, and this was repeated occasionally, the Bureau can come in and declare that the food and beverage receipts from that room are subject to tax, and levy a retroactive assessment against us. This spontaneous desire to sing would be construed as

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public entertainment. Also, the regulations include such terms as "related rooms," and upon varying interpretations of these terms substantial liabilities hinge.

We can well understand the problem which your committee faces today in even considering any type of tax reductions in the light of uncertain world conditions. As the Nation's seventh largest industry, may we express our belief that the country would applaud the action of this Congress in providing readjustments to the Revenue Code at this time, which would iron out some of the grave inequities now present. Then, if world conditions should worsen, 150,000,000 Americans would understand the necessity for a quick revamping of the entire tax structure to enable America to meet any emergency.

CONTROLLERS INSTITUTE OF AMERICA,
New York 17, N. Y., July 14, 1950.

Hon. WALTER F. GEORGE,
Senate Finance Committee,
United States Senate, Washington, D. C.

DEAR SENATOR GEORGE: Attached are the views and recommendations of the National Committee on Federation Taxation of the Controllers Institute of America on the following provisions of H. R. 8920:

Increase in corporate tax rate
Retroactivity of taxes
Loss from sale of business property—section 209 (b)
Loss from abandonment of business property—section 209 (d)
Withholding on dividends—section 601
Interest on refunds and deficiencies—section 602

These recommendations are submitted in this form in conformity with the suggestion of the clerk of your committee who informed us that they would be made a part of the record and given the same full consideration that would have prevailed had we had the opportunity to appear before you in person.

These recommendations are presented in keeping with the policy of this organization, which has always been to act in an advisory capacity to governmental bodies, and they supplement the original recommendations for revisions in the Internal Revenue Code which were mailed to individual members of your committee on March 28, 1950.

Respectfully,

OSCAR N. LINDAHL,
Chairman, Committee on Federal Taxation.

INCREASE IN CORPORATE TAXES (SECTIONS 218 AND 603)

Section 218 provides for an increase of 3 percent in the maximum corporate tax rate—from 38 percent to 41 percent. In the case of consolidated returns this rate is raised to 43 percent. Aside from the excess profits tax, this rate is higher than the corporate tax rates prevailing during the war years.

The institute urges that there is no justification or useful purpose in increasing the corporate tax rate.

First, capital investment requirements are high. Profits are the chief source of capital funds, and, therefore, business needs the profits it earns in order to fulfill its obligation of keeping its plant and equipment growing at a rate that will insure a rising standard of living and strengthened national security.

Second, our present high employment and production must be maintained. Increased corporate taxes could result in a lowering of our level of business activity.

Third, it is by no means certain that increasing the corporate tax rate would yield higher tax revenues. On the contrary, it is likely that an increased corporate tax rate, by reducing business activity and thus reducing the amount of business income, would result in a decreasing amount of revenue.

Fourth, at present corporate profits are doubly taxed—once when earned by the corporation and again when received by its stockholders as dividends. An increase in the corporate tax rate would further aggravate this inequity.

Fifth, the proposed acceleration of corporate tax payments (sec. 603), will yield currently, additional yearly corporate tax receipts of $730,000,000. This

sum is greatly in excess of the $433,000,000 expected from the increase in the corporate tax rate. (Table 1—Estimated revenue effect of committee bill—House Ways and Means Committee report, June 23, 1950.)

There is no good reason for increasing the corporate tax rate yielding $433,000,000 when the accelerated corporate tax payments of $730,000,000 will provide receipts far in excess of that amount.

We again emphasize that corporations will more than contribute their share to increase the tax receipts through accelerated tax payments, without the necessity of resorting to an increase in the corporate tax rate.

RETROACTIVITY OF TAXES

The Controllers Institute of America is unalterably opposed to retroactive tax legislation.

Contracts have been entered into based on the existing tax law. It is unfair, at a later date, to so change the prevailing law as to affect seriously the results and obligations of transactions made in reliance on the existing tax law, but which might not have been consummated if the proposed law were in effect at the time.

The institute urges that the effective dates of the provisions of the proposed bill be not earlier than 30 days after its enactment.

An example of retroactivity referred to is the dividends received credit with respect to dividends received in property—section 203.

SECTION 117 (J) SHOULD BE RETAINED IN ITS PRESENT FORM

To facilitate the disposition of obsolete business properties and encourage the acquisition of new equipment necessitated by the war emergency, Congress in 1942 added section 117 (j) to the Internal Revenue Code. Under this section aggregate net gains from the sale of depreciable assets and land held for more than 6 months and used in the taxpayer's business are treated as long-term capital gains, but the aggregate net loss from the sale of such property is treated as an ordinary loss.

Section 209 (b) of H. R. 8920 amends section 117 (j) so that all gains or losses from sales of depreciable assets and real estate used in the trade or business, whether or not held for over 6 months, shall be considered as gains and losses from sales of capital assets. Thus, if the amendment is finally enacted, losses on the sale of these assets will be treated as capital losses whereas under the present section 117 (j) net losses from sales of such property held for more than 6 months are considered as ordinary losses. The amendment would retain the treatment of net gains on such transactions as capital gains.

The institute is convinced that this amendment is ill-advised and that section 117 (j) should be retained in its present form for the following reasons:

(*a*) If the present section 117 (j) was needed in 1942 to "encourage the acquisition of new equipment necessitated by the war emergency," it is still necessary under the present emergency arising from the Korean situation, the implications of which still remain to be unfolded. Cold war, cool war, or hot war, our industrial plant must be kept at maximum efficiency. There must be no tax deterrent to the replacement of obsolete machinery and equipment and sales of unnecessary land and machinery and equipment to those who can use them for production.

(*b*) A loss on the sale of depreciable assets is in reality an amount to bring the depreciation (including absolescence) to the actual amount sustained. Since depreciation is allowed as an ordinary deduction, the loss on the disposition should likewise be allowed as an ordinary deduction.

(*c*) Section 117 (j) does not deal with assets purchased for investment or speculation but with assets acquired for use in the business. It would be grossly unfair to deny the purchaser the recovery for tax purposes of any part of his cost. Yet, the amendment which would allow the losses on sale of these assets only as capital losses, would produce this inequitable result in those instances, and it is believed this would be true in the majority of cases, where the taxpayer does not have capital gains against which to set capital losses.

To summarize, section 209 (b) should be deleted because it is grossly unfair, because it would endanger our economy and weaken our nation defensively and because it would actually reduce rather than increase the Government's revenues.

THE AMENDMENT WHICH TREATS ABANDONMENTS OF CAPITAL ASSETS OR PROPERTY USED IN THE TRADE OR BUSINESS AS SALES OR EXCHANGES OF SUCH ASSETS, SHOULD BE DROPPED

On the issuance of the text of H. R. 8920 and the Ways and Means Committee report, industry was shocked to find section 209 (d) which requires that abandonment losses be treated as capital losses instead of ordinary losses. Industry cannot help but feel that this amendment was inserted in the bill through lack of information as to its scope and disastrous effects. If its purpose was to deprive the taxpayer of different tax consequences from a choice of selling an asset or abandoning it, the amendment went far beyond this objective inasmuch as the bulk of abandonment losses are incurred on assets which cannot be sold because they are worthless. Certainly with relatively few exceptions, the deductibility of abandonment losses as ordinary losses does not constitute a "loophole." The amendment may be liked to having all of one's teeth pulled to get rid of one slightly aching molar.

The allowance of abandonment losses as ordinary losses, unlike section 117 (j) was not a recent innovation. It has existed in the income tax law since 1918. The abandonment loss is a business expense and should be allowed as such because the asset was acquired for business purposes and not for investment or speculation. In addition, the disastrous effect of the amendment lies in the simple fact that most businesses have very few capital gains so that in the vast majority of cases the amendment will deny entirely the right to an abandonment loss.

The Institute urges that section 209 (d) be eliminated by the Senate for the following additional reasons:

1. It will deprive thousands of taxpayers engaged in research and development projects and the search for natural resources involving the expenditure of tremendous sums in the aggregate of a right which they have relied upon in connection with these projects. Due to the very nature of this work it was reasonably certain that the major portion of these expenditures would ultimately be written off as wholly or partially worthless. A few examples are patents, secret formulas, licenses, leases, contracts, and mineral interests. It should be observed that these expenditures were essentially integral requirements of a successful business necessitated by the constant search for new sources of supply or better and cheaper industrial methods or new products. As such it was surely right and proper that when success was not encountered and the assets became worthless the losses should be treated as any other ordinary business expense. However, under the proposed amendment to the extent depreciation and depletion have not resulted in the recovery of these costs in the past, relief is permanently denied where the taxpayer has no offsetting capital gains. Thus the amendment violates one of the most fundamental of all tax principles—the right to a tax-free return of one's investment.

2. Abandonment of worn out and obsolete equipment and its replacement by modern equipment is necessary and in the national interest at all times. Under normal conditions losses from such abandonments simply mean that the estimates of useful life established in computing depreciation were erroneous. If depreciation is a proper deduction from income then so is a net loss on abandonment.

3. The amendment would seriously deter the search for new processes and additional natural resources, which are essential to the welfare of our people and to keep our country strong. Especially in the present emergency, it would be disastrous to curtail such efforts. (For example, mines and oil and gas fields are becoming increasingly difficult to find and our need for strategic and other metals and for oil is of paramount importance.) The cost of this work is constantly mounting and if the taxpayer cannot obtain a tax benefit from the projects which prove worthless, he must pull in his horns and not undertake a substantial part of such program. It is only natural that this will be the result because without the benefit of the tax deduction at 38 percent the net cost of the abandonment project would be increased by over 61 percent as compared with the loss after taking the tax deduction into consideration. It must not be overlooked that the successful projects are a small minority of the total investigated and there is no way of determining at the outset which will turn out successfully and which will prove failures.

4. If industry and natural resource companies had not been in a position to risk large amounts of capital in a bold way in the search for new products and natural resources, many of our large tax revenue producing enterprises would never have been born and this must of necessity be the outcome in the future if abandonment losses are denied. Accordingly, we are convinced that the net result of section 209 (d) will be to reduce rather than to increase the Government's revenues.

5. The amendment fails to profit by the lesson which the Canadian tax authorities have learned. While neither capital gains or losses are recognized under Canadian law, the new and more liberal depreciation regulations recently issued under the 1949 Canadian act expressly recognize an abandonment of an asset group as a deduction in full from ordinary income. This was not permitted under the old law.

6. The amendment ignores the lesson which the British tax authorities have learned. Nonallowance of losses on abandonments of business assets as well as extended lives and rigid rules regarding depreciation contributed heavily in the past to the failure of British industry to modernize and replace worn out and obsolete equipment. This has now been recognized by Great Britain in that more liberal policies regarding losses and depreciation have been adopted.

7. Taxpayers will be encouraged to expense items currently instead of capitalizing them and losing the benefit of a tax deduction in the event the project or facility is abandoned before it is fully amortized.

8. For many years taxpayers have been urging the Bureau to liberalize its restrictive depreciation policy. However, the enactment of section 209 (d) will encourage the Bureau to further reduce depreciation allowances and thus increase the chances of an abandonment loss which will be of no tax benefit to the taxpayer.

WITHHOLDING ON DIVIDENDS

Section 601—Title VI of H. R. 8920

The Controllers Institute is entirely sympathetic with the objective to make everybody pay his full share of the tax. We realize that underpayments by some taxpayers must be made up by other taxpayers who do pay their full share.

We believe that considerable improvement in collections can be had by requiring dividend paying corporations to make full information returns and by requiring the itemization of dividends on recipients' income tax returns, but without actual withholding. The institute would like to see this given a fair trial before withholding at source is enacted.

If such a trial does not accomplish the desired result, then the institute would favor withholding in substantially the same form as set forth in H. R. 8920 with one exception, namely, we recommend that the exemption provided for dividends paid by one member of an affiliated group to another corporation within the group when consolidated returns are filed, be extended to include dividends paid by one member of an affiliated group to another corporation within the group where, because of extent of ownership, the group is qualified for but may not use consolidated returns. This will avoid serious overwithholdings of total tax liabilities of parent corporations where consolidated returns are not used.

IF THE INTEREST RATE ON REFUNDS IS REDUCED FROM 6 TO 3 PERCENT THE 6 PERCENT INTEREST RATE ON DEFICIENCIES SHOULD ALSO BE REDUCED TO 3 PERCENT

For many years, the institute has urged that the present 6 percent interest rate on deficiencies be reduced to not more than 3 percent and that when this is done the present 6 percent interest rate on refunds be reduced correspondingly.

However, section 602 of H. R. 8920 reduced the interest rate on refunds to 3 percent but maintains the present 6 percent interest rate on deficiencies. The Ways and Means Committee report justifies this reduction on the ground that overpayment amounts to a loan to the Government and the interest rate on refunds is well in excess of the interest rate paid on United States Government securities. However, following the same reasoning an underpayment of tax is a loan by the Government to the taxpayer and the 6 percent interest rate should be reduced because the taxpayer can borrow money elsewhere at substantially less than 6 percent. The interest rates on corporate bonds, mortgages and commercial loans have been steadily declining since the 6-percent interest rate on deficiencies was originally adopted. Accordingly, under present conditions, the collection of 6-percent interest on deficiencies constitutes in large measure the imposition of a penalty.

With relatively unimportant exceptions, the assessment of deficiencies in income tax or excess profits tax are occasioned by honest differences of opinion between the Commissioner and the taxpayer and not by a desire of the taxpayer to borrow money from the Government. Because of the complexities of our tax laws, especially the recently repealed excess profits tax law, many of which will have to be cleared up by judicial interpretation, it is inevitable that in a large number of cases many years will be required to fix the tax liability.

In addition, even in usual cases, it takes two or more years after the return is filed before the audit of the return is even commenced. Under such circumstances, certainly it cannot be adjudged fair and equitable for the Federal Government to expect a taxpayer to pay interest on deficiency taxes at a higher rate than the Government is willing to pay on tax refunds.

Also, it must not be overlooked that deficiencies frequently arise from shifting income or expense from the return filed for 1 year to a return filed for another year. Surely this is not a case of a loan from the Government or vice versa when considering the return for the 2 years together. The effect of reducing in such cases the interest rate on refunds without a corresponding reduction in the interest rate on deficiencies is an unwarranted hardship.

The institute therefore recommends that the interest rate on deficiencies and refunds be the same and that both be reduced to 3 percent.

WHITFIELD, STRATFORD & Co.,
Medford, Oreg., July 11, 1950.

Hon. GUY CORDON,
Senate Building, Washington, D. C.

DEAR SENATOR CORDON: H. R. 8920 as passed provides that the loss on the sale of certain assets shall be treated as a capital loss for income-tax purposes, where formerly, under section 117 (J) of the Internal Revenue Code, the loss was treated as an ordinary loss. The new provision applies also to the loss on the cutting of timber to a taxpayer who has previously made an election under section 117 (K) (1). This new provision may become extremely burdensome to a lumberman.

At the present time timber prices are inordinately high. It is not unlikely that these prices will decline. For example, the present market value of sugar-pine stumpage in the Medford area is approximately $25 to $35 per thousand feet as compared with prewar prices of $6 to $9 and Douglas fir is $15 to $25 as compared with $0.75 to $3. If stumpage prices were to decline, a lumberman might suffer an over-all operating loss and still be required to pay substantial income taxes.

For example, if a lumberman cut timber costing him $25 per thousand feet at a time when the market value was $15 per thousand he would have a capital loss of $10 per thousand. Except as an offset to other capital gains, this loss would not be allowable to a corporation and would be allowable only to a very limited extent to an individual. Under section 117 (K) (1) a lumberman would then have a stumpage cost for determining his ordinary income-tax loss or gain of $15 (the market value) rather than his actual cost of $25. Accordingly the lumberman, even though he had an actual loss of say $4 per thousand, would be required to pay an income tax on ordinary income of $6 per thousand, i. e., his ordinary income would be increased by the amount of the capital loss on cutting of $10 per thousand. For a corporate lumberman with an annual volume of 10,000,000 feet an income tax (at the proposed rates) of $19,600 would apply although an actual operating loss of $40,000 had been incurred.

Although it is true that section 117 (K) (1) of the code provides that a taxpayer may revoke his election to come under the section in cases of undue hardship, the permission of the Commissioner of Internal Revenue is required. Such permission is not guaranteed and might not be granted.

The foregoing objectionable feature of the proposed amendment could be eliminated by granting the taxpayer an annual election without requiring the approval of the Commissioner. Thus, a taxpayer would not be bound to treat the cutting of timber as resulting in a capital loss if the market value of timber declines.

It is respectfully requested that you bring the foregoing to the attention of the appropriate Senate committee and endeavor to correct a provision that might become burdensome to lumber operators.

Yours very truly,

WHITFIELD, STRATFORD & Co.

WASHINGTON, D. C., *July 11, 1950.*

In re: Section 209 (b), H. R. 8920, amending section 117 (j) of the Internal Revenue Code.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
United States Senate, Washington, D. C.

MY DEAR SENATOR GEORGE: I am asking this statement on behalf of the American Polled Hereford Association, of Kansas City, Mo., with reference to the proposed amendment of section 117 (j) of the Internal Revenue Code, which was advocated by Secretary Snyder before your committee on July 5, 1950. I shall appreciate it if you will include this statement in the report of the hearings before your committee.

The pertinent part of Secretary Snyder's statement is as follows:

"MISCELLANEOUS LOOPHOLES

"The bill also contains technical provisions restricting the opportunities for tax avoidance. The most important of these in terms of the revenue to be gained is the correction of the present advantage permitted in the case of sales of business property. When such sales result in profit, the profit is taxed at the reduced rates allowed long-term capital gains; when the sales are unprofitable, the loss is allowed in full as an offset against ordinary income. This inconsistency and the resulting prejudice to the revenue can be eliminated either by treating both gains and losses as ordinary income and loss or by treating them both as capital transactions. The Ways and Means Committee adopted the latter solution but failed to act upon a related recommendation as to the tax treatment of sales of livestock.

"Present court decisions have held livestock regularly culled from a dairy or breeding herd to be depreciable property used in trade or business and, thus, any gain resulting from their sale to be capital gain. In light of the regularity with which such livestock is sold, and since cattlemen or dairymen are permitted to deduct the cost of raising the livestock currently from ordinary income, it seems appropriate to treat the profits therefrom as ordinary income. The Treasury Department is continuing its litigation of this important question. However, I believe that legislation specifically classifying these profits as ordinary income is desirable, regardless of which solution your committee adopts as to business property generally.

* * * * * * *

"The closing of technical gaps in the law is necessarily a continuing process, required to preserve the fundamental equities of taxation and especially important when tax rates have to be kept high. We cannot expect to preserve the confidence of taxpayers in our revenue system without continued vigilance and aggressive action to overcome technical defects in the law as they develop."

Section 117 (j) was added to the Internal Revenue Code in 1942, and in the report of the Committee on Ways and Means, No. 2333, page 97, and the report of the Senate Finance Committee, No. 1631, page 120, Seventy-seventh Congress, second session, it was specifically stated that the provision was intended as a relief measure for the special treatment of gains and losses realized on the sale of *depreciable property* used in the trade or business. Congress used the term "property" in its general sense, and did not intend discrimination against any kind of property.

The Commissioner of Internal Revenue issued two rulings, I. T. 3666 and I. T. 3712, in which he admitted that cattle used in the breeding herd were property used in the trade or business; that they were depreciable property; and that gains on the sale thereof were entitled to capital-gains treatment under section 117 (j). The Commissioner, however, wrote a qualification into his rulings, to the effect that if the breeder replaced the animals sold from the breeding herd, he was not entitled to capital gains.

Every court thus far has held that these rulings are invalid insofar as they provide that the breeder loses his right to capital-gains treatment merely because he replaces the animals sold from the breeding herd (*Albright* v. *U. S.* (Eighth Circuit), 173 Fed. (2d) 339; *Isaac Emerson*, 12 T. C. 875; *Fawn Lake Ranch Company*, 12 T. C. 1139; *Bennett* v. *U. S.* (D. C. Texas), 89 Fed. Supp. 106). The court correctly pointed out in the Albright case that the only way a breeder could obtain the benefit of the capital-gains treatment under these rulings would be to reduce his herd, which would mean that he would have to go out of business.

In his statement to the Committee on Ways and Means on February 3, 1950, the Secretary of the Treasury proposed that breeding and dairy animals regularly culled from the breeding herd be excluded from the term "property" which is entitlement to capital-gains treatment under section 117 (j), and the House refused comply with the Secretary's recommendation.

We respectfully submit that there is no logical reason why breeding and dairy animals which are property used in the trade or business of breeding or dairying and of a character subject to depreciation should be discriminated against by excluding them from the definition of property which is entitled to capital-gains treatment. Accordingly, we request of the Senate Finance Committee to retain section 209 (b) of H. R. 8920 as it passed the House, so that breeders and dairymen shall be entitled to the benefits of capital gains the same as all other businesses.

Respectfully,

WALTER E. BARTON

(Whereupon, at 1:05 p. m., the committee recessed to reconvene Tuesday, July 11, 1950, at 10 a. m.)

REVENUE REVISIONS OF 1950

TUESDAY, JULY 11, 1950

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D. C.

The committee met, pursuant to recess, at 10 a. m., in room 312, Senate Office Building, Senator Walter F. George (chairman) presiding.

Present: Senators George, Lucas, Hoey, Kerr, Myers, Millikin, Taft, Butler, Brewster, and Martin.

Also present: Senator Flanders and Mrs. Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will please come to order.

I would like to insert into the record at this point in the hearings the statement of the Cannon Foundation, Inc., submitted by Mr. James L. Rankin in lieu of personal appearance. Mr. Rankin expresses opposition to those sections of H. R. 8920 relating to taxation of unrelated business net income and taxation of lease-back rentals where the purchase price, or a portion thereof, has been borrowed, taxation on unexpended income in excess of 1 year's gross investment income.

(The statement referred to follows:)

BRIEF FILED WITH SENATE FINANCE COMMITTEE BY CANNON FOUNDATION, INC., IN RE REVENUE BILL OF 1950, H. R. 8920

Cannon Foundation, Inc., was incorporated under the laws of North Carolina on December 18, 1943, for "religious, charitable, scientific, literary, and educational purposes, all for the public welfare," with provision in the charter that "no part of the net earnings of this corporation, shall inure to the benefit of any private individual." The office of the foundation is in Concord, N. C.

Since the date of incorporation, the amounts actually paid out and for which firm commitments have been given have been 50 percent more than the total net income from investments During the last fiscal year ending on September 30, 1949, contributions were made to 50 different beneficiaries, consisting of 25 churches, 3 hospitals, 5 schools and orphanages, 3 Boy Scout groups, and 14 sundry charitable organizations. The largest contribution amounted to $1,250,000 pledged toward the building of a 150-bed addition to the Cabarrus County Hospital to which object the Federal and State Governments have also made substantial commitments. No salaries or other form of compensation have ben paid to anyone.

Title III of H. R. 8920 deals with the treatment of income of gifts and bequests to certain organizations which now are tax exempt. Briefly this title provides for—

1. Taxation of unrelated business net income;
2. Taxation of lease-back rentals where the purchase price, or a portion thereof, has been borrowed;
3. Taxation on unexpended income in excess of 1 year's gross investment income;
4. Requirement that the organization shall operate under an instrument providing that—

"(A) No part of the income or corpus of such trust or organization may be loaned to;

"(B) No compensation, other than a reasonable allowance for salaries or other compensation for personal services actually rendered, may be paid by the trust or organization to;

"(C) No part of the services of the trust or organization may be made available on a preferential basis to;

"(D) No substantial purchase of securities or any other property may be made by such trust or organization from; and

"(E) No substantial part of the securities or any other property of the trust or organization may be sold to, a person who has made a substantial contribution to, or any officer, director, or trustee of such trust or organization; or any member of the family (as defined in sec. 24 (b) (2) (D) of any such person; or a corporation controlled by any such person through the ownership, directly or indirectly, of 50 percent or more of the total combined voting power of all classes of stock entitled to vote or 50 percent or more of the total value of shares of all classes of stock of the corporation; and

"That no part of the income or corpus of such trust or organization may be paid to any trust or organization to which a gift or bequest would not be a deductible gift or bequest under this subsection."

Inasmuch as we are not affected by the provisions as to unrelated business net income and lease-backs, we are limiting the discussion in this brief to the two other features, namely, restriction of accumulations to 1 year's gross investment income and prohibition of stock transactions between a foundation and donors, families of donors, and estates of donors.

We believe that title III has been presented by the Treasury Department because of certain abuses or alleged abuses which have come to the Treasury Department's attention. We believe that the harm which will result from the two provisions discussed herein will be far greater than any good which can be expected therefrom.

We assume that the Treasury Department had in mind the conduct of a certain group of New England textile trusts. It seems to us that the criterion should be whether the organization is or is not acting in good faith for charitable, educational, etc., purposes. Since 1942 financial reports have been filed annually by charitable organizations and the Internal Revenue Commissioner is now in a position to learn how these organizations and trusts are functioning. We believe the approach to end the alleged evils should be along administrative lines under existing statutes and regulations or, in the alternative, to amend section 101 (6) as suggested herein.

We have in mind a great many endowments and foundations which have operated to the great benefit of thousands of people in our country over a period of many years. Specifically, we refer to the several endowments or foundations created by members of the Rockefeller family, the Carnegie Foundation, the Guggenheim Foundation, and the Duke endowment. The Rockefeller Foundation funds have been utilized largely in the interest of health and study of many serious diseases; the Carnegie Foundation largely in the interest of higher education; the Guggenheim funds in the interest of science and art; and the Duke endowment in the interest of Duke University, Duke Hospital and public hospitals all over North Carolina and South Carolina. The harm done to endowments and foundations of these types, whether large or small, will probably be far greater than any good which will be accomplished through the proposed bill in eliminating evils existing at relatively few points.

RESTRICTION AS TO ACCUMULATION OF INCOME

Bill section 301 (code sec. 425) provides that a tax at corporation rates shall be imposed upon undistributed income in excess of "the highest amount of the gross investment income for any of the five preceding taxable years." This provision is found in the portion of the act which deals with organizations. In bill section 321 (g) trusts are more liberally treated and under certain conditions may accumulate all income for a period of 25 years after the date of the death of the decedent without suffering any tax penalty. There would seem to be no sound reason for a distinction between corporations and charitable trusts.

Section 321 (a) (1) (C) provides for the exclusion of income of trusts in the nature of "gain derived from the sale, exchange, or other disposition of capital assets," but no such provision is found in code section 424. While it seems clear that capital gains will not be included within the term "gross investment income," it would appear to be wise to incorporate as a new section 424 (g) a provision similar to that

found with respect to charitable trusts, namely: "The term 'gross investment income' will not include gain derived from the sale, exchange, or other disposition of capital assets."

One of the strong meritorious features in a well-conducted foundation is the accumulation of a substantial portion of income during the years of plenty when the needs are less and to expend that accumulation in the periods when income is decreased and the needs are greater.

We found that it was advantageous to the residents of Cabarrus and Rowan Counties to accumulate a portion of our income during 1947 and 1948 and utilize that money plus current income of 1949 and a portion of our corpus to contribute $1,250,000 toward the cost of construction of a 150-bed addition to the Cabarrus County Hospital. We believe that 1 year's accumulation is far from adequate.

While it may be said that section 425 (a) (2) (A) provides a way out of this problem through the creation of "a trust within a trust," yet a study of that provision shows that the requirements are too rigid for practical purposes. If our foundation should plan a project to be accomplished in later years and create a special trust, that trust would be irrevocable and its terms could not be altered, modified or amended. The foundation might wisely decide to change the original purpose and it would be embarrassed in finding that such change could not be made, and the original need might no longer exist.

We therefore urge that the limitations expressed in code section 425 should be entirely eliminated. If, however, the committee feels it is desirable to have a limitation on accumulation, the accumulation, we think, should be liberal and you should allow an organization to retain at least 5 years' gross investment income.

THE PROHIBITION AGAINST SECURITY TRANSACTIONS

We have no objection to the first three provisions found in bill section 301 (c) (D), 321 (g) (4) and section 3810 (b), because we think that they are wise and we believe that all charitable trusts and foundations which are operated in good faith follow the practices covered in those three provisions. However, we believe that there are sound reasons for eliminating the fourth and fifth provisions dealing with purchases and sales of securities and other property.

It is an honorable ambition for men who have created prosperous business enterprises to want their children, grandchildren, and other descendants to profit from their labors. Frequently men in their young ages start a business in a small way and after many years succeed in a substantial way. These men have been aided usually by associates, generally younger men. It is commendable for the successful man to want to protect his loyal associates against losing their positions after the death of the principal creator of the business. If a man dies owing considerable stock in his company (whether it is small or large, closely held or publicly held) a foundation or charitable trust to which he and his family have been liberal donors is a very natural potential purchaser of the decedent's holdings, and usually it will pay a higher price than strangers.

In the definition of "family" found in section 24 of the Internal Revenue Code, trusts and estates are regarded as being in the family group if the beneficiaries of those trusts and estates are part of the family. Hence the proposed bill would bar the purchase from estates and trusts.

We do not see that any harm will be done to any taxing agency or to the public if the foundation or charitable trust is free to purchase the holdings of the decedent on the basis of a fair and equitable market value. The fiduciaries will be under a legal duty to obtain an adequate price. Getting such an adequate price will create values for estate-tax purposes at higher levels than would be true if the estate is limited to strangers as purchasers.

So far as the company and the family involved are concerned, it seems to be better for those who have assisted in its growth to continue in the management in place of bringing in strangers.

We therefore urge that the fourth and fifth provisions in the group of requirements stated at the three points in the bill either as (iv) or (v) or (D) and (E) shall be eliminated. If the committee deems that some provision should be retained along these general lines, it should be stated explicitly that these two sections will not prevent an organization or trust from purchasing securities from the estate of a deceased donor or the estate of a deceased member of the family of a donor on the basis of a fair and equitable market value.

ALTERNATIVE SUGGESTION

In the alternative, we suggest that title III of the Revenue Act of 1950 be entirely omitted and that the remedy sought may be obtained by adding the following amendment to section 101(6) of the Internal Revenue Code:

"Any organization or trust otherwise exempt shall pay taxes at the rate applicable for nonexempt organizations or trusts upon the net income received or earned from the operation by it of an unrelated trade or business. All applicable laws pertaining to nonexempt organizations or trusts shall apply to such income. An organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt on the ground that all of its profits are payable to one or more organizations exempt under this section from taxation. For the purposes of this paragraph the term 'trade or business' shall not include the rental by any organization or trust of its real property (including personal property leased with the real property). No organization or trust shall be considered exempted under this provision unless in practice the organization or trust loans no part of the income or corpus; pays no compensation other than a reasonable allowance for salaries or other compensation for personal services actually rendered; and makes available no part of its services on a preferential basis to a person who has made a substantial contribution to, or any officer, director or trustee of, such trust or organization, or any member of the family (as defined in sec. 24 (b) (2) (D)) of such person."

We believe that such an amendment, properly drafted, to the existing code plus the utilization of the powers now conferred upon the Internal Revenue Commissioner will be a remedy for the abuses which the House desires to correct and endeavored to answer in title III.

Respectfully submitted,

THE CANNON FOUNDATION, INC.
By JAMES L. RANKIN,
Counsel and Director.

The CHAIRMAN. Governor Stassen is first on the list this morning.

STATEMENT OF HON. HAROLD E. STASSEN, PRESIDENT, UNIVERSITY OF PENNSYLVANIA

Mr. STASSEN. Good morning, Mr. Chairman.

The CHAIRMAN. Good morning, Governor. Have a seat.

Mr. STASSEN. I would like to have Dr. Snavely here with me.

The CHAIRMAN. Yes, Doctor. You may have a seat right there. All the members of the committee have not yet arrived, but they will come in I think before very long.

Mr. STASSEN. Mr. Chairman and gentlemen of the committee, I wish first of all to express my appreciation of the courtesy of the committee in hearing me this morning, and to say to you further that I will be very concise, knowing of course the busy schedule of the committee, and knowing also that the committee will not take my brevity as any lack of emphasis upon the views I express.

I appear on H. R. 8920, which is now up for consideration. This measure contains a provision in title III, section 421, which proposes to levy a tax upon American colleges and universities, for the first time in the history of our country.

This is a proposal presented to the House by the Treasury. I might say it was presented to the House by the Treasury without consultation with the colleges and universities of America. They are organized; they have been for generations; their organizations are known. And they were not consulted.

I appear this morning as the chairman of the committee on industry and finance of the American Association of Colleges, which includes within it nearly all of the universities and colleges of America; and seated with me is Dr. Guy Snavely, who is the executive director of

that association, and who maintains offices in Washington, and whose activities are in the matter of improving teaching, exchange of information on curriculum and methods, and the general activities that should be carried on by an association of American colleges.

I consider that this is an outrageous proposal, to begin to tax colleges and universities now, in America, after this long history of tax exemption.

I think it is a thinly veiled attempt to weaken the colleges and universities, as a prelude to bringing them under Federal control.

To me it is reminiscent of the actions of the British Government in imposing a heavy tax on the drugs and the dressings used by the hospitals of Britain as a prelude to Government action taking over these hospitals in their thus weakened financial condition.

Senator MILLIKIN. President Stassen, there would not be any place for the colleges to go, if they were weakened financially, except under the wing of the Federal Government.

Mr. STASSEN. That is exactly it, Senator. The colleges and universities of America today are in difficult financial condition. They have been struggling against this inflationary situation, which cut down their endowment income on the one hand, made their tuition low—because you couldn't raise it, with the inflationary pressure—but the inflationary pressure on the living conditions of their professors and their faculties, and put them in a very serious condition.

Senator MILLIKIN. And is it not true that the high rates of our income taxes, almost amounting to confiscation in the upper brackets, almost eliminate the ability of many people to contribute to colleges and universities, who otherwise would?

Mr. STASSEN. That is right, Senator. The days of the very heavy personal gifts to colleges and universities are gone; because, obviously, with the necessitous heavy taxation that is now upon the citizens of our country, there is not that remainder left in large personal fortunes which in times past have established and endowed these universities and colleges.

So all of these facts mean that right today the universities and colleges of America are in a difficult and weak financial position; and H. R. 8920 can have no other effect than, first of all, to further weaken and trouble these colleges and universities.

Now, then, what could be the other reason? This is not a source of heavy revenue. The consideration in taxes, of course, is to try to find funds for the Government; and we recognize that necessity. But this is not a measure that from the standpoint of national statistics would bring in any heavy money. The few millions that would be brought in by this kind of a measure would be very seriously felt by the colleges and universities, and would not be a drop in the bucket of the Federal requirements for funds.

And, of course, the way in which it would work is immediately evident, because this proposal in H. R. 8920 would immediately give to the governmental officials in the Treasury the authority to tell the universities and colleges what activities they may enter, through the device of passing upon these activities as "related" or "unrelated" This will, in effect, be an immediate governmental censorship, which will be very serious to the academic and scientific freedom of the educational institutions.

Now, this is especially true in research. Under the bill, research for Government is exempted, but all other research is subjected to governmental review under the bill. Now, how does that add up? Obviously, in the research to be done by the Government, you have a governmental control in the first instance. And then you are saying as to all other research, under this bill, that the Federal Treasury officials can say whether or not that research should be taxed. If that research is taxed, it is to be taxed at such a heavy rate—the same heavy rate as for corporations—that it practically will stop nongovernmental research.

It is a matter of recorded history that many of the most remarkable and beneficial advances in research for the benefit of mankind have been made in university and college laboratories functioning under nongovernmental grants. Why should these suddenly be subjected to the blighting hand of governmental supervision through the Treasury officials?

Senator KERR. Would you give us some of the examples you refer to in the first sentence of that paragraph?

Mr. STASSEN. Yes. The whole development of streptomycin and aueromycin, which was one of the most recent, up at Rutgers University, was started not with governmental funds but under a distinguished member of the faculty there.

Senator KERR. Would that have been an activity that would have come under the provisions of the House bill?

Mr. STASSEN. What would the Treasury officials have said, when a professor at Rutgers wanted to start out in this direction, which was not related to his normal work?

Senator KERR. Was it a research effort for commercial benefit?

Mr. STASSEN. It will have commercial aspects to it in the sale of the drugs.

Senator KERR. With reference to the position of the college?

Mr. STASSEN. Yes; subsequently in the licensing of the making of the drugs. In other words, the question is that now, for the first time in the history of America, you would give an official in the Treasury the chance to say whether that research grant should be taxable and should be considered a related or unrelated activity of that university.

Senator KERR. That would be only in the event that it did become commercial property, would it not?

Mr. STASSEN. No; the paying of the original grant for the research to the university or college under this bill could be called an unrelated activity.

Senator KERR. But it there was some one paying the university for the research, then it would be because they would own the license, would it not?

Mr. STASSEN. No, Senator. It is a very well established principle of universities and colleges that they will not grant exclusive results of their research. It is open to the world. But on that basis they receive annually millions of dollars from various corporations, individuals, foundations, to go and probe in some direction.

Senator KERR. Well, now, does your objection go to the operation whereby money is paid to a university for research which they are to do, or after something is developed and it becomes commercially profitable is your objection to the Government having anything to say about whether or not that is a related activity and the profit from that taxable?

Mr. STASSEN. My objection goes to both, Senator; that these great institutions in this country, which have been an essential part of the freedom and development and advancement of mankind, have, up to this time, not been subjected to a censorship or veto by any governmental official on any of their research. And I hold that is essential for the future freedom of our society.

Senator KERR. What provision of the bill is it that would tax the university on what they might make out of the research operation as such?

Mr. STASSEN. It is in section 421, which is found in the bill, if you have before you the printed version of H. R. 8920, on page 96.

Senator KERR. I do have a printed version of it.

Mr. STASSEN. Then it is on page 96 of that bill.

Down in line 20, you begin, where it reads:

> There shall be levied, collected, and paid for each taxable year beginning after December 31, 1950—
>
> (1) upon the supplement U net income (as defined in subsec. (c)) of every organization described in subsec. (b) (1) * * *.

and that "every organization" includes the colleges and universities of America. And I say again that for the first time in the history of this country a normal tax of 21 percent of normal U net income and a surtax of 20 percent of the amount of the supplement U net income in excess of $25,000 is so levied.

Then you go down to "organizations subject to tax," which, as I say, includes colleges and universities, and then you come over to page 99, and it tells what shall be excluded. And it says:

> There shall be excluded all dividends, interest, annuities, and royalties, and all deductions directly connected with such income.

And then, it covers certain rents and then, when you go over to page 100, item (5), line 19:

> There shall be excluded all income derived from research for the United States or any of its agencies, and all deductions directly connected with such income.

Now, I believe it is a rule of law that if you explicitly exclude a certain kind of a research grant, to wit, a United States Government grant, there is at least an inference that other kinds of research grants are going to be taxed. At least, you reach the point where the official of the Treasury could say—and colleges and universities can't go fighting law suits in their weakened financial condition to try to overrule these officials throughout the 600 institutions in the country.

Senator KERR. Some of them are in lawsuits, are they not, Governor?

Mr. STASSEN. No colleges or universities that I know of, Senator.

Senator KERR. Has not New York University been in a lawsuit with the Government?

Mr. STASSEN. Senator, I am glad you asked that question, because that draws the clear line which we want drawn.

Senator KERR. Have they not been in litigation?

Mr. STASSEN. No; they have not, sir.

Senator KERR. What is their status?

Mr. STASSEN. In the New York University case they organized a separate corporation, a separate entity; and this separate entity went into the operation of a macaroni business. And we all, in the universities and colleges, agree that that should not be done, and

when it is done it should be taxed. Under the present law of the land, it has been ruled taxable by the Tax Court. It is not a question of New York University doing it. They went over and organized a separate entity.

We hold, and we are developing the moral code of the universities and colleges, that that should not be done; or that if it is done, it should be taxed like any other corporation. So the case you mention, which is the case always mentioned, is specifically a case that draws the line where we want it drawn. In other words, leave the colleges and universities with their traditional, their sound, tax exemption; and go to work on the problem of these special foundations and separate entities who are not educating anybody, who do not have any faculty, who do not have any students, and who are engaged in these other kinds of activities. There is a new problem that should be approached.

Senator KERR. Is not the income from those operations educating people?

Mr. STASSEN. Not thus far.

Senator KERR. They do not use that income in the operation of their universities?

Mr. STASSEN. The major part of the income is used in paying off the cost of the plant itself.

Senator KERR. Was not the purpose of it to make money to operate the university or develop the university? I am talking about the primary objective of the enterprise.

Mr. STASSEN. The Tax Court has held that the objective of the enterprise was, first of all, to operate a macaroni company, and that it therefore should be taxed.

Senator KERR. And to make money?

Mr. STASSEN. And to make money.

Senator KERR. For what purpose?

Mr. STASSEN. The certificates of incorporation said the purpose was then to use the money for education. But that should not be sufficient to carry a tax exemption.

Senator KERR. I agree with you on your conclusion, but as I understood the matter, the objective of the university in operating the enterprise was to make money to provide better educational facilities. Is that correct, or not?

Mr. STASSEN. May I restate that the university was not operating the enterprise. That is the crucial point. It was a separate corporation.

Senator KERR. But the objective of the enterprise was to make money for the benefit of education?

Mr. STASSEN. It was so stated in the articles of incorporation of the enterprise.

Senator KERR. You do not doubt that?

Mr. STASSEN. Well, I don't know it. I am not one of the incorporators of it.

Senator KERR. You do not take the position that that was not correct?

Mr. STASSEN. I take the position that the Tax Court was correct under the present law in taxing that foundation.

Senator BREWSTER. That is the reverse of the usual thing, about disregarding the corporate fiction, is it? In this case, the Tax Court

refused to disregard the corporate fiction and held that it was a separate enterprise and not the university.

Mr. STASSEN. It was actually organized separately, Senator. It had a separate legal entity.

Senator BREWSTER. Would the university have had the power to do that without a separate corporation?

Mr. STASSEN. No; it would not, in my judgment. It would be ultra vires.

Senator BREWSTER. Is that true for all universities?

Mr. STASSEN. I believe practically every university and college in America is chartered for educational purposes and not to run macaroni factories or anything of that kind.

Senator BREWSTER. And anything of that kind would be held ultra vires?

Mr. STASSEN. I am confident it would.

Senator KERR. It would be held ultra vires, you say?

Mr. STASSEN. Yes.

Senator KERR. Was it not organized under a State law?

Mr. STASSEN. The Senator asked if a university or college did it directly would it be ultra vires, and I say yes.

Senator KERR. I say, was not this particular situation organized under the laws of the State of New York?

Mr. STASSEN. As a separate corporation; not as a university or college.

Senator KERR. I understand. But did it not have the right under the laws of the State where it was organized to do what it was doing?

Mr. STASSEN. Yes; certainly.

Senator KERR. Then how could it be ultra vires?

Mr. STASSEN. The Senator asked me whether a university or college could do this itself.

Senator KERR. But I was asking you about what I was asking you about.

Mr. STASSEN. All right. You are mixing, Senator, the two questions and trying to have my answer to Senator Brewster's question apply to your question. Now I will answer your question.

Senator KERR. Answer it as applied to my question.

Mr. STASSEN. Answering your question, a separate entity organized under the laws of a State, not chartered for educational purposes, that is, not having a faculty and a student body, can engage in any business whatsoever under the laws of that State as appropriately provided, and then also can be taxed under the present laws, the same as any other corporation. You do not need this new law to do that, to tax it. And it should be taxed.

Senator KERR. Then let me ask you the question this way: As to the acts of New York University and the organization that it created or organized, were any of them ultra vires?

Mr. STASSEN. No; because New York University performed no acts. These were a few of the trustees.

Senator KERR. Well, whoever did take them, were they ultra vires?

Mr. STASSEN. No, they were not, because they were taken as citizens.

Senator KERR. Now I want to ask you the question I asked you a while ago. Are you telling this committee that what the New York University was doing, there, was not for the benefit of education?

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Mr. STASSEN. I am telling this committee first of all that New York University did not do it; secondly, that the trustees that did it thereby created a corporation which was taxable under present laws, and that has been so held.

Senator KERR. Yes.

Mr. STASSEN. And that because of that action of some of the trustees of New York University creating a separate corporation, now held to be taxable, you should not pass a law that affects 600 universities and colleges in America who have engaged in no such practices directly or indirectly.

Senator KERR. Fine. Now, would you be willing to answer the question? Are you taking the position here that what was done there, whether by New York University or its trustees or others, was not done for the benefit of education or for the securing of money for the benefit of education?

Mr. STASSEN. I am taking the position that I am in no position to know what the intentions of the trustees were.

Senator KERR. Then would you answer that question that you do not know?

Mr. STASSEN. The answer to that question is that I am not in a position to know, but that regardless of what their intention was they should be taxed when they establish a separate corporation for the purpose of engaging in the macaroni business, even though the funds are to go for educational purposes when net profits are realized.

Senator KERR. But you do not know whether they were or not?

Mr. STASSEN. I do not know.

Senator KERR. Therefore you are not taking the position that they were not to go for educational purposes?

Mr. STASSEN. No, because that is a matter of, first of all, the minds of the trustees, which neither you nor I can read.

Senator KERR. Is there anything in the record that would indicate to you that it was not for that purpose?

Mr. STASSEN. That it was not for that purpose? No, there is nothing in the record to indicate it was not.

Senator BREWSTER. Who held the stock?

Mr. STASSEN. A few of the trustees of New York University organized a special corporation and held all the stock. They bought the macaroni company.

Senator BREWSTER. Did they hold it in trust?

Mr. STASSEN. No, they held in in their own individual name. But the charter of the corporation said that all net profits were to go to the New York University Law School.

Senator BREWSTER. Are you familiar with the Textron case?

Mr. STASSEN. I have heard something of it.

Senator BREWSTER. There has been a great deal of discussion on that. Senator Tobey conducted an investigation. In that instance they created a number of these trusts for the benefit of the Massachusetts Institute of Technology and others.

Mr. STASSEN. That is right.

Senator BREWSTER. Very little money was apparently paid over. It did arouse a great deal of comment in New England.

Mr. STASSEN. Yes.

Senator BREWSTER. Do you think that that sort of situation invites any action?

Mr. STASSEN. Yes, I think it does, and I think the action could be taken under the present law.

The Textron case is spoken of as the most extreme abuse in the foundation picture, and I think that in interpreting what the present law can do on that, it is my opinion that the present law could tax it.

Senator BREWSTER. Are you familiar with the history of that? That the Internal Revenue Department ruled it was taxable, and then that decision was apparently not carried out?

Mr. STASSEN. Yes. I think the best source of information on that is Attorney General of the United States, who was on that Board. I think that you could question him and find out whether you need any amendments to correct it. But because of Textron and macaroni, do not place a new burden upon all the colleges and universities of America. That is my plea. Here are two abuses that arose under the present laws, which I believe can be corrected administratively or by amendment, and they should not be the basis of an assault upon the traditional, fundamental, important tax exemption of the colleges and universities of America.

These colleges and universities have been doing a remarkable job of educating the youth of the Nation. They are struggling against the effects of inflation and other financial problems. They deserve encouragement from the Government, rather than an attack in this reprehensible manner.

Their faculties as a whole are serving with devotion and loyalty at less compensation than they should be receiving. I might say in that regard that a full professor in an American university or college today has an average salary of $5,758. And that means many years of service. It means distinguished activity in his field, and selection by his fellows and his administration. An associate professor receives $4,594. And these are under the governmental statistics of the last report of the Department of Education.

Those are the sources by which we have been able to educate the youth of America.

Their physical facilities are in need of improvement in addition; in other words, the lack of maintenance during the war, when, naturally, the student bodies were depleted except for those who did war training of men in the armed service educational programs, was responsible for that condition. Their able students of poor families are in need of more scholarships today. And the answer by their Government through this bill presented by the Treasury is, on the one hand, to propose the use, not through this bill but through the two bills, of Federal funds and Federal authority over them—in other words, to use more Federal funds for the universities and colleges—and then, on the other hand, to propose that their time-honored, sound, wise tax exemption shall be breached and the tax officials of the Government shall have new authority over them.

Senator MILLIKIN. President Stassen, it seems to me that the paragraph that you read on page 100, to wit:

> There shall be excluded all income derived from research for the United States or any of its agencies, and all deductions directly connected with such income.

has an inevitable tendency to mess the United States into the affairs of educational institutions. Can there be any other conclusion?

Mr. STASSEN. I agree, Senator. I do not see how H. R. 8920 could be administered without putting Federal officials into the po-

sition of interfering in, auditing, questioning, analyzing every action that every college and university in this country does.

Senator MILLIKIN. Ultimately the colleges and schools themselves will be compelled to be down here lobbying for Federal grants of all kinds.

Mr. STASSEN. That is right.

Senator MILLIKIN. And the more Federal grants they get, the more Federal control over their institutions. It seems to me that is inescapable.

Could there not be this distinction between the macaroni factory and running a research project, on the part of the university: that you run a research project in a university under the direction of members of the faculty of the university, participated in by the students of the university? That certainly has a direct educational value, does it not?

Mr. STASSEN. Yes, Senator.

Senator MILLIKIN. As to running a macaroni factory, it is rather difficult to conceive how that would have a direct educational value, and you cannot even say with certainty that the profits from the macaroni factory will ultimately get into the university, which might have an educational value.

Mr. STASSEN. That is right.

Senator MILLIKIN. Your distinction is between dealing with something which is directly for the education of students and for the education of the faculty, if you please, and an entirely different thing, which you are dealing with, which at best can have only a remote secondary effect of that kind. Is that not correct?

Mr. STASSEN. Exactly right, Senator.

Senator KERR. Is not the thing that he has described specifically exempt under this bill? That which is for the benefit of the faculty or the students or the organization or the officers: Is that not specifically exempt under this bill?

Mr. STASSEN No, it is not, Senator.

Senator KERR. Have you read subsection (2) on page 102?

Mr. STASSEN. Yes, I have.

Senator KERR. Read that and see what it says.

Mr. STASSEN (reading):

> The term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by section 421 (a), any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 101, except that such term shall not include any trade or business: (1) in which substantially all the work in carrying on such trade or business is performed for the organization without compensation;

Now, you will agree this is limiting language, will you not?

Senator KERR. No; this is exempting language.

Mr. STASSEN. It is an exception under the generalization.

Senator KERR. You are about to come to the situation which the Senator just described:

> except that such terms shall not include any trade or business; (2) * * *.

Mr. STASSEN (continuing):

> which is carried on, in the case of an organization described in section 101 (6), by the organization primarily for the convenience of its members, students, patients, officers, or employees.

Now, what is the meaning of the word "convenience"? Who is going to define that? And by whose decision? When you engage in a research project, such as the Rutgers case I mentioned, that was not for the convenience of the students. That was for the future advancement of mankind and its protection against illness, and it was done by a man who was not a doctor. And they could well have said, "Why you cannot engage in research of this kind. This is for doctors and physicians."

Senator KERR. Was it carried on exclusively for the benefit of mankind, or was it carried on in the hope that as they benefited mankind they might make a commercial profit out of it?

Mr. STASSEN. Senator, when you start research of this kind, no one knows where you are going to end up. A great scientist has an idea, a direction in which he probes, and he finds something, and he goes off in another direction. Many times he just gets something that is abstract information. Sometimes he gets the basis of an atomic bomb. Sometimes he gets the basis of a great medicine. That is the whole fundamental point of what I am making: that you must not put a hand of governmental censorship or restriction upon the freedom of research of the institutions of America.

Senator KERR. If I understand this bill, it does not do that. If I understand this bill, the hand of the Government put on it is with reference to the commercial profit made out of such enterprise, which is unrelated to the objectives for which the university was established.

Mr. STASSEN. Well, Senator, the section which we have just been reading defines "unrelated." And then who is going to administer the definition? Obviously, the officials of the Treasury subject to——

Senator KERR. Of course, first there must be determined the principle which it is desired to implement, as to whether or not an unrelated activity should be taxed. If it decides that that is its objective, then it must provide means whereby the objective may be achieved.

Now, I cannot determine whether or not you are appearing against the objective or against the language whereby the objective is sought. If you are against the objective, that would be one thing, and we could determine whether or not there was agreement; but if you are favorable to the objective and feel that the language is inadequate, that would be another approach. Personally, for my own benefit, I would be glad if you would tell the committee whether you oppose the objective or favor it. And if you favor it, then I wish you would tell me if you feel that the language is inadequate to achieve it.

Mr. STASSEN. I believe that the objective of the men in the Treasury who drew this bill without consultation with the American colleges and universities was to bring the American colleges and universities under the control of the Federal Government. And I am against that objective. I am against any clause or any law that furthers that objective. And I believe that the moment you breach the time-honored principle of tax exemption of these institutions, which was passed by this Congress—you speak of policy being established by this Congress. It is this Congress, this Senate and this House, that established this great principle of tax exemption of universities and colleges. My plea is: Hold it inviolate. Do not let anybody breach that great principle of tax exemption. And then, when these abuses come up, when these extra corporations, these specially managed foundations that grow up on the fringe and the periphery of the educational system of the country——

Senator KERR. I wonder if you would advise me of what the periphery of the educational field is. The fringe of the periphery of the educational field? Give me a picture of that.

Mr. STASSEN. Well, here is a university like New York University, engaged with faculty and with students in carrying on a normal educational system. They need funds. So out on the edge of their need of funds——

Senator KERR. Now, is need and periphery synonymous here?

Mr. STASSEN. Surely the Senator knows better than to ask that question.

Senator KERR. I am a man who is in need of enlightenment, and so far I have gotten mighty little of it.

Mr. STASSEN. All right, Senator. The fringe is the outer edge of something.

Senator KERR. But what is the periphery? The fringe of the periphery of education?

Mr. STASSEN. All right. The fringe of the periphery of education is the macaroni case in New York, specifically, that you have been talking about.

Senator KERR. I know what macaroni is. So if it is synonymous, you do not need to go any further.

Senator MILLIKIN. Just give the Senator a definition of "periphery." That seems to be what he wants.

Mr. STASSEN. "Periphery" is the outer edge.

Senator KERR. Then what would the fringe of the outer edge of the periphery be?

Senator MILLKIN. It is the fringe of the end of the rug.

Mr. STASSEN. That would be the very fine lines on the very tip.

Senator KERR. All right. Now, you have said that the objective of the Treasury men who wrote this bill, which is an assumption that I believe is unjustified, because I was under the opinion that the House Ways and Means Committee had written the bill, was to gain control of the universities. Now, I neither admit nor deny that, because you are not appearing before officials of the Treasury. So far as I am concerned, I am interested, and I believe this committee, is, in the validity of an objective that has been mentined, as to whether or not the unrelated profitable operations of our universities shall be subject to tax. Now, I would appreciate it if you would tell the committee what your position is with reference to that principle, aside from your fear and concern with reference to the objective of somebody who is neither on this committee nor controlling of this committee.

Mr. STASSEN. My position is that no one from the exterior can wisely define what is a related or an unrelated activity of a university or a college; and therefore you should not attempt to define and tax unrelated activities of universities and colleges.

Senator KERR. Do you have in your own mind a definition of unrelated activities for commercial profit? Would that be of such an indefinite form or character that you would not attempt a definition of it?

Mr. STASSEN. I would attempt to define it with reference to my own institution, under its own circumstances, my own administrative responsibilities. I would also attempt to develop it as a code of moral and ethical conduct of investment for the universities and colleges, so that they would not go over into an area that should not be entered into by universities and colleges.

Senator KERR. Then you think there is a possibility of an unrelated activity of a university engaged in for the purpose of commercial profit?

Mr. STASSEN. There is a possibility of it, yes.

Senator KERR. Now, then, do you think that that should be subject to taxation?

Mr. STASSEN. No.

Senator KERR. You do not?

Mr. STASSEN. No. I feel it should not be engaged in by the university or college.

Senator KERR. And if engaged in, it should not be taxed?

Mr. STASSEN. Well, it should not be engaged in.

Senator KERR. This committee has no power and seeks no power to determine what a university engages in. They operate under our State laws, in the main. We are approaching it from the standpoint of whether or not the unrelated activities of the university which result in commercial profit should be subject to commercial taxation. Do you favor that principle, or oppose it?

Mr. STASSEN. I oppose that principle.

Senator KERR. Then you think that no activity of a university, whether related or not to the purposes for which it was organized, and whether commercially profitable or not, should be taxed by the Federal Government?

Mr. STASSEN. That is right.

Senator KERR. That is your position. Thank you.

Mr. STASSEN. Because the moment you enter into taxation, you fundamentally bring about a measure of control and supervision over those institutions. And I immediately draw the line between what the university and college does itself, under its own charter, as compared to what might be done by some special foundation or special corporation.

Senator MILLIKIN. Mr. Chairman, I respectfully suggest that there may be some confusion because the questioner and the witness may be talking about different things.

Is this a roughly correct statement of your position, President Stassen: that if the university, the school itself, carries out these research projects directly and as a part of its school activity, there should be no tax?

Mr. STASSEN. Right.

Senator MILLIKIN. If an organization is set up that is not directly connected with the educational activities of the institution, set up in the hope of profit, which might ultimately come to the university, that should be taxed. Is that the clear line of distinction?

Mr. STASSEN. Right.

Senator MILLIKIN. In other words, the distinction between the macaroni factory, which has no relation to the direct educational activities of the university, and a research project conducted within the university.

Mr. STASSEN. Right.

Senator MILLIKIN. The one, the former, is taxable, or should be taxable; the latter should not be?

Mr. STASSEN. That is the precise line which should be drawn, Senator.

Senator KERR. Well, Governor, you are aware of the fact that a university could do anything directly that it can do through a separate entity, are you not?

Mr. STASSEN. That is not true, Senator. You are mistaken in that.

Senator KERR. I am not talking about "legally"; I am talking about "physically." Can not the university hire a businessman and put him on their payroll, who could operate a macaroni factory which was owned by the university just as effectively if it were unincorporated as they could if it were incorporated?

Mr. STASSEN. No; Senator.

Senator KERR. I am talking about this from the standpoint of the commercial success of the enterprise.

Mr. STASSEN. And I say, "No," Senator; that 98 percent of the colleges and universities of America, under their charters, could not do that.

Senator KERR. I am not talking about their legal right to do it. I am talking about the physical operation of doing it.

Mr. STASSEN. Well, Senator, you cannot successfully operate something if at any moment a lawsuit may completely stop your operation as ultra vires and throw you into receivership.

Senator KERR. You are aware of the fact that the State law that says that they cannot do it can tomorrow be amended to say that they can do it?

Mr. STASSEN. No, it could not, Senator.

Senator KERR. You say the States could not pass a law to permit a university to operate a macaroni factory directly as an incident of the operation of the university?

Mr. STASSEN. No; because in four-fifths of these instances these charters go back to the constitutions of the States, which cannot be lightly changed.

Senator KERR. Cannot States change constitutions?

Mr. STASSEN. They can, Senator. Certainly.

Senator MILLIKIN. President Stassen, I remind you that the Dartmouth case had considerable to say on that subject.

Mr. STASSEN. Yes, Senator.

I submit that this honorable body of the United States Senate, which has performed so many other noteworthy and vital services to the future freedom of our people, should turn back this dangerous assault on higher education in America. And I should like to specifically emphasize that this bill would put the colleges and universities in a less favorable position than many other associations. In this respect, in the summary report that is presented by the House, on page 36, half way down the page, there is a long list of the institutions that are not affected by this law and thereby are left in better position than the colleges and universities. It is the mutual savings banks, the building and loan associations, the cooperative banks and credit unions, and the whole group of those institutions, that are not touched by the law, and therefore they would be left, if H. R. 8920 became law, in a better position than the universities and colleges of America.

I respectfully submit that this committee and the Senate should insist that educational institutions should keep their rightful places alongside of the churches as tax exempt uncontrolled institutions serving tne higher ideals of mankind.

The CHAIRMAN. Thank you very much, Governor.

Senator MILLIKIN. Mr. Chairman, may I ask the witness, please, whether there is any strong dissent in the Association of American Universities to the position taken here today by the witness?

Mr. STASSEN. Senator, I have heard none. The Association of American Universities, which is an integral part of 37 of the universities threshed this whole question through very thoroughly. Mr. Killian, who appeared yesterday, was chairman of that committee. We were in unanimous agreement when we concluded. At the Cincinnati meeting of the Association of American Colleges, which was before this specific bill came up, the subject was brought up Our committee has met, and I have had voluminous correspondence with colleges and universities throughout the country, and I have yet to hear a dissent on this question.

Senator LUCAS. May I ask the Governor a question?

The CHAIRMAN. Yes; Senator Lucas.

Senator LUCAS. Governor Stassen, the meeting that you had in Cincinnati touched off quite a debate on this, did it not?

Mr. STASSEN. The debate was going on before that, and it heightened after that, yes.

Senator LUCAS. Let me ask you this question: In the report here, from that meeting, it says this:

> The amount of the extraneous business activities is very small thus far, according to Mr. Stassen. He said that only 11 colleges actually "owned" businesses, while 50 to 60 had laboratory-testing projects, directly in competition with industrial companies.

Is that correct? Is that what you said?

Mr. STASSEN. That sounds substantially correct. If that is the New York Times story, it was quite accurate.

Senator LUCAS (reading):

> "This kind of operation at present," he added, "is just a drop in the bucket" for the university.
>
> "However, in 20 years' time it could become a major problem," he warned. "We want to be certain that we are on morally and ethically sound ground."
>
> Explaining how "unfair competition" can become dangerous, Mr. Stassen gave the following illustration:
>
> Two restaurants are operating side by side. Both net an annual profit of $100,000. If one pays the 38-percent corporate tax, it has $62,000 left for its stockholders.
>
> However, if the other is "owned" by a college, it does not pay any tax, though it pays the original owners $80,000 for operating expenses. This means that the college has made a net profit of $20,000 and the concern has made $18,000 more than its competitor.
>
> "Everybody wins but the Federal Government," a delegate said wryly, and Mr. Stassen commented: "This is an unsound and unethical situation."

Is that all correct?

Mr. STASSEN. That is right.

Senator LUCAS (reading):

> "The owner gives the university a part of what he would pay in taxes and gets a substantial profit himself. Before a college enters into such an agreement it should ask: Is the true owner of the business better off financially than if he would pay taxes? If he is, then he is playing shenanigans with the university and with the Government."

You agree to all that?

Mr. STASSEN. That is right.

Senator LUCAS (reading):

> "This problem is just sticking its nose up, but it's a bad one."

Now, is not your position, as the result of what you said to Senator Kerr, just the reverse of what you said there?

Mr. STASSEN. No; Senator, it is exactly the same. In other words, at that session I there also took the position that the time-honored principle of tax exemption should not be breached; that we colleges and universities have what I have referred to as a code of moral and ethical conduct in investments; in other words, clear our own house of these few fringe abuses of a few institutions.

I should say "edge" abuses. I did not mean to use the word "fringe," Senator.

Senator KERR. Do not get back on the periphery.

Mr. STASSEN. I will keep away from both the fringe and the periphery.

And, Senator, we have moved in that direction since the Cincinnati meeting. In other words, the Association of American Universities has now taken the official position that its members should not engage in mercantile or manufacturing businesses, even if in those few instances their charters permit, you see.

Senator LUCAS. I understand your position, and I think it is a sound one, but in answer to Senator Kerr you said even though a university of this kind did enter into one of these unrelated businesses, you would still be for that in preference to what we are trying to do here under this bill.

Mr. STASSEN. Senator, I would not be for them doing it, but I would be against bringing a tax measure against 600 institutions because 1 institution went out of line and created an abuse. And that is, Senator, what I plead with you about. Let us go to work on the abuses, that are very rare in the universities and colleges themselves—and we are working on it—and let the present laws be administered against those practices. In many instances they will clear it up.

Senator LUCAS. You said here in this statement that there were 11 colleges that actually owned businesses at this time which would be considered as unrelated to the curriculum activities of a college. Also you said that there were 50 to 60 that had laboratory-testing projects directly in competition with industrial companies. Now, how are you going to stop that? How are the people in the education field going to stop this growing tendency, as you discussed it here, in a very able manner as it seems to me?

Mr. STASSEN. We have already stopped it, in my judgment, and we have already turned it back. We did it by bringing the problem up at Cincinnati and at the New York meeting of university presidents, talking it through, and adopting a code of moral and ethical conduct of investment for the universities and colleges. That Code has now been approved by my committee of the Association of American Colleges and will go to the next annual meeting of the association. So it will soon become clear that the whole body of academic and scientific leadership of America in education is opposed to universities and colleges going out in these kinds of merchandising and manufacturing ventures.

Senator LUCAS. Does that mean that these 11 colleges who actually own businesses are going out of business as far as the unrelated program is concerned?

Mr. STASSEN. Yes, Senator. I believe what will happen will be either that they will sell the business or that they will put it up in a separate corporation and pay taxes for it.

Senator KERR. Are you authorized to speak for them here?

Mr. STASSEN. No, Senator. I can only report to you what has happened in the association. In other words, I am not a legally binding representative of individual colleges. But I do know that with all these university presidents around the table this was discussed very thoroughly and frankly, and that was the conclusion that came out. And when you know of the sense of the position within these associations, I do not believe that any of these colleges and universities are going to hold themselves out as doing things that are condemned by their fellows as not ethically sound in investment.

Senator MILLIKIN. Mr. Chairman, I would like to say that the representative of a certain educational institution came to me and suggested that we make this law somewhat prospective, to give a few years' time in which to accomplish the very readjustment that you are talking about.

Mr. STASSEN. Of course, Senator, I don't think that this law as to taxing the universities and colleges should ever be approved.

Senator MILLIKIN. I am speaking to the argument that you have made that there is a ferment going on that should cause the educational institutions to clean up their own houses. This gentleman was very frank in saying that there had been some things done that were perhaps not correct and he hoped there would be an opportunity so that they could clean their own houses before they felt the full impact of a law of this kind.

Mr. STASSEN. Yes. It has been gone through very thoroughly. You see, it flares up after the war, Senator, in this great inflationary pinch on the institutions. Just as desperate men will do things that they would not ordinarily do, so desperate institutions, some of them, will go into avenues they would not ordinarily go into.

Senator LUCAS. Mr. Chairman, I should just like to read one further sentence from this report.

> Agreeing with this view, Dr. Carter Davidson, president of Union College, Schenectady, N. Y., said that some institutions were embarrassing their fellow colleges by going into business enterprises that had no connection with educational activities.
>
> "Only those businesses that are directly beneficial to the college's students, faculty, or guests who visit the campus should be permitted," he said. For the last 3 years, Dr. Davidson has been chairman of a special committee appointed by the American Council on Education to study the financial problems of higher education.

My only comment on all of this is simply that as a result of your statement before the group at Cincinnati last year, there has been a definite trend among colleges to go into unrelated programs to make a profit for their schools. I do not know what this committee is going to do with respect to this. I respect your opinion, as to this, that the Federal Government should under no circumstances get into this business. On the other hand, the Federal Government will have to get into this business, if it does not do it now, unless the colleges reverse the trend as far as these unrelated programs are concerned. There cannot be any question about that. Would you agree upon that? That unless they do reverse this trend, something should be done by the Federal Government to tax these unrelated programs in line with the example that you gave of the two restaurants side by side?

Mr. STASSEN. Senator, I agree that action should be taken if the colleges and universities do not straighten it out. I think the kind of

action that should be taken is some ultra vires suits in these States as to any colleges and universities that go into these commercial transactions.

Senator LUCAS. I do not think that would affect the revenue situation down here.

Mr. STASSEN. Well, Senator, this is not an item of substantial revenue.

Senator LUCAS. That may be true. But it can grow.

Mr. STASSEN. Not in a major way. All of the endowments of all of the private colleges and universities in America are only $2,000,000,000.

Senator KERR. Say that again.

Mr. STASSEN. All of the endowments and resources other than land and buildings of all of the private colleges and universities in America are only $2,000,000,000. So the gross annual income of all of these things, which includes the normal investment in bonds and stocks, and so forth, is obviously something like 5 percent of that, or $100,000,000 at a maximum. So you are aiming at a gross of $100,000,000 of income, and if 10 percent of it was abusive, you would be aiming at a $10,000,000 income, and the tax would be 3 or 4 million dollars.

Senator BREWSTER. It is your position that much of any possible abuses can be solved under existing law by an honest and intelligent administration of our present revenue laws?

Mr. STASSEN. That is right.

Senator BREWSTER. That is, as time goes on, we find by experience that there are still abuses needing correction, we can give it consideration?

Mr. STASSEN. That is right.

Senator BREWSTER. But on this other point it seems to me there is a distinct question you have raised with respect to research. One of your statements about that was that there was one of the research laboratories that was in direct competition with private enterprise. That seems to me to be a distinct aspect of the matter. But, as I apprehend, you do not consider that it at present is so serious?

Mr. STASSEN. No, Senator. It is again a matter of enforcement.

Senator KERR. Enforcement of what?

Mr. STASSEN. Of existing laws. In other words, if a special research institute is set up, taking tax exemption, and then does applied research, that is, direct translation to commercial products, then I believe it can be taxed under present laws. But if it does fundamental research, of the kind of basic material which, when discovered, is then published to the world, and which any commercial house or anyone else can then have, I do not then think it should be taxed.

Senator BREWSTER. If the colleges and universities do not as time goes on check a trend which you thought was unfortunate from the standpoint of their ethics and morals, you will not be back here in future years seeking to protect them in the abuses of your moral and ethical code?

Mr. STASSEN. No. In fact, I think what we would do: We would start some ultra vires suits to clear up some of those who do not come into line. I know of instances already in which trustees of these institutions have refused to enter into these kinds of transactions. In other words, I think the trend has already been reversed, Senator.

I think the overwhelming weight of the moral and ethical convictions of this country has already reversed the trend.

Senator LUCAS. Mr. Chairman, I would like to read one more paragraph of this report, which I think is a very interesting one:

> Reporting on a recent survey of his committee, Dr. Davidson said that 445 colleges and universities in the country were getting income from sources other than tuition or traditional sources, and this represents a total investment in noneducational businesses by institutions of higher learning of $300,000,000 to $400,000,000. This list of enterprises owned by colleges included farms, stores, testing laboratories, cattle ranches, and orange groves.

Mr. STASSEN. That list, Senator, included such things as farms attached to land grant colleges, where they are using them as a direct part of teaching. It included such things as restaurants around the campus. It included all that kind of activity, much of which clearly, under anyone's definition, would be related.

Senator BREWSTER. What we call experiment stations, we have in the towns of Maine.

Mr. STASSEN. Experiment stations, yes; and sometimes some of those run by universities actually net a profit. If you have a good wheat crop, it can produce a profit.

Senator MARTIN. I presume that would include book stores, and things of that kind, operated even by the smaller colleges.

Mr. STASSEN. That is right.

Senator MARTIN. But they are a very important adjunct to the educational work.

Mr. STASSEN. That is right.

Senator KERR. Governor, did I understand you to say that you were of the opinion that the profit a university would make on a research project done for commercial interests, is now taxable?

Mr. STASSEN. I say that if it is set up as a separate research corporation, that is the case.

Senator KERR. I am not talking about that.

Mr. STASSEN. That was my statement before.

Senator BREWSTER. That was what he said, yes.

Senator KERR. Were you aware of the fact that anything it makes with reference to a research project done for a commercial interest, if it is done by the university itself, is not subject to tax?

Mr. STASSEN. No; and it should not be.

Senator KERR. What do you think about the lease-back problem?

Mr. STASSEN. What phase of it, Senator?

Senator KERR. Where the university owns a macaroni factory, and instead of setting up a separate corporation to operate it, and getting its money out of it in dividends, it takes that same macaroni factory and leases it to a private company, who does that and who pays the university substantially the same amount in rentals that it would earn if it operated it as a private entity?

Mr. STASSEN. Then the company which has leased it should pay the regular corporation taxes that all other corporations in America pay.

Senator KERR. But what about the money that the separate corporation pays the university?

Mr. STASSEN. That should not be taxed. In other words, the tax should be charged on the macaroni company and its operations as it is on any other corporation, and the university should no more pay

taxes on the money it receives from that kind of an operation than it should pay taxes on the dividends it receives from A. T. & T. stock, for example.

Senator KERR. Your position, then, is that the tax should be determined as to the form of the owner rather than in accordance with the benefit derived by the owner. The question of whether or not there should be a tax should rest solely on the form of the ownership rather than on the identity of the ownership?

Mr. STASSEN. No, Senator.

Senator KERR. Suppose a university could get a million dollars a year leasing to somebody a macaroni factory. Do you think that that should be tax-exempt; while if it took it and operated it as a separate identity and had made $500,000 a year you think that should be taxed?

Mr. STASSEN. In either case the macaroni factory should pay the same tax as all other macaroni factories.

Senator KERR. But suppose it is leased out on a basis where the rental takes all the profit out of it?

Senator BREWSTER. I think, Mr. Chairman, what he means is if they pay more than a fair rental. I assume you would consider that an attempt to evade, and I think Internal Revenue would. In the case he cites, if they paid a million dollars rental for a thing that was fairly rentable only for $500,000, that is an obvious attempt to evade the law.

Senator KERR. It is an abvious attempt to conform to the law.

Mr. STASSEN. Then, in auditing the books of the macaroni factory, they can refuse to permit a deduction for that exorbitant rental against the profits of the macaroni factory.

Senator KERR. Under what provision of the law?

Mr. STASSEN. Under the regular Internal Revenue provisions, as to the review and audit of the expenses of operating a business.

Senator KERR. You mean that if a private citizen figured he could make $30,000 or $40,000 a year, or $50,000 a year, leasing a property from the university, even after paying a very high rental for it, the Federal Government would not permit him to do it, and although the university had driven a very hard bargain with him, if he had agreed to it they could set that agreement aside and say that it could not be done?

Mr. STASSEN. It is not a question of a hard bargain in the case you gave. It is a question of an obviously inflated specially constructed lease arrangement.

Senator MILLIKIN. Collusive rental. And the Internal Revenue Department could, as it does in all cases of that kind, disallow the deduction.

Senator MARTIN. Mr. Chairman, would not that be absolutely opposed to the moral and ethical plan of investment that the universities and colleges are striving now to attain?

Mr. STASSEN. Definitely.

Senator KERR. I do not know. If somebody willed them a macaroni factory, and some citizens offered them a million dollars a year to rent it from them, I think they would be unfaithful to their trust if they did not charge that amount for it. And if their rental were free from taxation, I think they would be very foolish not to take advantage of that situation and get all the rental they could that

was free from taxation, rather than operate it themselves and pay taxes.

Senator MARTIN. Mr. Chairman, I think that would be absolutely contrary to the plan that is now set up by the universities and colleges to keep their investments on a high moral and ethical standing. Because, as I understand it, where it is operated as a business, it would now be taxable.

Senator KERR. Not unless it were a separately identified business. If they operated the macaroni factory as a university by hiring a manager and made a million dollars a year, it would not be subject to any tax, whether it were related to the purposes of the university or not.

Senator MILLIKIN. But it might be ultra vires.

Mr. STASSEN. It would be ultra vires.

Senator KERR. It might not be ultra vires, too.

Senator MARTIN. Mr. Chairman, I do not know whether Governor Stassen could furnish this information, but probably his organization could. I think it would be valuable if this committee had a list of all of the businesses—and that includes books, records, and so forth—that the various colleges in this country operate in this country.

Senator KERR. The Senator from Illinois has just read considerable information on that subject, that comes from the witness.

Senator MARTIN. I know. And that is the reason I feel it would be of great advantage to this committee to have it. I was very much interested in what Senator Lucas read, there, a moment ago. I think that Governor Stassen's position was very well taken, and I think it very clearly explained the position of the colleges and universities of this country.

Senator LUCAS. Mr. Chairman, that same committee that discussed all of these very important questions over at Cincinnati had this to say about the question you just raised, lease-back arrangements:

> The issue of lease-back arrangements on real estate holdings also came in for considerable discussion. Mr. Stassen said that a growing practice had developed among colleges to buy the property of the business, then lease it back to its former owner on a long-term basis. Not infrequently the latter benefits by this arrangement, as he may be able to save the corporate tax on the property.

That is about what you said, I presume, Governor?

Mr. STASSEN. Right.

Senator LUCAS (reading):

> This "code of investment" for colleges seeking to lease property was suggested: A lease-back arrangement on real estate should be entered into only if the terms of the lease are the same as those entered into by noneducational organizations, and provided an unfair advantage is not extended to a business competitor.

That is the statement you made, and that is the position you take here?

Mr. STASSEN. That is right. And let me say further, Senator: I do not know of a single lease-back arrangement of that objectionable nature that has been entered into by any college or university in America in the last year.

Senator KERR. Does not your university own property, a department store or something, in Philadelphia, that you have leased back to the former owner?

Mr. STASSEN. That is right; from some years back.

Senator KERR. Well, is that lease contract still in effect?

Mr. STASSEN. Yes.

Senator KERR. Are you still getting income from it on the favorable basis on which it was developed at the beginning?

Mr. STASSEN. Yes. But it was developed in the beginning on a perfectly honorable appraised basis; in other words, the same as any insurance company or anybody else would do it. In other words, it is as clean as a hound's tooth.

Senator KERR. I am not talking about the condition of its face. I am talking about the identity of the transaction.

Mr. STASSEN. That is what I am talking about, Senator.

Senator BREWSTER. It is like any other endowment funds you might have?

Mr. STASSEN. That is right.

Senator BREWSTER. The income from them you do not pay tax on. You might have a million shares of stock in an oil company. The dividends from that, if they were paid to a private individual, would be taxable. If they were paid to a college or university, they are not taxable.

Mr. STASSEN. That is right. And this organization pays taxes of every kind. It pays Federal income taxes.

Senator KERR. But it deducts what it pays to you as an operational expense before its tax liability to the Government is determined, does it not?

Mr. STASSEN. Certainly. But what it pays to us is only a reasonable rental. It is not a specialty loaded transaction, in other words.

Senator MILLIKIN. If it were especially loaded, the Department of Internal Revenue would disallow a part.

Mr. STASSEN. That is right.

Senator BREWSTER. Exactly as they would disallow any other expense, such as a political celebration in Washington or Chicago.

Senator KERR. I want to say to the Senator from Maine that that statement gives me a very special and heart-warming assurance.

Senator MILLIKIN. And I want to say it is very chilling to me.

Mr. STASSEN. I take no part in that interchange. My interests are now academic. [Laughter.]

Senator MILLIKIN. Have I not been calling you "Mr. President"? I am always practicing against contingencies.

Senator KERR. I do not know how successful we were in influencing your change of interest, but we will encourage the implementation of it.

Senator BREWSTER. I noticed how reluctant the chairman was to call him "President" instead of "Governor".

Senator KERR. I am at least fortified by the record.

Mr. STASSEN. Senator, may I just close with this statement: While we have very properly ended on a somewhat lighter note——

Senator LUCAS. Are you sure it is that light?

Mr. STASSEN. It should be clear that I am very earnest and very serious about this matter of keeping your institutions of higher learning, your colleges and universities, entirely free from any kind of supervision or control by officials of the Government under any political party, because that is fundamental and far-reaching for the future of our free society.

And I plead with this committee not to infringe that time-honored and traditional freedom of the institutions of America, one of the

pillars of which is their tax-exempt status along with the churches of America.

Senator KERR. (presiding). Thank you, Governor.

Mr. STASSEN. Thank you.

Senator KERR. Mr. Walter R. McDonald, of the Public Service Commission of Georgia.

We are happy to see you. We have seen you on many occasions.

STATEMENT OF WALTER R. McDONALD, GENERAL SOLICITOR, NATIONAL ASSOCIATION OF RAILROAD AND UTILITIES COMMISSIONERS, WASHINGTON, D. C.

Mr. McDONALD. Thank you, Senator Kerr.

Mr. Chairman and gentlemen, I wish first of all to express my gratitude to you for this opportunity to appear personally and I want to apologize for bringing you back so abruptly from the intriguing problems of high education to this mundane subject of excise taxes on transportation and communications and the corporate-income tax on public utilities, but after all it is a subject that affects all of the citizens of the United States.

My name is Walter R. McDonald. I have been a member of the Georgia Public Service Commission since January 1, 1923, and I am now general solicitor of the National Association of Railroad and Utilities Commissioners with offices at 7413 New Post Office Building, Washington, D. C.

This association is a voluntary organization made up of the members of the various regulatory commissions and boards of all the 48 States, as well as the members of the Federal regulatory commissions; viz, the Interstate Commerce Commission, the Federal Power Commission, the Federal Communications Commission, and the Securities and Exchange Commission. In legislative matters we do not presume to speak for these Federal agencies, for as a matter of fact the national association is supported entirely by contributions from State commissions, which commissions control the policies of the organization.

State commissions are vitally concerned over the treatment which you may accord excise taxes on transportation and communication services as well as corporate income taxes because of the direct and indirect effect which such taxes have upon the rates of operating utilities, the regulation of which is a responsibility of these commissions. Insofar as excise taxes are concerned, this association has given consideration to the propriety and economic advisability of repealing these wartime emergency levies at each of its annual sessions beginning in 1946 as evidenced by the memorializing resolutions reported in our printed proceedings.

At its 1949 convention, the association carefully considered the effect that any increase in corporate Federal income taxes would have upon the consumers of utility service and unanimously adopted a resolution directing that such information be related to the appropriate committees of Congress.

In the interest of time I shall not read these resolutions but request that appendix I, which is a copy of the latest resolution adopted by my association at its annual meeting in Cleveland, Ohio, August 8-11, 1949, with respect to the repeal of Federal excise tax on transportation and communication services; and appendix II which is a copy of the

resolution dealing with the matter of the increase in corporate Federal income taxes which was adopted at the same meeting, be included in the record of this hearing.

Senator KERR. That will be fine. That will be done.

(The documents referred to follow:)

APPENDIX I

RESOLUTION FAVORING REPEAL OR REDUCTION OF FEDERAL EXCISE TAXES ON TRANSPORTATION AND COMMUNICATION SERVICES

Whereas the Federal excise taxes on transportation and communication services were initially levied or greatly increased during World War II, as war measures, to help defray war costs then current and also, in the case of the tax on transportation of persons, to discourage unnecessary travel; and

Whereas more than 4 years have elapsed since the end of the war, and the special and urgent needs for the levying or increasing of such taxes no longer exists; and

Whereas there has been a substantial reduction in railroad passenger traffic during the last 2 years, with resultant unprecedented deficits in passenger service operations, so that the public interest now requires that travel be encouraged rather than discouraged; and

Whereas in view of the changed situation respecting passenger travel the excise tax on such travel has reached the point of diminishing returns, since the Government is probably losing about as much revenue through decreased Federal income tax payments, due to deficits in passenger operations, as it is gaining in excise tax payments on such service; and

Whereas all such taxes are discriminatory against the long-distance user of transportation and communication services, and against sections of the country far removed from centers of population, for the reason that the tax is calculated as a percentage of the transportation or communication charge rather than on a flat basis; and

Whereas the removal of the 15 percent Canadian excise tax on passenger travel, on March 23, 1949, makes it possible for persons traveling within the United States to evade the United States excise tax by purchasing tickets at a Canadian office, resulting in intolerable discrimination against United States citizens who do not attempt to avoid payment of the tax, and added financial burden on American railroads which must give Canadian railroads a division of the revenues received from this evasion traffic, and must receive their own share of revenues in Canadian funds; and

Whereas all such transportation and communication excise taxes are discriminatory in many other ways, including the discrimination against public transportation agencies which must collect the tax and in favor of private carriers which are not required to; and the discrimination against businesses which have to make frequent use of communication services; and

Whereas although Congress initially levied or increased said excise taxes during the war with reference to the rates and charges for transportation and communication services then in effect very substantial increases in such rates and charges have since been placed in effect or are now pending, the result being that these substantial increases in rates and charges for transportation and communication services have brought about a great and unintended increase in excise tax revenue per unit of transportation and communication services, with consequent uncontemplated additional burden upon the users of such service; and

Whereas 37 bills have already been introduced in the Eighty-first Congress proposing the repeal or reduction of such taxes, these bills being as follows: H. R. 43 (Dingell, Michigan), H. R. 108 (O'Toole, New York), H. R. 205 (McDonough, California), H. R. 207 (McDonough, California), H. R. 208 (McDonough, California), H. R. 393 (Farrington, Hawaii), H. R. 879 (Morrison, Louisiana), H. R. 1228 (King, California), H. R. 1564 (Stefan, Nebraska), H. R. 1724 (Multer, New York), H. R. 1734 (Talle, Iowa), H. R. 1894 (Dolliver, Iowa), H. R. 1895 (Dolliver, Iowa), H. R. 2100 (Martin, Massachusetts), H. R. 2117 (Smathers, Florida), H. R. 2560 (Multer, New York), H. R. 2651 (Jonas, Illinois), H. R. 2657 (Mansfield, Montana), H. R. 2845 (Reed, New York), H. R. 2913 (Kennedy, Massachusetts), H. R. 3183 (Hand, New Jersey), H. R. 3245 (Keating, New York), H. R. 3260 (Chesney, Illinois), H. R. 3374 (Scudder, California), H. R. 3538 (Hand, New Jersey), H. R. 3653 (Poulson, California), H. R. 3656 (Poulson, California), H. R. 3657 (Poulson, California), H. R. 3658 (Poulson, California), H. R. 3844 (Reed, New York), H. R. 3846 (Vursell, Illinois), H. R.

4217 (Phillips, Tennessee), H. R. 4298 (Tollefson, Washington), H. R. 4751 (Bartlett, Alaska), and H. R. 4946 (Douglas, California), S. 1603 (Langer, North Dakota), and S. 1029 (Wiley, Wisconsin): Now, therefore, be it

Resolved, That the National Association of Railroad and Utilities Commissioners is of the opinion that the present excise taxes on transportation and communication services are inimical to the maintenance of a reasonably-priced and nondiscriminatory public transportation and communication service and that, accordingly, the excise tax on transportation of property should be repealed and the excise tax on other transportation and communication services should be repealed; and

Resolved further, That the committee on legislation and the legal representatives of this association are charged with the duty of appearing on behalf of the association at any hearing before any committee of Congress which may be held to consider any of said bills listed above or any similar bills, for the purpose of making a statement in support of the views herein expressed; and

Resolved further, That the secretary of the association is directed to transmit a copy of this resolution to the chairman of the Committee on Ways and Means of the House of Representatives.

Appendix II

Resolution Relating to Proposed Increases in Federal Income Taxes

Resolved that the committee on legislation, through the legal representatives of the national association, be instructed to make a presentation in behalf of the consumers of public utility services relative to the effect of any proposed increase in corporate Federal income taxes on those consumers.

Mr. McDonald. I would like to say further that in appearing here as the single witness for all the State commissions we are undertaking to cooperate with the expressed desires of your committee and assure you that our lack of numbers is not indicative of our interest. In view of the rather full showing made before the House Ways and Means Committee on H. R. 8920, and your inclusion of the two resolutions as a part of this record, I shall be brief and endeavor to avoid repetitious arguments.

We have been apprised through the press of the apprehension of your committee with respect to the repeal of any tax law in the light of the present international situation but we are convinced that there are sound economic reasons why excise taxes on transportation and communication services should be entirely removed in any eventuality. This assertion is made on the basis of the effect which these taxes are having upon the consumers of utility service and particularly in the light of the provisions of H. R. 8920 which passed the House on June 29, 1950.

First, let me state frankly that it is simply astounding and almost inconceivable that Congress could seriously consider giving more favorable treatment to purely luxury items such as cabaret charges, jewelry, furs, expensive handbags, et cetera, than to items of absolute economic and personal necessity such as transportation and communications. The national transportation policy and the preamble to the recently enacted Rural Telephone Act are but two manifestations of congressional recognition of the vital necessity of adequate, nondiscriminatory transportation and communication services. Yet, percentagewise these services were made the stepchild of H. R. 8920, and in absolute terms they are left with the highest taxes remaining in effect.

In terms of percentage the only item of utility service which received treatment comparable with that accorded the luxury items was telegraph service, the tax on which was reduced from 25 percent to 10

percent. Here the House no doubt very properly took into consideration the highly unsatisfactory operating results of Western Union Telegraph Co., brought about largely by the effect of this high wartime excise tax. Yet H. R. 8920 completely ignores the fact that an equally urgent condition exists with respect to the passenger operations of the railroads. In 1949 the class I railroads incurred passenger operating deficits totaling $649,000,000. It has been necessary to discontinue the operation of literally hundreds of passenger trains because of the competition of private automobiles, and to saddle substantially increased freight rates on shippers throughout the Nation to try to offset this deficit.

Many of the regulatory commissions I represent are urging upon the railroads experiments with reduced fares to recapture lost traffic, and recently the carriers have been heeding these suggestions. If the substantial reductions in fares now being made by the railroads could be accompanied by complete elimination of the excise tax on the transportation of persons, a great step would be made toward the solution of one of the most serious and perplexing regulatory and economic problems now facing the Nation. I should like to make clear that the effect of this tax is not confined to the railroads. The bus companies are also experiencing an alarming traffic decline because of private-car competition, and the Congress is of course aware of the subsidies it finds necessary to pay the airlines.

As you know the statutes universally have two requirements with respect to utility charges. The charges must be reasonable and they must be nondiscriminatory. At least from the standpoint of the eyes and pocketbook of the consumer, excise taxes are merely an inseparable part of the total charges for utility services, and except from a strict legal standpoint, the tax plus the prescribed charge of the utility company must be viewed as the total utility charge. The meager reductions provided in H. R. 8920 indicate that the House apparently recognized that the influence of the excise taxes produced total charges that did not meet the first requirement—that of reasonableness, but the House obviously failed to give consideration to the discriminatory aspects of these taxes as applied to utility services.

For two reasons excise taxes on transportation and communication services result in unjust discrimination. First, larger companies, and those having favorable geographical locations, are enabled to employ private facilities, including privately operated trucks, barges, coastwise and intercoastal ships, private wires, and private radio communication, and thus escape payment of excise taxes, the burden of which must be borne by the smaller companies and those with less favorable locations.

Second, the straight percentagewise method of assessment is discriminatory in that it results in an unjustifiable burden on the user of long-haul services. Regulatory commissions have long since realized that it is seldom equitable to increase rates by straight percentages. For example the Interstate Commerce Commission has been compelled to devote many days of hearings on the recent freight rate increase cases exclusively to the problem of maintaining origin and destination relationships. These delicate economic patterns have been preserved by providing percentage increases subject to maximums and by other complex methods. It is indeed discouraging, inequitable,

and economically disturbing to have these efforts to remove discrimination frustrated to a great extent by a tax the effect of which is discriminatory.

Furthermore, Congress should bear in mind that the law of diminishing returns applies with equal force in the case of increased taxation as it does in the case of price increases by private businesses. Again the railroad passenger deficit may be cited as a convincing illustration.

During the fiscal year ended June 30, 1949, the Treasury Department collected from all carriers excise taxes on the transportation of persons amounting to $251,000,000. I do not have the figures separating the sources of this tax revenue, but it may be assumed for the sake of this statement that approximately 55 percent was derived from the railroads, or approximately $138,000,000.

During the calendar year 1949 the railroads incurred passenger operating deficits of 649 million dollars. This 649 million dollar deficit was subtracted from the taxable income earned by the railroads from freight service, thus depriving the Government of any corporate income tax on the net operating income from freight service eroded away by the passenger deficits. Applying the 38-percent corporate income tax on this 649 million dollar deficit indicates that the Government was deprived of approximately 247 million dollars in corporate income taxes. Subtracting the estimated 138 million revenue in excise taxes derived from this source shows a net loss in tax revenue of 109 million dollars.

Of course, this is an extremely unrefined calculation and in order to obtain absolutely accurate results it would be necessary to make adjustments for those few carriers who derive no taxable income from freight service, and also adjust for interest and other so-called below-the-line items. It does, however, provide a good indication of the over-all result. I think it has been almost certainly demonstrated that the continued maintenance of the excise taxes is an extremely important factor in this passenger deficit.

Certainly complete elimination of these taxes, along with the other remedies now being employed by the regulatory commissions and the railroads, should put passenger service on approximately a break-even basis and thus increase the Government's revenue from corporate income taxes sufficiently to more than offset the loss of revenue resulting from the elimination of excise taxes.

One of the problems which has beset the State regulatory commissions for many years and one on which we are now conducting extensive cooperative studies with the Federal Communications Commission lies in the fact that interstate telephone toll rates are now about $100,000,000 (in annual over-all effect) lower than intrastate telephone toll rates.

The application of the 25-percent Federal excise tax on toll messages in excess of 24 cents compounds this discrimination to an extent of about $25,000,000 annually and is but another example of the discriminatory effect of the excise tax on the charges of regulated public utilities.

The action of the House in increasing the corporate income tax from 28 to 41 percent while directed at the earnings of corporations must inevitably directly affect the charges paid by consumers of public utility services and therein lies our interest. The present corporate tax rate on utility companies with annual net income in excess of

$50,000 per year is 38 percent. The new corporate tax formula contained in H. R. 8920 provides for a 21-percent normal tax on all corporations and a 20-percent tax on all earnings in excess of $25,000 annually. Thus, the tax on corporations having annual earnings over $167,000 will be increased from 38 to 41 percent. Any increase in Federal income taxes is an added expense to the utilities and, in accordance with court decisions, it is reflected in the rates which the consumers must pay.

In the case of utility corporations furnishing transportation and communications services, this increase in Federal corporate tax offsets to a considerable extent any benefits that might have accrued to users of these services by reason of the meager reduction in the excise taxes and in the event of rate increase applications, more than offsets such benefits.

At present under the 38 percent corporate income tax rates, State commissions must authorize charges on consumers sufficient to provide $1.61 of net revenue before Federal income taxes for every $1 of net income required by the utility to service its investment and avoid confiscation of property through the present tax of 38 percent. Additionally, 33 State governments now levy corporate income taxes which average 4.5 percent.

Under the provisions of H. R. 8920, these commissions will be compelled to provide $1.70 of net revenue—and that does not include the State tax—before Federal income taxes for every $1 of required net income.

This problem becomes particularly acute to the consumer at the present time because it greatly augments the danger of further inflationary increases in the cost of regulated public utility service. It is well known that within the past several months many regulated utility companies have incurred increases in operating expenses which have reduced their earnings to that twilight zone between reasonableness and confiscation.

I know from my experience over the years that if the earnings of a utility are only slightly less than sufficient to produce a fair return, it is reluctant to go through the expensive and often drawn-out procedure necessary to secure a rate increase. Especially is this true in periods of economic uncertainty when some business acceleration might offset the increased operating expenses.

However, should this condition be aggravated by the proposed increase in corporate income taxes, there is little doubt that many companies would find their net income so depleted as to make it necessary to seek rate increases. In such cases they would not only seek the additional revenue necessary to offset the tax increase but would ask for additional amounts sufficient to give them a full return. This problem is not hypothetical because as a result of court decisions within the past 5 years many commissions are operating under compulsion to allow required returns on investment as high as 6 to 6.5 percent.

The corporate tax proposal further complicates the problem of State regulatory commissions because of the extent to which present taxes are being capitalized and reflected in the rate base of operating utilities. This matter was tersely summarized by a former president of the association, Justus F. Craemer, a member of the California

Public Utilities Commission, who, in his address at this association's annual convention in 1949, stated:

Now let's look at General Motors, one of the major Diesel locomotive products. The total value of its products in 1948, including excise tax, was $4,930,000,000; of this amount $2,368,000,000 was paid for goods and services General Motors purchased. Among the purchases are such items as steel, tires, and the like.

The steel companies and the tire companies do not escape taxes so their products are also saturated with taxes. General Motors' payroll was $1,368,000,000. To this we must add the payroll tax. The total tax bill, from payroll, corporate, and excise taxes included in the $4,930,000,000 was $694,000,000 or over 14 cents out of every consumer dollar.

When rail lines, bus lines, or truck lines buy General Motors products, it is fair to assume that in excess of 14 percent of the sales price is tax influenced. Let me say again, I have no idea what taxes are involved in the $2,368,000,000 which General Motors paid to the steel industry, tire industry, and others, but I am sure it was no small item. Sales tax, common in many States, is another item to be added.

All these taxes obviously become a part of the cost of the goods and whoever buys them in turn must capitalize them. Thus the railroad company, when buying a Diesel locomotive, of necessity finds itself capitalizing a substantial part of the cost which is represented by these taxes. The same is true of the purchaser of trucks, busses, or any other products purchased from General Motors or, in fact, any manufacturer.

When such equipment goes on the books of corporations, remember they are entitled to earn a return on that investment and they must also provide for depreciation of this equipment. Capital goods are thus well saturated with pyramided taxes.

As will be noted from the resolution reproduced in appendix II, the association gave me no definite instructions as to what recommendations I should make with respect to the proposed increase in Federal corporate income taxes, but as General Solicitor, I was instructed to make a presentation showing the adverse effect of this increase on consumers of public utility services in order that this committee may be informed of the complications and inequities that it will bring about and give consideration to the adoption of appropriate measures to adequately protect the consumer.

In closing I would like to reiterate the position of our association that this committee should recommend the outright repeal of the discriminatory excise taxes on the essential items of transportation and communication services before any consideration is given to repealing or reducing nondiscriminatory levies on nonessential or luxury items.

I thank you very much, Mr. Chairman.

Senator KERR. We thank you, Commissioner McDonald.

Mr. Carter Davidson of the American Council on Education.

STATEMENT OF CARTER DAVIDSON, CHAIRMAN, COMMITTEE ON TAXATION AND FINANCIAL REPORTING TO THE FEDERAL GOVERNMENT, THE AMERICAN COUNCIL ON EDUCATION, WASHINGTON, D. C., ACCOMPANIED BY JOHN MECK, TREASURER, DARTMOUTH COLLEGE, HANOVER, N. H.

Mr. DAVIDSON. My name is Carter Davidson, chairman of the American Council on Education's committee on taxation and financial reporting to the Federal Government. I am also president of Union College, Schenectady, N. Y. I would like to have Mr. John Meck, a member of the committee and the treasurer of Dartmouth College, with me, if permissible.

I would like to give these copies of my statement to the members of the committee.

Mr. Chairman and gentlemen, the American Council on Education is a nonprofit organization founded in 1918 with a present membership of 131 national organizations in the field of education, 975 colleges and universities, and a number of public-school systems and State departments of education.

For the past 3 years our present committee has been working on some of the problems now under consideration in H. R. 8920. We have held several sessions with representatives of the Joint Committee on Internal Revenue Taxation, the Treasury Department, and the Bureau of Internal Revenue to prepare a form for the annual reporting of income and expenditures of colleges and universities; we realize that our tax exemption is based upon our expending our funds in the public service, and that the Government needs to be informed of the ways in which our funds are used. Two years ago this committee conducted a survey of the sources of college income, and discovered that the entire gross income from sources other than tuition, gifts, Government appropriations, and investments was only $150,000,000; when expenses and Federal research grants are deducted, the net sum which might be made subject to tax is very small, indeed. In round numbers, American colleges and universities possess a $3,000,000,000 plant, $2,000,000,000 in endowment funds, and operate on approximately $1,000,000,000 a year, of which about 10 percent, or $100,000,000, comes from invested funds. Of this latter figure, perhaps 10 percent, or $10,000,000, might be subject to this proposed Federal tax. The tax "loophole" to be plugged up, therefore, is too small to offer any help to the Federal budget.

But the loophole which is created in the principle of tax-exemption of educational institutions is both dangerous in itself and menacing for the future. From the founding of our country the colleges and the churches have been granted tax exemption because they are public service, nonprofit agencies. We are frankly puzzled today to discover that the Federal Government proposes to treat the churches differently from the colleges in respect to taxation. All colleges are tax-exempt because their service is public in nature; but some colleges are supported by public tax funds, others by private contributions. These two channels of support must both be kept open and unimpeded. Charitably minded donors must not be discouraged by the fear that their gifts may be taxed away. At this present moment, when more students are eager to attend college, when the costs of operation are at an all-time high, when income from investments is reduced (partly because of Federal fiscal policy), and when tuition fees have reached a limit, an attack by the Federal Government upon our long-established tax-exemption may mark the beginning of the end of privately supported education in America. But President Stassen has developed this point, and we do not need to say more, merely to remind you that colleges are not, and never have been, profit-making, that every cent of income merely increases our public service.

When we consider the sources of college income questioned by the proposed legislation, we find three main classifications: (1) income from research contracts, Federal and industrial; (2) income from real estate subject to mortgage; (3) income from commercial businesses not directly related to the purpose of the educational institution.

President Killian of the Massachusetts Institute of Technology has already presented our stand on research income; here we confine ourselves to endorsing his stand for continued tax exemption to stimulate research (sec. 422, p. 100, line 19).

Investment of college funds in real estate (sec. 423) is the oldest and most respectable of all forms of investment. Colleges have been interested in such investments because of long-range values. The fact that in some cases the property is subject to heavy mortgages should not alter the principle of tax exemption on the rent to a college owner, for the college must pay interest on the mortgage, and the holder of the mortgage pays the tax. Also, with many mortgages, it is impossible under the contract for the tax-exempt owner of the property to pay off the mortgage before a date some years in the future. The principle of taxation of borrowed funds is a new and potentially dangerous one. Again, there seems no reason why the former owner of a building should not have a right to lease the property. He may be the only possible renter. If the sales price and the rental are fairly arrived at, and if there is no agreement for later repurchase at a fixed low price, we can see nothing unfair in the so-called lease-back. Only colleges and insurance companies can be in a position to make such long-term frozen investments. Colleges are in competition only with other investors, not operating a business in a competition with other businesses. In any case, the Commissioner of Internal Revenue has adequate legal means to deal with this problem, through taxes on the seller-lessee. It should be remembered that the seller is seeking fluid funds from the sale to expand his business; the result should be, and has been in every case known to us, an increase in the corporate income and in the Federal tax on that income.

In the third case (sec. 422, p. 102, line 8) there is virtually unanimous agreement among the colleges that educational institutions should not engage in commercial businesses not related to the propose of education, and we feel there is no widespread indulgence in such direct commercial activity. There will, however, be endless difficulties in distinguishing between taxable and nontaxable activities. Judge Learned Hand, in his opinion in the Roche's Beach case, gives clear reasons why colleges will avoid such business:

> There are several checks upon this possibility; first, the business must be small, if the corporation is to retain its classification under its appropriate subdivision; second, in many cases it will wince at exposing its funds to the hazards of business; third, its charter will often forbid such excursions.

Business ventures for profit to the colleges are carried on for the most part by corporate subsidiaries, referred to as feeder corporations. Our committee believes that the time has now come when, in the public interest, such noneducational separately organized corporations should be made subject to the corporate-income tax. This will maintain our principle since it will not constitute a direct tax upon the colleges. We respectfully suggest, however, that since the tax exemption of such corporations has been legal to date, and such arrangements have been entered into by the universities in good faith, they be given reasonable time to dissolve such arrangements.

Senator Taft. It is uncertain whether it has been legal to date.

Mr. Davidson. Yes; it has been before the court and there have been decisions on both sides.

Senator KERR. The fact of the matter is that it was an opinion of the Tax Court and it is now on appeal. Is that a fact?

Mr. DAVIDSON. That is correct.

This will require amendment of section 302, page 119, line 9 to 12, to grant a year's further extension, to January 1, 1952, instead of 1951, to allow for this change in arrangements. Also, in view of this good faith and legality, no taxation of income of such feeder corporations now established should apply to activities before that date. The working of the bill should make crystal clear that no change in taxation policies will be retroactive.

One change is of vital importance to the faculty and staff of colleges and universities.

Senator MILLIKIN. Do you think that a year would be sufficient?

Mr. DAVIDSON. At your committee meeting yesterday it was the feeling that 2 years would be better but at least a year would give us an opportunity to check on all the possible cases and see that as much as possible could be done. If there should be hardships arising so that it could not be accomplished in a year, we might ask for an extension after that date, but 2 years would be better, although according to those who seem to be most closely involved a year might make it possible.

Senator MILLIKIN. A year with a further extension discretionary.

Mr. DAVIDSON. That would be very helpful indeed.

It apparently was assumed that teachers retirement fund associations are exempted under another part of section 101 of the Internal Revenue Code. But the Teachers Insurance and Annuity Association, through which over 70,000 employees of more than 370 institutions of higher education are covered by annuity provisions, gains its exemption under section 101 (6). We therefore urge that in section 424, page 106, line 18, the following phrase be added:

> or an organization primarily engaged in providing retirement or other benefits for such educational institutions.

Senator TAFT. That is an attempt to exempt it from this tax on the accumulation of trust funds?

Mr. DAVIDSON. Yes. It is an accumulation of funds to meet the annuity requirements of the teachers who are depending on them.

Senator TAFT. This bill might tax them because of the provision that we are talking about, income accumulated by a charitable trust; is that it?

Mr. DAVIDSON. That is right. Other local teacher retirement associations are exempt specifically in the statement under another paragraph, but apparently the Teachers Insurance and Annuity Association, which was established by the Carnegie Corp. many years ago to take care of college teachers and staff members, has been exempt under the educational provision rather than the other.

Senator MILLIKIN. They necessarily have to accumulate the fund to meet the annuity?

Mr. DAVIDSON. That is right.

Senator MILLIKIN. Do they operate on a fully funded basis or how do they operate?

Mr. DAVIDSON. That would be a question that I would have to refer to the Teachers Insurance and Annuity Association.

Senator MILLIKIN. Experience has shown that in order to meet their future commitments they must accumulate their income?

Mr. DAVIDSON. That is right, sir.

They are fully funded, Mr. Meck says.

Section 1311, page 138, which requires the withholding of 10 percent of each dividend will work a real hardship upon tax-exempt institutions. We respectfully suggest that some procedure be established by which tax-exempt institutions may arrange to receive their dividends in full, without deductions and without the necessity of applying for refund of overpayment.

Senator BUTLER. That is a part in which I am especially interested. I should like to ask the representative of the Treasury here if the suggestion made by the witness is practical and could it be followed out?

Mr. KIRBY. We considered it very seriously and will want to consider it further with your committee. The main reason for not giving an exemption with respect to dividends received by charitable organizations is that it is highly desirable to make the withholding plan as simple as possible for the withholding agent, the corporations throughout the country, and the minute we do put in exemptions, then it makes it more difficult for the withholding agent to comply with the law. That is the basic consideration that is involved.

Senator BUTLER. It is very troublesome for the exempt institutions because in many cases it will hold back for about 1 year a good percentage of the capital on which they operate.

Mr. KIRBY. We realize that. As a matter of fact, it really would not be as long as a year. These refunds are paid, under the wage and salary withholding, very promptly and we would anticipate that that would be true in the tax-exempt organization area and it would not be anything like a year, but there would necessarily be some delay.

Senator BUTLER. Would it not be practical to permit the corporations to not withhold dividends that are payable to tax-exempt corporations?

Mr. KIRBY. It is entirely possible to do that. It would involve the filing of exemption certificates by the charitable organizations with the corporations in which they hold stock.

Senator BUTLER. I hope something like that can be done.

Mr. DAVIDSON. That is our hope.

Senator MILLIKIN. That is, as an alternative to not having it at all?

Mr. DAVIDSON. Surely.

Senator MARTIN. There are a lot of organizations that are now on a very tight budget and have investments, such as churches, foundations, and colleges, where they are operating on a very tight budget because of inflation. There ought to be something worked out if we could.

Senator KERR. That is a fact of which the committee will take judicial notice and also it is not limited to either charitable or eleemosynary institutions.

Mr. DAVIDSON. In conclusion, this committee once more asserts its willingness to cooperate with the Bureau of Internal Revenue in making such studies and preparing such forms as may be helpful to the Government. It feels that the whole matter of tax exemption needs further careful study; we must be certain that the benefits of tax exemption accrue to the nonprofit service organizations, and to them alone. We assume that the Members of Congress believe now as firmly as did the builders of our Government that free educational

institutions are the very fountainhead of a vital living democracy and that such institutions must be encouraged and preserved. Our committee urges in closing that no hasty steps be taken by Congress in its search for revenue which will have the effect of destroying privately supported education or of curtailing the freedom of the colleges and universities to secure funds through the management of their own resources to support the education of American youth.

I shall be glad to answer any questions. I have attached also a memorandum which was prepared as a public service, not especially for this committee, by Mr. Paul F. Myers, of the firm of Williams, Myers & Quiggle, a Washington firm.

Senator KERR. Do you wish to have that in the record?

Mr. DAVIDSON. Yes, sir, I would like to have that in the record.

(The memorandum referred to follows:)

MEMORANDUM—DANGER TO EDUCATIONAL INSTITUTIONS IF PROPOSED CURTAILMENT OF THEIR PRESENT EXEMPTION FROM FEDERAL TAXATION IS ENACTED INTO LAW

(By Paul F. Myers, Williams, Myers & Quiggle, Washington, D. C.)

We can assume at the outset that the men of Congress now believe as firmly as did the builders of our free Government that free educational institutions are the very fountainhead of a vital living democracy and that such institutions must be encouraged and preserved.

Practically all colleges and universities are in financial distress today because of higher costs and lower yield on endowment funds. It is obvious that, if any additional burden in the form of a Federal tax is put on the colleges and universities and if these institutions are to be preserved, it will be necessary for alumni, churches, States, and others to make good the Federal take. Our privately financed colleges and universities had their beginnings sponsored and supported by religious organizations. Many of them today have the same close tie. The Treasury and the staff have recommended that the amendments proposed by them should not relate to or apply to religious organizations.

The logic is irresistible that it would be unwise to treat our educational institutions differently than our religious organizations. The purpose of this memorandum is to demonstrate that there is no present compelling reason why the Congress should not leave educational institutions in the same classification and category as religious organizations. At this point it should be stated that perhaps other institutions in section 101 (6), such as hospitals, likewise should be treated the same as religious organizations for the same reasons. This memorandum is silent on other institutions only because it is confined to educational institutions.

There is substantial agreement that educational institutions should not engage in commercial businesses not related to the purpose of the educational institution. It is confidently believed that there is no widespread indulgence in such commercial activity for profit by educational institutions directly. Commercial business ventures for profit, it is submitted, are carried on for the most part by corporate subsidiaries, and it will be demonstrated later that corporate subsidiaries can be reached by amendment of section 101 (14). Such amendment will be discussed later. The matter is so important to the preservation of a free democracy that the Congress should give educational institutions the benefit of the doubt until the real facts are known. To get the real facts, Congress should require an annual report from educational institutions which will clearly show whether or not the institution itself is carrying on business activities not related to the purpose of the institution and claiming freedom from tax on those activities. It is respectfully submitted that there appears to be little revenue involved in cases of businesses not related to the purpose of the institutions being carried on directly by educational institutions.

There are a few known instances where educational institutions are supported substantially by business activities conducted directly by, but only remotely connected with, the educational purposes. It is believed these are exceptional cases. Furthermore, it is believed that if the Congress directs the compiling of this information and indicates the probability of legislation if it finds the practice

substantial, instances of educational institutions directly engaging in substantial business ventures will be few and far between. In other words, the procedure suggested would seem to have the same healthy effect as the proposed recommendations of law, without threatening disaster to educational institutions.

It has been stated that the Treasury and the staff have not recommended amendments which would affect religious organizations because the abuses have not been found among religious organizations. It is not believed that the engaging in business unrelated to the educational institution is substantial, and there is compelling reason to believe that it never can be substantial. These reasons were stated by Judge Learned Hand in his dissenting opinion in the case of *Roche's Beach, Inc.* v. *Commissioner of Internal Revenue* (96 F. 2d 776). Under Roche's Beach case, the corporate business involved was a bathing beach, bathhouse, etc., a commercial venture. It was incorporated and all the stock was owned by a charitable trust conceded to be exempt. The majority of the court took the position that the test of exemption was the destination of the income, and that the corporation was exempt under what is now section 101 (6) and that section 101 (14) did not prevent such exemption. Judge Learned Hand in his dissenting opinion gave reasons why an exempt institution would not ordinarily enter into business operations directly. It was his view that an exempt institution would have to use a separate corporation. He stated his reasons in the following words:

"* * * The purpose of subdivision 14 was to tax all business income, however destined, unless the company was really not in business at all. To some extent it is indeed true that that purpose can be evaded; an exempt corporation may go into business not strictly germain to its charter powers without losing its exemption. But there are several checks upon this possibility: *first*, the business must be small, if the corporation is to retain its classification under its appropriate subdivision; *second*, in many cases it will wince at exposing its funds to the hazards of business; *third*, its charter will often forbid such excursions. But I believe that when, however actuated, an exempt parent does resert to a business subsidiary, any income so obtained becomes taxable. * * *" [Italics added.]

It would seem that the three reasons given by Judge Hand need no elaboration. For example, if university A bought the assets of a going corporation—let us say, General Motors—and if its charter did not permit it to build automobiles, it would have to obtain an amendment to its charter in order to engage directly in building automobiles. It certainly could not then be said that university A is organized and operated exclusively for educational purposes. Its fundamental exemption as an educational institution would be clearly jeopardized.

Another question needs to be answered. Is it necessary to do anything about leaseback arrangements that have been made by educational institutions? It would seem that the Commissioner has found enough law on the statute book to adequately deal with this problem, and his approach appears to be entirely in accordance with the law, and the revenue sought is coming from the proper party, namely, the seller. The criticism has been made that an exempt institution can afford to lease back the property purchased at a lower rental and on more favorable terms than could tax-burdened persons. If that is factually true, then the seller has obtained not only cash for his property but a lease to which a value can be attached. I understand that the Commissioner is taking this position, and that there will probably be no loss of revenue on account of the transactions. It is also probable that some of these arrangements do not qualify as completed sales. The seller, in substance, may not have parted with his property. The presence of options to repurchase and other terms may indicate that the arrangement is nearer to a mortgage than to a sale in substance. It seems clear at present that there is adequate law to protect the revenues in these transactions, and therefore it is respectfully submitted that the Congress would be wise to await the outcome of the Commissioner's administrative attack on this problem.

The proposal to tax any segment of an educational institution's income is unsound in principle. Every educational institution involved will probably be found operating at a loss. The tax on a segment of the income therefore is in the nature of a penalty and not a true tax. It is respectfully submitted that the Congress should do nothing with respect to this matter until it has the true facts before it from required annual reporting. Certainly there is not enough revenue involved to justify hasty action.

We turn now to a substantial problem, namely, the exemption from Federal tax of business corporations wholly owned by exempt institutions. It is respectfully submitted that this particular development is the only real threat to the revenues. The courts for more than a quarter of a century have been in substantial agreement that the law does free from tax corporations wholly owned by an exempt

organization where all of the income of such corporation goes to an exempt organization. The courts have applied as a controlling test the destination of the income and have refused to consider the activities involved important. I am attaching as exhibit 1 to this memorandum a copy of an opinion handed down on April 7, 1950, in the United States Court of Appeals for the Fifth Circuit in the case of *Willingham et al.*, v. *Home Oil Mill et al.* It is generally conceded that arrangements such as in that case should not be permitted to continue. There is a threatened loss to the revenues, and the competitive advantage of such a commercial business and the temptation to make other such arrangements are too great to leave the matter as it is. It would seem that the criticized arrangement could be taken care of by adding a proviso to section 101 (14) of the Internal Revenue Code.

Section 101 (14) reads as follows:

"SEC. 101. The following organizations shall be exempt from taxation under this chapter—

* * * * * * *

"(14) Corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from the tax imposed by this chapter;"

The following amendment to section 101 (14) would appear to be adequate:

"* * * *Provided, however*, that a corporation actively conducting and operating a business not directly related to the primary purpose because of which said organization would be itself exempt, shall not be exempt under any provision of this section; provided further, that this amendment shall be effective at the date of the enactment of this Act with respect to corporations organized or acquired after such date, and with respect to corporations theretofore organized and owned by such organization which itself is exempt, shall be effective for taxable years beginning on or after January 1, 1953."

A reading of the Home Oil Mill case (exhibit 1) shows clearly the general view that it is legal under the present law to operate a business free from tax if all the income is required to go to an exempt institution. No attempt will be made to discuss the exceptions here. The general view is that it is legal and proper under the present law to make such arrangements. Many have been made in good faith relying upon the law as it stands. Many believe that Congress intended the law to be none other than it has been interpreted. It would be particularly unfair to make the provision retroactive. A reasonable amount of time and a fair opportunity should be given the exempt institution to liquidate or sell the corporate business, if it wishes, and invest the proceeds in securities which are not subject to the criticism and the income of which would be clearly tax exempt. The proposed amendment would be effective to stop any new arrangements of this sort.

The proposal has been made to amend section 162 (a) of the Internal Revenue Code requiring charitable trusts or educational trusts to distribute annually substantially all of their income. Congress should keep in mind that over the years trusts have been created for the benefit of universities or for particular purposes in colleges and universities, requiring accumulation for a certain time or until a certain amount has been raised before distribution is made for the particular purpose. There are so many serious problems in connection with this because of the great variety and kinds of old trusts in existence in which educational institutions are beneficiaries, that it would seem wise and fair to exclude from application of the proposed amendment to section 162 (a) all existing trusts that are irrevocable where accumulation is mandatory or where for any other reason the trustee is without authority to administer the trust in a way to obtain the tax exemption.

I wish to particularly emphasize the danger of making any provision retroactive. By and large, institutions, foundations, and trusts have operated within what the courts said was the law. As is clearly implied in the opinion attached hereto of the fifth circuit, the Government and the Congress are partly to blame if there is any blame. Many of the important cases were not appealed, and over a period of more than a quarter of a century, the Congress has not overruled decisions of the courts by legislation. Apart from the hardship of retroactive legislation, taxpayers would have a just cause to feel that the Congress was not fair.

In conclusion, I want to reiterate my own personal view that I do not think educational institutions should engage in any substantial manner in commercial businesses not related to the institution. I also want to reiterate my view that they are not at present indulging in this practice in a substantial manner or to an

extent that is a material threat to the revenues. I also want to reiterate my view that there are good and substantial reasons why an educational institution would not engage in substantial outside business not related to the institution—they would jeopardize their fundamental exemption. I wish to reiterate my view that educational institutions should be treated in the same manner as religious organizations for the reasons stated above. I wish to reiterate my view that annual reporting should be required to ascertain whether or not with the facts before Congress any legislation is necessary.

So-called feeder corporations engaged in competitive business should not be exempt from Federal tax, but in curing this matter, the legislation should not be made retroactive and exempt institutions should be given sufficient time to liquidate or sell their corporations and reinvest the proceeds in investments whose income is clearly free from tax. And finally, it is hoped that if any legislation is enacted amending section 162 (a), existing trusts should be exempt therefrom, in case the trustee is without power to so arrange the affairs of the trust to bring it within the exemption.

Although I have been associated with a number of educational institutions in a study of this matter, the ideas expressed herein are my own.

EXHIBIT 1

WILLINGHAM ET AL. V. HOME OIL MILL ET AL., UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT, APRIL 7, 1950

"Holmes, Circuit Judge: This appeal involves income taxes for the fiscal years ended July 31, 1943 and 1944. The taxpayer is the Home Oil Mill, a corporation, which was originally organized and operated for private profit; but, after all of its stock was bequeathed to a trust by the will of a philanthropist, the corporation was reorganized by an amendment to its charter so as to exist and operate forever thereafter solely and exclusively for religious, charitable, and educational purposes, and so that no part of its net earnings would ever inure to the benefit of any private individual. The facts, issues, and parties, in this case, except as to years and amounts, are the same as were involved in *Home Oil Mill* v. *Willingham* (68 Fed. Supp. 525 (46-2 USTC, par. 9368)), from the judgment in which there was no appeal.

"We might put our decision in this case solely upon the doctrine of collateral estoppel, since a determinative issue here was necessarily decided by implication against the Government in *Home Oil Mill* v. *Willingham*, supra; see *Tait* v. *Western Maryland Railway Company* (289 U. S. 620, 624, 77 L. Ed. 1405, 1408, 53 S. Ct. 706 (3 USTC, par. 1109)); Cf. *Sealfon* v. *United States* (332 U. S 575); or we might rest our decision solely upon the authority of the majority opinion in *Roche's Beach, Inc.* v. *Commissioner* (96 Fed. (2d) 777 (38-1 USTC, par. 9302)), since certiorari was not applied for in that case and several sessions of Congress have passed without any change in the statute. Without doubt, the Roche's Beach decision establishes the right of Home Oil Mill to the refund sought. It would be difficult to frame legislation against the doctrine in Roche's Beach without at the same time changing the law as announced in *Trinidad* v. *Sagrada Orden* (263 U. S. 578, 68 L. Ed. 458 (1 USTC, par. 88)), and no one seems to want to do that.

"The good faith of the Home Oil Mill's reorganization and its freedom from motives of tax evasion are not questioned. The court below found that neither in the reorganization nor operation of the mill was the motive of tax evasion even remotely involved. Neither is there any question about the destination of the income of this taxpayer. If it is possible for a religious, charitable, and educational trust to operate an industry through a corporate agency, and be exempt under section 101 (6) of title 26, United States Code, the appellant is entitled to such exemption. In the first Home Oil Mill case, supra, the court held that since its reoganization the taxpayer has been operated solely and exclusively to produce income for religious, charitable, and educational purposes. In *Trinidad* v. *Sagrada Orden*, supra, the Supreme Court held that the destination of income was more important than its source.

"The Roche's Beach decision has been followed, or the same principles declared, in the following cases: *Bohemian Gymnastic Association* v. *Higgins* (147 Fed. (2d) 774, Second Circuit, decided Mar. 8, 1945); *Debs Memorial Radio Fund* v. *Commissioner* (148 Fed. (2d) 947, decided Apr. 2, 1945 (45-1 USTC par. 9258)), wherein the court said it would 'continue to do so until instructed otherwise by final authority'; *Commissioner* v. *Orton* (173 Fed. (2d) 483, decided March 28, 1949, Sixth Circuit (49-1 USTC par. 9225)); *Home Oil Mill* v. *Willingham* (68 Fed.

Supp. 525, July 26, 1945, District Court, Alabama, of Fifth Circuit (49-1 USTC par. 9257)).

"As Marshall, C. J., said in the Dartmouth College case, if a civil institution be employed in the administration of the Government, it would be a public corporation. So here we have a private corporation employed in the administration of a religious, charitable, and educational trust.

"On the ground of equitable estoppel, on the authority of the Trinidad and Roche's Beach cases, and because of the reorganization and legal rebirth of appellant by the amendment of its charter, the judgment appealed from should be affirmed.

"Over a period of 36 years, with opportunity to change but without changing, the intention of Congress has been to exempt from income tax corporations organized and operated exclusively for the sole purpose of devoting their net earnings to religious, charitable, and educational purposes. If this intention is wrong from a legislation standpoint, the courts should let changes in the law come from the legislative department."

Senator MILLIKIN. Have you made an estimate of how much of your total investment fund would be noninterest-bearing in the operation of this withholding business? How much money is involved? How much loss of income is involved?

Mr. DAVIDSON. Yoy mean withholding 10 percent?

Senator MILLIKIN. Yes,

Mr. DAVIDSON. As I indicated, the total invested funds of our colleges and universities are $2,000,000,000. Assuming the average income is 5 percent, which would be a pretty generous assumption, that would be $100,000,000. If you assume 10 percent is withheld at the source, that might be $10,000,000 a year which is involved.

Senator KERR. That would indicate that the entire endowment fund was invested in dividend-bearing securities and that the entire income was in the form of dividends.

Mr. DAVIDSON. It would not be as high as that. You would probably have to cut that in half again.

Senator KERR. Are there any further questions? If not, thank you very much, Mr. Davidson.

Mr. DAVIDSON. Thank you, Mr. Chairman.

STATEMENT OF CLARENCE SCHOCK, PRESIDENT, THE SICO CO., BOROUGH OF MOUNT JOY, PA.

Mr. SCHOCK. Mr. Chairman and gentlemen of the committee, my name is Clarence Schock; I am a citizen of the State of Pennsylvania. I reside in the Borough of Mount Joy, Lancaster County, Pa. I am president of the SICO Co. I am appearing before you today on behalf of the SICO Co. and its beneficiaries.

The SICO Co. was organized as a nonprofit corporation in December 1941. Its purpose is to promote public education. All of its net earnings must go to or be used for the benefit of public schools. Even in the case of liquidation all of its net assets must go to the public schools. Thus, the SICO Co. taxes itself 100 percent for the benefit of public schools. We know of no other corporation like it anywhere except the Joy Co., which I also created, the net earnings of which must go to the public schools of the Borough of Mount Joy.

SICO's charter permits itself also to engage in commerce. It is a marketer of petroleum products.

In December 1941 I was the owner of all the capital stock of the Schock Independent Oil Co., Crane Hook Oil Storage Co., and Rollman Manufacturing Co. The net worth of the assets of the three

companies at that time was about $1,500,000. In order to help the SICO Co. to carry out its purpose, I offered to sell all my right, title and interest in these three companies to the SICO Co. for the purchase price of $1,000,000 to be paid over a period of 22½ years, $140,000 the first year and $40,000 for each year thereafter, until the total price was paid. The SICO Co. accepted that proposition and thereafter SICO operated the oil business.

The SICO Co. has a terminal at Wilmington, Del., where it receives liquid petroleum products in tank ships and sells it chiefly in the southeastern portion of Pennsylvania. It sells to consumers, retailers and wholesalers.

Attached to our written statement is a printed report showing that up to date the SICO Co. has paid to the public schools of Lancaster County $316,743.

Senator MILLIKIN. Would I be intruding too much on the personal affairs of the company if I asked what its annual gross is?

Mr. SCHOCK. About $3,000,000.

Senator MILLIKIN. Over how many years have you paid this $316,743?

Mr. SCHOCK. We began at the end of 1942. We made annual payments to the school districts of Lancaster County. The statement attached will tell you how much to each one but that gives the total to date.

(The statement referred to follows:)

$316,743 TO DATE TO PUBLIC SCHOOLS OF LANCASTER COUNTY

THE MORE SICO CUSTOMERS THE MORE PROFITS FOR SCHOOLS

REPORT OF THE SICO CO. 1949

SICO'S 1949 REPORT PRESENTED TO THE CONVENTION OF PUBLIC SCHOOL DIRECTORS OF LANCASTER COUNTY, MARCH 16, 1950

The SICO Co. is about to make its eighth annual contribution to the public school districts of Lancaster County. The amount to be distributed from the earnings as of December 31, 1949, is $49,619. SICO's annual contributions to date to the public school districts of Lancaster County are as follows:

Dec. 30, 1940	$20, 020. 44
June 14, 1942 in United States bonds	20, 000. 00
Dec. 28, 1944	64, 064. 00
Dec. 31, 1945 (delivered Mar. 14, 1946)	32, 262. 00
Dec. 31, 1946 (delivered Mar. 13, 1947)	30, 636. 00
Dec. 31, 1947 (delivered Mar. 18, 1948)	49, 517. 56
Dec. 31, 1948 (delivered Mar. 17, 1949)	50, 624. 00
Dec. 31, 1949 (delivered Mar. 16, 1950)	49, 619. 00
Total to date	316, 743. 00

On March 16, 1950, a check will be mailed to each school district in Lancaster County for its share of this contribution. SICO's total cash contributions to date to each public school district in Lancaster County is as is shown on a sheet hereto attached.

We thank you for your interest in the public schools which leads you to accept the office of school director. We thank you for your cooperation in helping to promote the SICO plan to help the public schools.

Nineteen hundred and forty-nine was a good year for SICO and its earnings have materially increased. We regret, however to announce that the percentage of increase within Lancaster County is less than the percentage of increase outside of Lancaster County. A statement of the financial condition of the SICO Co., as of December 31, 1949, is being delivered to the county board of school directors.

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Contrary to interpretation of the Federal law by a large number of Federal courts including one decision by the Supreme Court, the Revenue Department has chosen to interpret the law otherwise than the courts and has exercised its authority by withdrawing exemption from income tax from the SICO Co., for the year 1948 and subsequent years. This action has been protested by the SICO Co., but a part of the tax imposed by this decision has been paid under protest and we have proceeded to institute suits in the Federal courts to recover what we have paid and to avoid the payment of any more, which we will not be required to pay unless and until the courts have made an adverse decision in the suits which we have filed.

We believe and are confident that the decision of the courts will be in our favor under the law as it is, but it is not prudent for us to handle our finances without due regard to the possibility of an adverse decision. Accordingly, our present distribution is less than it otherwise would have been. No matter what the decision is, SICO will continue to pursue its educational purpose and will continue to earn funds for that purpose by continuing its business as usual. In case of an adverse decision, a large part of our earnings will go to Washington instead of to the public schools of Lancaster County.

With or without exemption, we hope that SICO's earnings for benefit of public education in Lancaster County will grow abundantly and that Lancaster County will be an example for neighboring counties to emulate. In the near future we expect to begin distributions for the benefit of public schools in one or more neighboring counties.

Let us all remember that SICO customers are the real benefactors under the SICO plan.

Thanking you for your past, present, and future cooperation,

Yours truly,

The SICO Co.,
By CLARENCE SCHOCK, *President.*

Total cash contributions made by the SICO Co. to the public school districts of Lancaster County up to and including the date of Mar. 16, 1950

District	Amount
Adamstown Borough	$963
Akron Borough	1, 521
Bart Township	2, 075
Brecknock Township	2, 928
Caernarvon Township	2, 345
Christiana Borough	1, 616
Clay Township	2, 592
Colerain Township	2, 115
Columbia Borough	12, 921
Conestoga Township	2, 236
Conoy Township	2, 851
Denver Borough	2, 755
Drumore Township	1, 672
Earl Township	4, 604
East Cocalico Township	4, 399
East Donegal Township	6, 175
East Drumore Township	1, 611
East Earl Township	4, 968
East Hempfield Township	7, 165
East Lampeter Township	6, 711
Eden Township	846
Elizabethtown Borough	7, 829
Elizabeth Township	1, 439
Ephrata Borough	11, 344
Ephrata Township	4, 559
Fulton Township	2, 121
Lancaster City	58, 629
Lancaster Township	5, 436
Leacock Township	3, 494
Lincoln Independent	353
Lititz Borough	8, 745
Little Britain Township	2, 013
Manheim Borough	7, 352
Manheim Township	12, 938
Manor Township	$6, 345
Manor-Millersville Joint	385
Millersville Borough	4, 543
Marietta Borough	3, 286
Martic Township	3, 085
Mount Joy Township	3, 291
Mountville Borough	1, 302
New Holland Borough	4, 294
New Milltown Independent	276
Paradise Township	4, 319
Penn Township	3, 593
Pequea Township	1, 921
Providence Township	2, 391
Quarryville Borough	3, 288
Rapho Township	4, 825
Sadsbury Township	888
Salisbury Township	5, 603
Southern Lancaster County Joint	521
Strasburg Borough	1, 527
Strasburg Township	2, 350
Terre Hill Borough	1, 575
Upper Leacock Township	5, 017
Warwick Township	6, 277
Washington Borough	390
West Cocalico Township	3, 525
West Donegal Township	2, 392
West Earl Township	4, 468
West Hempfield Township	2, 843
West Lampeter Township	5, 661
Mount Joy Borough	25, 241
Total	316, 743

The contribution to the school district of Mount Joy Borough was caused by a desire to transform the beauties of the Little Chickies Creek which passes alongside of Mount Joy Borough into a school playground with a swimming pool which could only be created by rebuilding the old broken down dam. We ask all people of Lancaster County to look upon this playground as a place open to all school children in Lancaster County, as well as to all adults in Lancaster County. It is particularly convenient to all people residing in western Lancaster County.

A BIT OF SICO HISTORY

The business of SICO began in Lancaster County in 1876. It has been under present management since 1886. The foundation of SICO's capital structure was built by the patronage of SICO customers in Lancaster County.

SICO's field of operations in neighboring counties is now building a similar foundation. Schools outside of Lancaster County will receive SICO contributions in due time and in all probability much sooner respectively than Lancaster County received such contributions.

Lancaster County having furnished the patronage to build the foundation of SICO's capital structure is now enjoying no more reward than the amount that it is now creating by its present patronage.

Earnings outside of Lancaster County are being used to pay for a similar additional economic foundation sufficient, by the use of which, to create earnings outside of Lancaster County which will justify contributions to public schools outside of Lancaster County.

Mr. SCHOCK. The officers and employees of the SICO Co. receive no more than the value of their services. I have given all my time in service to the company without salary although I believe that even if I received a salary commensurate with the value of my services, it would have any effect upon the eligibilty for exemption under the existing law.

Senator TAFT. They pay you $40,000 a year on account of purchase price?

Mr. SCHOCK. Yes, but I gave them value.

Senator TAFT. I know that, but they are paying you that $40,000 a year on account of purchase price?

Mr. SCHOCK. Yes.

Senator TAFT. How much is the net income over and above that, as a rule?

Mr. SCHOCK. The net income has varied. In the beginning our income for 1949 was about $150,000.

Senator TAFT. After the $40,000 payment or before that?

Mr. SCHOCK. Before.

I said for 1949. For 1948 it was $150,000. For 1949, on account of the great rise in inventory values, our profit was almost $240,000.

Senator TAFT. This company has been held to be exempt by the Internal Revenue Bureau right along?

Mr. SCHOCK. They gave us an exemption in 1943. In September 1948 they withdrew our exemption and we are now contesting that question in the Court of Claims.

Inasmuch as the SICO Co. taxes itself 100 percent and even in case of liquidation must give all of its net assets to public schools, we contend that if Congress sees fit to tax the SICO Co. it will be taxing the public schools of Pennsylvania, it will be taxing the Department of Public Instruction of Pennsylvania, it will be taxing a political division of the State of Pennsylvania. In substance, we claim that it will be taxing the State of Pennsylvania, and that gentlemen, I do not believe you aim to do either directly or indirectly.

We submit proposal of an amendment to H. R. 8920 which would grant the SICO Co. or similar companies complete exemption. We

commend it to your consideration and we hope that you will give it serious consideration.

(The proposed amendment follows:)

PROPOSAL FOR AMENDMENT TO H. R. 8920

Section 301 proposes to amend section 421 of the Internal Revenue Code. The proposal is to add to section 421 (b) (1), as proposed, a new sentence reading:

"The taxes imposed by subsection (a) (1) shall not apply in the case of a corporation, all of the net income of which is to be used for the exclusive benefit of public schools in any State or States of the United States, and any political subdivision thereof; and whose charter also provides that upon dissolution of such organization, all net assets shall be paid to the public school districts of any State of the United States."

Mr. SCHOCK. Now in order to prove the statements that I have made, we have with us today a representative of Ford, Bacon & Davis who have just completed an appraisal of the value of the assets of the SICO Co. as of December 31, 1941. We also have with us a representative of Lybrand, Ross Bros., and Montgomery who have audited our accounts and inventories and all other things that the company owns, excepting the fixed assets, and these two gentlemen together are able to prove to you that at that time the assets of those three companies that I sold to the SICO Co. were worth a little more than $1,500,000. I sold them to the company for $1,000,000 payable over a period of 22½ years, as I have previously stated.

Now I have also with me James R. Morford of Wilmington, Del., who has been an attorney for the SICO Co. and its predecessors since 1926. He knows our history from a legal standpoint.

We come to you gentlemen with clean hands. Everything that we are doing is an open book to you. We shall be glad to give you any information at any time about what we have done and what we are doing and what we are planning to do.

Senator TAFT. Is there a board of trustees or directors or what?

Mr. SCHOCK. We have five members of the corporation, the same five members. They were the incorporators. They are all living still and they are now the directors.

Senator TAFT. Do they own any stock or just members?

Mr. SCHOCK. No stock.

Senator TAFT. A self-perpetuating board?

Mr. SCHOCK. Yes; self-perpetuating. In case of vacancy caused by death or otherwise, the remaining four members by unanimous consent may name a successor.

Senator MILLIKIN. Do any members of your family draw salaries?

Mr. SCHOCK. No, sir. My wife is one of the directors, one of the members. She does not take an active part except just an active interest.

Senator MILLIKIN. The directors do not draw a salary?

Mr. SCHOCK. Not as directors. There is no salary paid as directors. All our officers but one are directors.

Our bylaws do not permit the payment of any salary to directors. We are contemplating, and will probably do it at our next board meeting, to amend our bylaws so that in the future no person can have a salary in excess of $20,000 or $25,000. We think that ought to be the limit in case we earn even as much as a half million dollars. At the present the total salaries that we paid for 1948 were less than $20,000.

Senator MILLIKIN. Is there anyone who draws a salary who also was an owner in the property at the time it was conveyed to the corporation?

Mr. SCHOCK. Myself.

Senator MILLIKIN. You do not draw a salary?

Mr. SCHOCK. No; I do not draw a salary. I am the only one.

Senator MILLIKIN. No one who draws a salary participated in the sale of the property to the corporation?

Mr. SCHOCK. No, sir. I owned the property just sold. It was my idea. I created the corporation. I also created the Joy Corp. for the benefit of our schools in the Borough and home town.

As I have said, if you tax us, why it will not make any difference in what we do; we will go on just the same. But the trouble is that you will take 41 percent of our assets, according to this bill, down here to Washington which we think would very probably go to the benefit of the public school children of the State of Pennsylvania in the district where we operate.

Let me add that we are supporting public education as contrasted with private education. We are helping all the people to help them make better citizens. I have great faith in the public schools.

Senator KERR. All right, Mr. Schock, we thank you for your appearance here. Your full statement will be inserted in the record.

Mr. SCHOCK. Thank you for your courtesy.

(Mr. Schock's statement follows.)

STATEMENT OF CLARENCE SCHOCK

I am a citizen of Pennsylvania residing in the Borough of Mount Joy, Lancaster County, Pa. I am president of the SICO Co. in whose interest I am appearing before your committee.

The SICO Co. was organized as a nonprofit corporation in 1941.

The primary purpose of the SICO Co. as stated in its charter is to promote public education. All of its net earnings must go to or be used for the benefit of public schools In other words, it voluntarily taxes itself 100 percent for the benefit of public schools. Even in case of dissolution all of its net assets must go to public schools.

Its charter also authorizes it to conduct a business corporation, and it is engaged in the marketing of petroleum products. It has a deep-water terminal at Wilmington, Del., where it receives tank ships drawing as much as 32 feet of water. It distributes petroleum products from its terminal at Wilmington by tank car, barge, or transport trucks chiefly to points in Pennsylvania. The major part of its business is in Lancaster County where it has bulk stations from which it distributes by tank truck in bulk to dealers and consumers. It is able through its terminal at Wilmington to supply jobbers as well as retailers and does some business of this nature. It operates also in neighboring counties adjoining Lancaster County but its chief business has been in Lancaster County.

In accordance with the provision of its certificate of incorporation, it has distributed earnings among school districts in Lancaster County to the amount of $316,743. A statement of this distribution is attached hereto in the form of a report made to the convention of school directors of Lancaster County in March 1950.

Inasmuch as the SICO Co., voluntarily taxes itself 100 percent for benefit of public schools and inasmuch as all of its net assets in case of dissolution must go to public schools, it seems that the SICO Co., is substantially and voluntarily a part of the economic department of the public schools of the State of Pennsylvania. Whatever technical argument there may be against this claim, the fact still remains that we are working solely for the Department of Public Instruction of the State of Pennsylvania. To the best of my knowledge, SICO is the only corporation of its kind in the United States.

If Congress sees fit to tax the SICO Co., it will in effect be taxing a political division of the State of Pennsylvania, and that, we understand, is contrary to the intent of the Constitution of the United States. Whatever amount Congress sees

fit to take away from the SICO Co., will actually be taken away from a political division of the State of Pennsylvania.

It seems reasonable that a corporation such as the SICO Co., should be entitled to exemption just as completely as State and municipal authorities who furnish water, electricity and sewerage to the community are exempt from Federal taxation.

The question arises as to what degree of activity for public benefit is the equivalent of governmental activity. If such public service as water works, sewers, electric light and power works, etc., operated by municipal authorities can be deemed subdivisions of government, together with such other entities as the Port Authority of New York, why is it not logical to regard the advancement of public education exclusively conducted by a corporation to be the equivalent of a governmental activity. If a corporation such as the SICO Co. conducts an activity for public benefit, even though it be under private management, why should it not be given the same consideration as to Federal taxes, as municipal authorities such as referred to above?

Let it be remembered that the SICO Co. is operating for the benefit of public schools. There are many corporations operating for the benefit of private schools, but that is a different proposition compared to operation for the benefit of public schools. Operation for the benefit of public schools is for the benefit of all the people without cost. Operation of private schools is limited to those who are able to pay tuition and boarding expenses. Public schools are free. Anything which helps the public schools helps all of the people, just as government is intended to do.

It may be that some of the corporations which have been granted exemption under existing law have been unworthy of such exemption, but even if the present law was thoroughly enforced, such abuses could be stopped. Let us suggest that Congress could provide the revenue department with authority to compel thorough annual audit of exempt corporations at the expense of the exempt corporation by reputable accountants approved by the revenue department. The present law in granting exemption distinctly provides that "no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation;"

If the assets of any going business are sold to an exempt corporation for more than their real value, then this special provision of the law would be violated because some of the earnings would be used to pay to a previous owner more than the assets sold are worth. Excessive salaries also would be a violation of this provision. All of these could be stopped under the present law if properly enforced.

We submit herewith a proposal for amendment of H. R. 8920 which would grant complete exemption to the SICO Co. We commend this to your serious consideration.

If you fail to grant complete exemption to the SICO Co., we contend that you will in effect be taxing a political division of the State of Pennsylvania; that you will actually be taxing the State of Pennsylvania; and that we believe you will not choose to do.

We have present with us a representative of Lybrand, Ross Bros. & Montgomery and a representative of Ford, Bacon, & Davis, both of whom jointly can testify to the fact that the assets which Clarence Schock sold to the SICO Co. in December 1941 for the purchase price of 1 million dollars were actually worth more than 1½ million dollars.

We have also with us our attorney, James R. Morford, Esq., of Wilmington, Del , who has been our attorney since 1926 and knows the history of the SICO Co. and its predecessors since 1926. He can tell you the facts about the history of the SICO Co. and is willing to testify, if you so desire.

The purpose of this testimony is to show that the price paid for the assets of the company in 1941 was less than their value and that there has been no abuse of the exemption privilege. I can also say that I devote practically all my time to mangement of the affairs of the company and have received no salary or other compensation.

I repeat again that this company is unique; and that the amendment we propose would apply only where the operation of the company is for the benefit of public schools.

The SICO Co. shall be pleased to submit to the committee any information about its business which they may require.

LYBRAND, ROSS BROS. & MONTGOMERY,
Philadelphia, July 10, 1950.

Mr. CLARENCE SCHOCK,
President, The SICO Co., Mount Joy, Pa.

DEAR SIR: We have made an investigation of the bases of valuation of the assets acquired and the amounts of liabilities assumed by the SICO Co. as of December 31, 1941, as a result of its purchase agreement with Clarence Schock dated December 18, 1941, except that we did not investigate the valuation of the property, plant, and equipment.

In connection therewith we made sufficient tests by tracing realizations and by other methods to satisfy ourselves that the net assets (exclusive of property, plant, and equipment) consisting of cash, United States Government bonds, accounts receivable, and inventories at replacement values, less liabilities, are fairly stated at $526,875 as at December 31, 1941.

Very truly yours,

LYBRAND, ROSS BROS. & MONTGOMERY.

LETTER REPORT, PHYSICAL PROPERTY, THE SICO CO., MOUNT JOY, PA., AS OF DECEMBER 31, 1941

FORD, BACON & DAVIS, INC.,
New York, July 10, 1950.

The SICO Co.,
Mount Joy, Pa.

DEAR SIRS: Pursuant to your request we have made an inspection and inventory of the physical properties reported to us as owned by The SICO Co. having been acquired on December 31, 1941, from the Shock Independent Oil Co., located at Mount Joy, Lancaster, Lemoyne, Ephrata, Carlisle, Columbia, Allentown, Lebanon, Llanerch, Oxford, Philadelphia, Reading, York, Steelton, Lititz, Gap, Manheim, Quarryville, Elizabethtown, Christiana, all of the above properties being in the State of Pennsylvania together with a water front terminal located at Wilmington, Del. These properties consist of land, buildings and structures, machinery and equipment, and transportation facilities.

Our field inspection was made during the period June 6 to 17, 1950. Based upon our inspection and using material and labor prices current in the Lancaster area and Wilmington as of December 31, 1941, our estimates of cost of reproduction new and cost of reproduction new less depreciation are as follows:

Estimated cost of reproduction, as of Dec. 31, 1941

Reproduction cost new	$1, 297, 941
Reproduction cost new less depreciation	1, 007, 020

The values included in the above totals for land owned in fee are based upon appraisals by Leo I. Hain, Inc., Lancaster, Pa., and Robert E. Hickman, Wilmington, Del.

An allowance has been made in the estimated costs of material and labor to cover general overhead costs, such as organization and legal expenses, engineering and supervision, interest, taxes, and insurance during the period of construction and installation, wherever such costs normally would be incurred.

Facilities nonexistent today but existing on December 31, 1941, are included in our inventory.

Our estimate of reproduction cost new results from a detailed appraisal of the entire properties in the course of which we eliminated from consideration those facilities now existing that we ascertained had been installed subsequent to December 31, 1941.

Our depreciated reproduction cost is based on observation of the present condition and obsolescence of the various units and facilities, with suitable allowance for depreciation which has accrued since December 31, 1941.

Our inventory does not include raw materials, materials in process, stores and supplies, perishable tools, or miscellaneous items chargeable to expense.

No allowance has been made for any value attaching to good will, trade-marks, trade-names, copyrights, effect of future market conditions, advantages due to locations, efficiency resulting from arrangement in plant, going concern, or other elements of intangible property.

The foregoing estimates are not intended to represent the commercial value of the going business or the sale value of the property and business.

The terminal dock facilities included in the above totals consisting of wharf, dolphins, and steamer anchorages are located on city land, and are the property of the city of Wilmington.

The cost of construction of these facilities, however, was reported to us as paid for by the Schock Independent Oil Co. which has, through the agreement, exclusive rights to use the dock for loading and unloading petroleum and its liquid products and preferential rights to the use of the dock at all times.

The agreement, referred to above, also provides for a right-of-way for pipe lines of the company to the wharf over land owned by the city of Wilmington.

Very truly yours,

FORD, BACAON & DAVIS, INC.

Senator KERR. Mr. Robert Cutler.

STATEMENT OF ROBERT CUTLER IN BEHALF OF COMMUNITY CHESTS AND COUNCILS OF AMERICA, INC., UNITED COMMUNITY SERVICES OF METROPOLITAN BOSTON, HOSPITAL COUNCIL OF METROPOLITAN BOSTON, AND PETER BENT BRIGHAM HOSPITAL (BOSTON)

Mr. CUTLER. My name is Robert Cutler, of Boston. I am a fiduciary and lawyer. I appear here today in connection with that portion of H. R. 8920 which deals with the disallowance of charitable deductions.

I speak in behalf of the Community Chests and Councils of America, Inc., of which I was formerly national president. That is an organization of some 1,200 community chests and councils in this country.

I also speak in behalf of the United Community Services of metropolitan Boston, which is one of the largest community funds in the country; in behalf of the Hospital Council of Metropolitan Boston, from which I have just retired as president; and in behalf of the Peter Bent Brigham Hospital, one of the great teaching nonprofit hospitals in Boston, of which I am now president.

I have devoted a great deal of my time in the last 20 years to philanthropic causes as a volunteer like many other American citizens.

I only mention these titles that I have held and positions that I have held so that you may see that I am qualified to speak on this subject. I have filed a brief in 80 copies with the committee and therefore I can speak very shortly on this subject. I shall attempt to do so. I hope you will forgive me if I speak in general terms because the details are all set forth in the brief.

For want of a better term, the agencies I am going to refer to I shall call Community Chest agencies, for I think you gentlemen are well aware of the type of agency to which I refer, the nonprofit hospitals, visiting nurse associations, family welfare societies, boys' clubs, YMCA's and YWCA's, some 200,000 volunteer nonprofit organizations scattered throughout our country which derive annually some assistance from Community Chests and funds to which Community Chests and funds over 8,000,000 citizens contribute every year.

No one has ever suggested that these organizations were other than tax-empt. No one had ever suggested that gifts to these organizations should not be charitable deductions in computing the income tax of the giver until H. R. 8920 came along.

Now I believe that the language, to which I wish to call your attention in H. R. 8920, is entirely inadvertent. I do not think the spon-

sors of the bill ever intended to deprive the 8,000,000 people, who give through community funds to the support of these nonprofit hospitals and other agencies, of their charitable deductions or to make the income of any of these genuine valid charities a taxable income to those charities.

I am buttressed in this belief by the very language in the committee report which states that this type of organization will not be covered.

On the other hand, if you will carefully examine the language which has been used in section 3810, on pages 123, 124, and 125, you will see that this is the case. Gifts for charitable purposes, which have hitherto been deductible as a charitable deduction to the giver in computing his income tax, are under this section not to be allowed as charitable deductions unless the instrument under which the agency operates contains certain specific language in it, which language is set forth on page 125.

Of course, none of the instruments under which these 150,000-odd agencies in the United States operate contains this language because some of them have been in existence, like the Boston Dispensary, for over 150 years. They could not have such language in their governing instruments.

The second part of this section says on page 124 that we will exclude from the operation of this section, which would render the gift not a charitable deduction, certain classes of charitable organizations. They are listed on page 124: Fraternal societies; religious organizations; educational organizations; organizations supported by Federal or State funds.

Then at the end of (4) I call your attention to the language—

> an organization which is * * * primarily supported by contributions of the general public.

Category (5) is an organization operated, supervised, controlled, or principally supported by a religious organization.

So that if you take the ordinary non-profit hospital, such as my great hospital in Boston which has operated for 25 years at a great deficit, unless it changes its charter so as to include these provisions or unless it fit into these excluding languages, a gift to my hospital—and I use that merely as an example of all the other agencies—would not be a charitable deduction to the donor, the income of the hospital would be taxable, and the hospital could not accumulate any income, as we do from time to time to tide us through a tougher year than ordinary.

Now the reason that we do not fit, and most of the community fund agencies in the United States do not fit, under the language which is used in subsection (4) on page 124, "an organization primarily supported by contributions of the general public," is that Boston is one of the great medical centers in the world. We have 36 hospitals operating in that small area. We are an old community. Through the years we have received endowments. In 1949 the income from endowments for these nonprofit hospitals was 8.5 percent of their aggregate gross income. A further 78.7 percent of their aggregate gross income came from patients, paying all or some part of the cost of care, or who were insured in Blue Cross or some other insurance. Only 5.2 percent was received by these hospitals in the aggregate,

some $900,000, from the local community fund. So you see those hospitals were not primarily supported by contributions of the general public.

If you look at the other 300 agencies in the United Community Services of Metropolitan Boston, you will find because they have smaller endowments they derived 42.6 percent of their aggregate gross income in 1949 from community fund contributions but they would not be primarily supported by the general public either.

Now I have checked through the national headquarters and find a similar situation exists in other parts of the United States. We had a survey made of 29 urban areas scattered throughout the United States, in every section of the country, so as to make it a perfect cross section, and here are the percentages of support received by important categories of nonprofit Community Chest agencies from contributions made to the local chests and funds.

The groups of nonprofit hospitals in-patient care, 4.1 percent; nonprofit hospitals clinic and out-patient care, 32.7 percent; YMCA's, YWCA's, and other like building-centered programs, 41.1 percent; established summer camps, 27.9 percent; specialized services for the handicapped, 12.2 percent.

Therefore, my point is that the language put in to exclude the typical Community Chest and community fund agency that is primarily supported by contributions of the general public does not exclude those agencies because they do not receive, except in some instances of course—but not in the important categories I have mentioned—their primary support from the general public.

Senator MILLIKIN. Mr. Chairman, I would like to ask Mr. Kirby whether it was intended to exclude organizations of the type described by Mr. Cutler here.

Mr. KIRBY. Senator Millikin, I feel that from Mr. Cutler's description of them they are the type of public charity that I would think should be exempt. I think we had that feeling in working out the language with the Ways and Means Committee.

Now I think it has been very helpful to us to hear this statement and I think we will want to improve this language to make sure that these organizations are exempt.

Senator MILLIKIN. I should think so. Mr. Cutler has presented an irrefutable case for exemption of the type of institution about which he is talking.

Mr. KIRBY. Yes, Senator Millikin, we will want to study this very carefully.

Senator MILLIKIN. Thank you.

Mr. CUTLER. I quoted in my brief, Senator, a sentence from page 42 of the House committee's report which states:

> Gifts made to other exempt organizations such as universities, religious organizations, community chests, and other public organizations would not be subject to these restrictions.

But the language which has been used is so broad and not strictly accurate that it does not actually exclude them. As I say, it is in my opinion entirely through inadvertence.

Senator TAFT. I do not find any distinction between organizations that are wholly exempt and those that have to conform with (b) and (c) sections. What kind of corporation is that? What is the difference between a hospital that pays salaries to people who had something

to do with setting it up and any other institution that does it? What is the difference? Why exempt some altogether and not others? Why have this instrument thing anyway? Why not just have a provision that is they do that, they are not deductible?

Mr. CUTLER. That would be perfectly satisfactory.

Senator TAFT. You are drawing a distinction between two different types of charitable organizations.

Mr. KIRBY. That is right. On the one hand we wanted to exclude the public charities, the ones that are operated not for the benefit of any particular donor or contributor, and that is exactly the type of charity that——

Senator KERR. What is the difference whether 100 people support it or one person supports it?

Mr. KIRBY. I think you will want to look more carefully into those organizations that are set up by a single individual to see that the charitable purposes are really carried out and the funds are not merely, say, accumulated until a much later date for the use of those funds.

Senator TAFT. Take (c) Gifts of stock:

> No gift or bequest consisting of stock in a corporation shall be considered a deductible gift or bequest for purposes of subsection (a) if the contributor of such stock, or members of his family * * * comprise a majority of the officers, directors, or trustees of such trust or other organization.

Supposing somebody started a private school and after he gets along to 60 years old he proceeds to set up a trust and turns it over to a board of trustees; although he retains control, it becomes a charitable trust just alike any other school that has always been a not-for-profit school. Why should that gift not be exempt?

Mr. KIRBY. If they follow the provisions of this bill indicating they do not pay him unreasonable compensation for his services and they do not loan money to that contributor——

Senator TAFT. That is under (b), but is this under (c), too?

Mr. KIRBY. I would like to say with respect to (c) that that is a provision that is directed at a regular business corporation, part of the stock of which may be turned over to a charity which is controlled by the person who owns the balance of the stock. In that way he may eliminate from his gross estate a large part of this business organization. Yet he will control the entire business organization through his control of the family foundation, through the board of directors.

Senator TAFT. If the foundation is kept on a not-for-profit basis and does operate as a not-for-profit institution, what difference does that make?

Mr. KIRBY. He can get the full deductions by not controlling the board of directors through himself or his family.

Senator TAFT. I do not see what difference that makes if the actual operation of the institution is not for profit.

Mr. KIRBY. But it is not a full and outright gift if he controls the stock which he normally turns over to this corporation.

Senator KERR. If a man builds an estate or an estate that is capable of supporting a charity, he must be precluded from dedicating it to that purpose if he is going to have anything to do with operating the charity?

Mr. KIRBY. In other words, it is not a full and complete gift to charity if he retains some of the stock in his own hands or in the

hands of his family and retains the control of, say, the board of directors of this charitable organization.

Senator KERR. You think the quality of the charity would be so soiled by the association with the one who created it that it should be taxed unless he at the same time he created it eliminated himself entirely from any operation of it?

Mr. KIRBY. He does not have to eliminate himself entirely from the operations so long as he does not have the control of the board of directors of the organization.

Senator TAFT. Let us take the SICO Corp. Supposing instead of selling it, Mr. Schock had just given the institution and set up a board of trustees and handed $1,500,000 to this board of trustees of which he and his wife are two members, he pays himself no salary. Do you not think that is a gift to charity? Is that not a deductible gift?

Mr. KIRBY. I do not know whether he retained the control of the board of directors. If he retained control of the board of directors, he has not fully parted with that enterprise.

Senator KERR. It is fixed so that he does not get any money from it.

Mr. KIRBY. But that is not the only use which he can make of that enterprise.

Senator KERR. Suppose that it was unsoiled by any control of his but suppose it was set up before this law was passed and the provisions set forth in this act were not in the bylaws?

Mr. KIRBY. Speaking of section (c), it does not apply with respect to any past transfers, nor do you have to amend your charter to put in these requirements shown on page 125. That is a different type of case, as pointed out by Senator Taft.

Senator KERR. I understand, but I was getting back to (b).

Mr. KIRBY. Yes. If a person sets up a charitable organization and does not forbid the transactions between that charity and the contributor of the funds, then there is really a serious question as to whether this is a true charity.

It should be noted that this section does not apply until the middle of next year, 1951, so there will be an opportunity to be aware of these provisions.

Senator KERR. It does not apply to gifts but it does apply to trusts set up before that.

Mr. KIRBY. It gives them an opportunity to so arrange their charity.

Senator KERR. Suppose it is set up by somebody who then died?

Senator MILLIKIN. I do not know of anything more difficult to accomplish than changing the terms of a trust. I do not know of anything more difficult to accomplish, especially if you have minors in it. As Senator Kerr suggested, if you have dead people who at one time had a live interest in it, how are you going to proceed to change a trust of that kind?

Mr. CUTLER. There is one thing more difficult than that. A great percentage of the Community Chest agencies such as my hospital are incorporated under a State statute and have been incorporated for scores of years under a State statute. Can I get the legislatures of the 48 States to change the charters of all the community fund agencies in order to include this language? They will say, "Certainly not, we will not clutter up our files with any such thing as that."

Mr. KIRBY. Bearing in mind that the organizations that Mr. Cutler, is pointing out will be excluded specifically, and it was intended that

they be excluded under this bill, we should not bring those into this section to affect the type of organization that is in this abuse area.

Mr. CUTLER. I have suggested in my brief some specific language for amending the excluding section, to add to this subparagraph (b) on page 124 language to the effect that where it is supported in whole or in part by the Community Chest or Community Foundation, as described in section 101 (6), the agency was not intended to be treated in this way. Of course it has to go in three places, in the section dealing with the charitable deduction by the generous-minded donor, in the section dealing with taxation of the income of the agency, and in the section which deals with the accumulation of the income. I have referred to all those.

Mr. KIRBY. What has been raised really is a technical drafting point which we certainly will want to carry out.

Senator TAFT. I think of a case, and it is a family case, of my Uncle Horace Taft who built up a school and had it all his life. When he got to be over 60 he turned it over to a board of trustees, deeded it all. I think he went on as headmaster for 5 years and drew a salary during that time, but that was all the property he had. When he gave it to the school that was all the property he had. He had no children. So he established a school, which is still run today by a board of trustees, but for 5 years or so he was getting a salary as headmaster. I think there was some arrangement to pay his retirement salary during the rest of his life, also. What happens in a case like that?

Mr. KIRBY. I do not think he drew an unreasonable salary. It is not the type of thing that would be affected by this provision at all.

Senator TAFT. Yes, but neither would the situation fall under this complete exemption. It would then have to meet this business about setting up a special instrument and trust to do a lot of things, and he could not serve at all, or he and his friends could not serve as a board of trustees. I think he was only one of some eight or nine trustees.

Mr. KIRBY. He would not have control of that school.

Senator TAFT. He had practical control.

Mr. CUTLER. Thank you very much, Mr. Chairman.

Senator KERR. Thank you, Mr. Cutler. Your complete statement will be placed in the record.

(The statement referred to follows:)

STATEMENT BY ROBERT CUTLER, BOSTON, MASS., IN RE H. R. 8920 IN BEHALF OF COMMUNITY CHESTS AND COUNCILS OF AMERICA, INC., UNITED COMMUNITY SERVICES OF METROPOLITAN BOSTON, HOSPITAL COUNCIL OF METROPOLITAN BOSTON, PETER BENT BRIGHAM HOSPITAL (BOSTON)

GENERAL

1. This statement is addressed principally to certain sections of part III of title III of H. R. 8920, relating to the disallowance of deductions now permitted for certain gifts and bequests for charitable purposes.

2. The purpose of part III is disclosed in the report of the House Committee on Ways and Means, Report No. 2319 to accompany H. R. 8920, pages 42–43, and 129 and following. (See also p. 107 and following.) That purpose, as there stated, is to check abuses under which "the donors of trusts and foundations either have derived, or at least have had the opportunity to derive, substantial benefits from their dealings with trusts and foundations."

3. This statement offers no objection at all to the avowed purpose of the bill or to the proposed provisions of the bill insofar as their effect is solely to check such abuses.

4. The purpose of this statement is to point out that certain of the language used to accomplish this objective would seriously cripple and perhaps force the

closing of thousands of genuine nonprofit charitable organizations which have been in existence for scores of years and the worthy charitable purposes of which have never been questioned (such as nonprofit hospitals, visiting nurse associations, family welfare societies, boys' clubs, YMCA's and YWCA's, and other like nonprofit charitable enterprises). These genuine, nonprofit charitable agencies derive financial assistance from America's 1,200 community chests and funds, to which over 8,000,000 citizens in the United States annually contribute, and from direct gifts and bequests by charitably minded American citizens.

5. A careful reading of the committee report makes clear that it was not the intention of the bill's sponsors in the House to cripple or force the closing of any such genuine charitable organizations. "Gifts made to other exempt organizations such as universities, religious organizations, community chests and other public organizations would not be subject to these restrictions" (p. 42). It must be assumed, therefore, that the language as to which question is here raised was used inadvertently, and that amendments which will avoid the unfortunate results described herein will be welcomed and supported.

SECTION 331

6. Subsection (a) of section 331 of the bill amends chapter 38 of the Internal Revenue Code, adding a new section to be numbered section 3810, entitled "Disallowance of Certain Charitable etc. Deductions."

7. Hitherto gifts and bequests to nonprofit hospitals and other "community chest or fund agencies" of the type described in paragraph 4 above have been consistently allowed to the donors or to the testator's estates as charitable deductions.

8. Section 3810 (a) provides, however, that no gift or bequest for religious, charitable, scientific, literary, or educational purposes, otherwise allowable as a charitable deduction under the appropriate income-, estate-, and gift-tax provisions of the Internal Revenue Code, is to be allowed as a charitable deduction unless—

"(1) The instrument under which the * * * organization is administered provides that—

"(*a*) No part of the income or corpus of such * * * organization may be loaned to;

"(*b*) No compensation, other than a reasonable allowance for salaries or other compensation for personal services actually rendered, may be paid by the * * * organization to;

"(*c*) No part of the services of the * * * organization may be made available on a preferential basis to;

"(*d*) No substantial purchase of securities or any other property may be made by such * * * organization from; and

"(*e*) No substantial part of the securities or other property of the * * * organization may be sold to;

a person who has made a substantial contribution to, or any officer, director, or trustee of, such * * * organization; or any member of the family * * * of any such person; or a corporation controlled by any such person through the ownership, directly or indirectly, of 50 per centum or more of the total combined voting power of all classes of stock entitled to vote * * *; and

"(2) Such instrument provides that no part of the income or corpus of such * * * organization may be paid to any trust or organization to which a gift or bequest would not be a deductible gift or bequest under this subsection. * * *."

9. The same subsection (3810 (a)) provides that the term "gift or bequest" shall not include a gift or bequest made to—

"(1) A fraternal society, order, or association;

"(2) A religious organization;

"(3) An educational organization which normally maintains a regular faculty and curriculum and normally has a regularly organized body of pupils and students in attendance at the place where its educational activities are regularly carried on;

"(4) An organization which is supported, in whole or in part, by funds contributed by the United States or any State or political subdivision thereof, or is primarily supported by contributions of the general public; or

"(5) An organization operated, supervised, controlled, or principally supported by a religious organization (other than a trust) exempt from taxation under section 101 (6)."

DISCUSSION

10. It is obvious that none of the many thousand nonprofit hospitals and other "community chest or fund agencies" in America referred to in paragraph 4 above contain in the "instruments" under which they are "administered" any such provisions as are set forth in the bill (quoted in par. 8 above).

Therefore, gifts or bequests made to such nonprofit hospitals and other "community chest or fund agencies" would no longer qualify as "charitable deductions," unless the hospitals and other agencies fall within the definition of one of the five types of organization exempted from the operation of section 3810 (a) by the language used in defining "gift or bequest" (see par. 9 above), or unless they can amend the basic "instruments" under which they are "administered" so as to bring themselves in line with the requirements of section 3810 (b).

11. Two questions arise:

(*a*) Are the nonprofit hospitals and other "community chest or fund agencies" referred to above covered by the language which exempts from the operation of section 3810 gifts or bequests to certain organizations specifically excluded (see par. 9 above)?

(1) The only language apt so to exclude such organizations from the impact of this proposed provision is found in subsection 3810 (a) (4): "an organization which * * * is primarily supported by contributions of the general public."

(2) This language appears inadequate to exclude the above-mentioned hospitals and other "community chest or fund agencies" from the prejudicial operation of the proposed provision.

(3) Take, for example, the nonprofit hospitals which annually receive financial support from the annual community fund campaign of United Community Services of metropolitan Boston. Boston is one of the great centers of America for medical care, teaching, and research. These nonprofit hospitals are not "primarily supported by contributions of the general public." Because Boston is an ancient community, many of its hospitals have endowments given by charitably minded citizens during many years. In 1949, income from such endowments provided to such hospitals 8.5 percent of their aggregate gross income. A further 78.7 percent of their aggregate gross income came from patients, paying all or some part of the cost of care, or from Blue Cross or other like insurance sources. Only 5.2 percent (about $900,000) of the aggregate gross income of Greater Boston's red feather nonprofit hospitals was contributed by the general public through the annual community fund campaign. And even after this assistance from the general public the Greater Boston red feather nonprofit hospitals in 1949 operated at an aggregate net deficit (before any allowance for depreciation) of approximately $346,000, which had to be met by liquidation of endowment funds.

(4) The other 300 red feather charitable agencies participating in Greater Boston's annual community fund campaign received—because of smaller endowments and much less costly services—42.6 percent of their aggregate gross income in 1949 from contributions by the general public through the annual community fund campaign. Thus, in the aggregate, these great health, social, and welfare nonprofit agencies did not derive "primary support" from contributions of the general public.

(5) A similar situation will be found to exist, in the hundreds of other American communities with community chest or funds, as to many important categories of nonprofit charitable agencies. A survey recently conducted in 29 urban areas throughout the United States showed the following percentages of support derived by important categories of "community chest or fund agencies" from contributions by the general public to such chests and funds: nonprofit hospitals inpatient care—4.1 percent; nonprofit hospitals clinic and out-patient care—32.7 percent; YMCA's, YWCA's, and other like building-centered programs—41.1 percent; established summer camps—27.9 percent; specialized services for the handicapped—12.2 percent. In certain other categories of charitable agencies, major support was derived from public contributions to a community chest or fund.

(6) The manifestly unfair, prejudicial, and unintended result of the proposed language in the excluding clause referred to (subsec. 3810 (a) (4))—see paragraph 9 above—can be readily remedied by either one of the following two amendments:

Revise section 3810 (a) (4), section 424 (a) (1) (c), and section 301 (c) (C) to read as follows:

Alternate A

"An organization supported, in whole or in part, by funds contributed by the United States or any State or political subdivision thereof, or by con-

tributions of the general public, or by any community chest, fund, or foundation of the character referred to in section 101 (6); or * * * ."

Alternate B

"An organization supported, in whole or in part, by funds contributed by the United States or any State or political subdivision thereof, or which receives substantial support from contributions of the general public, or which receives support from any community chest, fund, or foundation of the character referred to in section 101 (6); or * * * ."

(B) What is the meaning of the language used in subsection 3810 (b) (1): "the instrument under which the * * * other organization is administered * * * "? An exact understanding is required of this general term as it would apply to the usual form of "community chest or fund agency" (association or corporation), of which there are many thousand in the United States.

(1) If nonprofit hospitals and other "community chest or fund agencies," throughout America, do not receive their "primary support" from contributions of the general public, and accordingly would be required under the bill to amend their governing instrument in order to validate their obviously unassailable charitable status, what is the nature of "instrument" which must be so amended?

(2) Many such nonprofit charitable agencies are incorporated by legislative act. It is open at least to reasonable doubt whether prior to June 1, 1951, the effective date of this section, it would be possible for them to obtain from the 48 State legislatures passage of the necessary amendatory acts to their respective statutory charters to validate their obviously unassailable charitable status.

(3) The manifestly unfair, prejudicial, and unintended result of the proposed language in subsection 3810 (b) (1)—see paragraph 8 above—can be readily remedied by the following amendment:

Revise section 3810 (b) (1) to read as follows:

"The instrument under which the trust is administered or the charter or certificate or articles of incorporation or constitution or bylaws of any other organization, provides that * * *."

(4) Such a revision would make it possible for an association or corporation to comply with the requirements of section 3810 (b) (1) by amendments which it (or its members or governing board) may make in one or another of the basic documents governing its administration and operations.

CONCLUSION

12. The language in the bill which has been discussed above presents a situation which is intolerable in a country like the United States, which has long been distinguished by the genuine charitable impulses of its citizens and which has drawn so much spiritual strength and liberty from the encouragement and nourishment of such genuine charitable impulses.

The changes in H. R. 3810 proposed above in this statement will appropriately correct this situation, without in any way infringing on the objective sought by the bill's sponsors.

Senator KERR. Mr. Charles F. Brown.

STATEMENT OF CHARLES F. BROWN, TRUSTEE AND LAWYER FOR UNION COLLEGE, SCHENECTADY, N. Y.

Mr. BROWN. Mr. Chairman and gentlemen of the committee, my name is Charles F. Brown. I am a trustee and lawyer for Union College, in Schenectady.

When H. R. 8920 was passed I was on my vacation and a copy of the bill was sent to me. I had no other books around so that I have not in my brief been technical and referred to lines or words. My statement which I have submitted to you has matter in it at the start which is of interest in studying the picture of taxing any part of fixed lease-back rentals, but I do not wish to burden you with that in my oral statement.

I am here because Union College was one of the first colleges to enter into a big lease-back deal. In 1945 we purchased seven depart-

ment stores from an institution called Allied Stores with borrowed money and in 1948 with similar funds we purchased the building occupied by Abraham & Straus, in Brooklyn.

There has been a great deal of newspaper notoriety about these two transactions and primarily with the idea that the Government was losing taxes as a result of the deals. I am here to make a few statements and answer questions which I think will convince you that the Federal Government did not lose taxes as a result of these two deals.

In 1944 while the war was still on, the Allied people knew that when the war was over they would have to modernize their plant and carry larger inventories. They had a multitude of stores which they leased and they owned the seven stores with a depreciated book value of about $16,000,000. Against those stores were mortgages aggregating $8,000,000.

Senator KERR. You are talking about the buildings?

Mr. BROWN. The buildings and the land. They owned the land and the buildings.

Senator KERR. But not the inventory?

Mr. BROWN. No. They owned seven stores worth about $16,000,000, subject to $8,000,000 of mortgages.

Senator KERR. You are talking about the seven store buildings?

Mr. BROWN. Yes, not the stuff on the shelves but the buildings, The other stores they rented. They had two-hundred-odd, I guess.

Senator KERR. Other buildings?

Mr. BROWN. The other buildings, excuse me, they rent.

In 1944 they started negotiating with the Prudential Life Insurance Co. and others to borrow more money to get additional funds. They found that bankers would not lend money against real estate. So they negotiated for the sale of the property. They made a bona fide attempt to sell it at approximately the book value. There was a statement made at the time of the closing that they actually took a $340,000 loss on the transaction and that was in the proxy statement which went to the stockholders who approved the deal, but when all of the work was done they discovered—I think to their satisfaction—that instead of having a loss, they had a $75,000 profit.

Now what they did was that they got $16,650,000 from this corporate subsidiary of Union and $8,000,000 of it was cash to them which went into their till. It became part of their current assets.

Senator MILLIKIN. Where did the subsidiary get the cash?

Mr. BROWN. The subsidiary got the cash by selling $12,000,000 worth of bonds to the Prudential and borrowing $4,750,000 from a bank. The college put only $25,000 into the venture in the form of 100 percent of the capital stock of the company.

Senator MILLIKIN. Was the subsidiary an authorized subsidiary of the college or was it an enterprise of friends of the college?

Mr. BROWN. A subsidiary of the college. This is not a foundation or trust situation. This is a wholly owned subsidiary under subdivision 14 to hold title to real estate.

If this deal had not occurred and Allied had continued to own this land, it could have continued to take depreciation on its property and it could have taken deductions for interest on the mortgages which were liens on the property. Those two sums in round figures amounted to $600,000.

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Now the rental for the first year was high and it starts down. The rental for the first year was $1,141,000, so right at first blush it seems that if Allied could take that deduction of $1,141,000 as opposed to $600,000, that there had been five hundred thousand dollars-and-some-odd of money which did not become taxable, it just disappeared because this corporate subsidiary was free of income taxes. But that is not the whole story.

In the first place, this subsidiary paid out in interest some $500,000,—$150,000 of it to a bank. There is no question about the bank paying taxes on what it gets in interest and profit. The subsidiary paid out the rest of it to an insurance company.

Now for the moment under the interpretations of the revenue regulations insurance companies do not pay substantial taxes based on income, but the fact is that the whole situation would be the same if Prudential sold the bonds to individuals and they are negotiable bonds. If Prudential sold the bonds to private investors who bought them for the income—and incidentally they could sell them above par, I think, because of the high-grade security they are——

Senator TAFT. How did you get $4,000,000 from a bank?

Mr. BROWN. You mean, why did they lend it to us?

Senator TAFT. Yes; for the purchase of the property.

Mr. BROWN. They were very glad to do that because of the stipulated rentals guaranteeing the payment of the loan with interest.

Senator TAFT. You mean they were loaning you on the credit of the Allied Stores?

Mr. BROWN. Of course.

Senator KERR. And on the fact that all of your income which you did not pay out for interest was available to pay them in repayment of the loan.

Mr. BROWN. No; I do not think that is the complete answer to that.

Senator KERR. That is the only way they had of getting their money back.

Senator TAFT. Anybody paying interest would deduct it from his gross income, so it does not make any difference.

Mr. BROWN. Interest is always deductible for tax purposes.

Senator KERR. But I understand what is left after interest is not deductible for tax purposes and that is the fund out of which you were to repay the loan and that is why you made a loan that the bank would accept.

Mr. BROWN. That is right.

I am here to prove that the Government did not lose any taxes in spite of this fact, for this reason: The $8,000,000 of quick cash that went into the drawer of Allied became part of its current working capital. Since that date that company has earned on that type of capital an average of over 30 percent. The profits have been bigger. They never could have done this type of business without cleaning up their balance sheet.

Senator KERR. But the income to the Government from taxes on that is still dependent on whether or not the company makes a profit.

Mr. BROWN. Of course, but the proof is that they have done it.

Senator KERR. The record that they have done it for the past 4 years constitutes but little assurance or guaranty that it will continue to do so in future years.

Mr. BROWN. I think, sir, if you will look at this form of Allied's statement which they send out to their stockholders, and this is for a 10-year period, you will see that even in wartime there were substantial profits made by this company.

Senator KERR. I think if you look at any business you will find even in wartime there were substantial profits that might not have been made prior thereto and which we have no assurance will be there subsequently.

Mr. BROWN. I cannot prove that you are wrong and you cannot prove that I am wrong.

Senator KERR. I am not trying to. I thought you were here to prove that you are right.

Mr. BROWN. I am here to prove that so far the Government has lost not 1 penny of taxes.

Senator KERR. Thus far.

Mr. BROWN. Yes, sir.

Senator KERR. I see.

Senator TAFT. Let me get a picture of this thing. You have $1,141,000 in rent and you pay out how much interest?

Mr. BROWN. It varies because we are amortizing the debt. If you will look at the schedule, sir, it will give you the complete picture. It is the exhibit which unfolds.

I would like to have you disregard the first line because we closed title in the middle of the year and that is confusing, with 6 or 8 months. But look at the second line. On February 1, 1946, there was this figure of $1,141,000 of rent paid. Across the line are the various payments, for interest, amortization, and so forth. Now there is a column called Expense and reserve. That is the little net which is paid directly to the subsidiary after the assignee of the rent has paid these various expenses.

Senator KERR. That was left after $600,000 was paid on your loan?

Mr. BROWN. Of course. Now I did not say that this company paid taxes. I said that you look at the entire picture and you either have to look at it as a result of the sale or Allied keeping the property. I claim that so far at least there has been no losses in taxes.

Senator TAFT. How much does the university get out of this net?

Mr. BROWN. The university gets very little out of it now because the college pays taxes at the local level. We are qualified in five States.

Senator TAFT. Who? The subsidiary corporation?

Mr. BROWN. Yes. There are seven stores in five States. We pay around $4,000 a year to the State of Texas. We pay larger sums to other States and smaller sums to other States.

Senator TAFT. For what purpose? Business tax?

Mr. BROWN. Business tax.

Senator KERR. No real-estate taxes?

Mr. BROWN. No real-estate taxes.

Senator TAFT. I assume the Allied Stores pay real-estate taxes?

Mr. BROWN. All real-estate taxes, all insurance, repairs.

Senator KERR. Are there any real-estate taxes on these incomes?

Mr. BROWN. Every State gets full real-estate taxes.

Senator TAFT. The corporation pays taxes; you do not run the stores?

Mr. BROWN. No.

Senator TAFT. This is not like the operation of a business.

Mr. BROWN. This is quite different and that is the reason that I wanted to appear here because I did not want this situation to be confused with the operation of a noodle factory.

Senator TAFT. Does this corporation have a net income? It must. I suppose it pays these amortization payments out of net income?

Mr. BROWN. It does not; the assignee, the rent does, sir. We do not physically handle the money. At the closing of the title the rents for the period of the bond issue were assigned to a corporate fiduciary. The corporate fiduciary makes these various payments and then the amounts in the column called "Expense and reserve" are available for the college and for the brokers for their commissions for handling the transaction on which of course they pay income taxes when they get the money.

Now it so happens that we underestimated the amount of State taxes which this corporate subsidiary would have to pay. So, over a period of 20 years, we estimate that we are going, the college is going to pay $300,000 approximately over and above what they collect for State taxes.

Senator MILLIKIN. Did anyone make an appraisal of these stores?

Mr. BROWN. Yes, sir. This property was appraised in 1944 by the Prudential Life Insurance for $24,000,000.

Senator MILLIKIN. How much did you pay for it?

Mr. BROWN. $16,750,000.

Senator MILLIKIN. So you made an advantageous purchase?

Mr. BROWN. Yes. Instead of paying a high price, which is indicated when people say they take advantage of their tax exemption, we paid a low price.

Senator MILLIKIN. That would give the opportunity to adjust the rental scale, also.

Mr. BROWN. That is true.

Senator MILLIKIN. Did anybody appraise the value of rentals?

Mr. BROWN. No; not that I know of.

Senator TAFT. What is the advantage of the college doing it if you are not going to get any income to speak of? I am a trustee of Yale University and I would not think of going into such a transaction. I would not conceive of it. I would not for a moment, as trustee, authorize the college to get into such an enterprise of this kind. I do not understand the action of the trustees. There is no immediate income practically, is there?

Mr. BROWN. The reason for going into the deal was that we were posed with tremendous expenses in the future and we needed additional income. We are a poor college.

Senator TAFT. At Yale we have a deficit of $1,000,000 this year, so we need it, too.

Mr. BROWN. We did not; we operated in the black.

Senator KERR. And with this kind of judgment you will continue to do that.

Mr. BROWN. I think so.

Senator TAFT. I think you have one of the poorest cases I have ever heard for the principle of the thing. I can see how a man could go in and actually invest money and see where he is going to get a 10-percent return, a college putting money in and getting a 10-percent return, but to go in on a shoestring and not get a cent and go to all this trouble to build something for the future seems to be extraordinary.

Mr. BROWN. As a matter of fact, in our other deal we did put in money. The proposed legislation, sir, is going to hurt the poor college which cannot take advantage of the law as it is proposed and will not hurt a college like yours.

Senator TAFT. I can see a much better argument against the provision of the bill where a college goes in and buys property subject to a mortgage of 50 percent and puts the money into the other 50 percent. This is where you really invest money where you hope to get more. I can see some reason against the bill on that kind of case but I do not quite see it to take this tax-exemption privilege and make it thereby worth while for a college to go out and engage in vast financial transactions on a shoestring. It seems to me that is rather extraordinary.

Senator KERR. In your case, Senator, you would be risking your initial investment. In this case the initial investment was $25,000 and the estimate was that it would pay $15,000 a year for 20 years at which time they would own outright a $20,000,000 to $25,000,000 business.

Mr. BROWN. We estimate frankly that at the end of the 30 years we will get an income the equivalent of $5,000,000.

Senator MILLIKIN. It will be your property?

Mr. BROWN. Yes, sir.

Senator MILLIKIN. What did you have to trade on except your tax exemption?

Senator KERR. Twenty-five thousand dollars.

Mr. BROWN. No; I beg your pardon. It is a little bit different than that. It is a question but it really is not a fair question for this reason: There are two ends to every stick. Allied had to sell to get money to carry on its business and it wanted to continue to use these very stores. Jordan Marsh was a valuable place. They could not go somewhere across the street. There was no competitive market. The only place they could sell was to an insurance company or to a tax-exempt institution.

Senator KERR. Or another tax-exempt corporation.

Mr. BROWN. That is right.

Senator KERR. And no one but a tax-exempt corporation could make this transaction and have any hope either of paying it off or having anything when they paid it out.

Mr. BROWN. That is of course a question of the result of your general income-tax laws. We have gotten almost to the point of Carnegie's motto that, "A man who dies rich dies disgraced."

Senator KERR. That is another question and about which there is still some slight difference of opinion.

Mr. BROWN. Yes; I would hope so.

(The prepared statement follows:)

MEMORANDUM SUBMITTED BY UNION COLLEGE IN OPPOSITION TO THE PROPOSED LEGISLATION WHICH WOULD REMOVE THE EXEMPT STATUS UNDER SECTION 101 (14) OF WHOLLY OWNED CORPORATE SUBSIDIARIES OF EDUCATIONAL INSTITUTIONS AND TAX ANY PORTION OF THE NET INCOME RECEIVED BY SUCH EXEMPT CORPORATIONS FROM LEASE-BACK RENTALS

FOREWORD

This memorandum is limited to the narrow question stated above and is not intended as an argument for or against any proposed changes to section 162 (a) which now permits trusts and estates an unlimited charitable deduction for gross income used, paid or put permanently aside for charitable purposes; or to any proposed changes which would eliminate exemption where an exempt corporation,

through a foundation or a wholly owned subsidiary, buys a commercial enterprise and pays for it with the tax-exempt earnings of the property which has been taken over.

Union College, through a tax-exempt subsidiary, has owned title since 1945 to seven dry goods stores acquired from Allied Stores, Inc., and, through another similar subsidiary, has owned title since 1947 to another dry goods store occupied by Abraham & Straus in Brooklyn. The purchase prices of those stores are being paid for by lease-back rentals. It is the purpose of this memorandum to prove: (1) That no substantial losses of taxes to the Federal Government resulted from either of the transactions; (2) that no substantial income taxes can be collected by the Federal Government through the proposed legislation; and (3) that the only effect of such legislation will be to "wipe out the equity" which the college has in the properties.

SOME PERTINENT FACTS ABOUT UNION COLLEGE

Union College was organized in 1795, and was the first nonsectarian college in the United States. It has always been known as a "small college" (its prewar enrollment was about 900 and after the present GI's graduate its total enrollment will be about 1,000). For over a century the college has not accepted any grants from any governmental agency—local, State, or Federal—and for the last 48 years has "lived within its income," i. e., payments by or for students, income from endowment funds and occasional gifts for current expenses.

Union College is a balanced institution: 40 percent of the freshmen accepted enroll for engineering; 20 percent as "premedics;" and 40 percent for liberal arts degrees.

Union College has been known for years as "a college where poor boys can get a good education at little cost." The tuition for the year beginning in September 1950 will be the same as that charged in recent prior years—$500. No other college in the eastern United States which is free from governmental or church subsidies has such a low tuition. Although it costs more to educate an engineer than a liberal arts student, the average annual cost for educating each student at Union for the year ended June 30, 1949, was $825 per student and for the year just ended about $875 per student. More than 10 percent of the boys at Union College receive financial aid from endowed scholarships and student aid funds; and most of those boys obtain their college education without financial assistance from their families or friends.

Although Union College has been strictly nonsectarian since its formation, the records show that up to 1920, of the average enrollment, more than 90 percent of Union boys were Protestants. It is not surprising, therefore, that so far as endowment funds can be traced, a study indicates that more than 90 percent of the aggregate gifts which are now in the endowment fund came from Protestant donors.

No questions are asked from an applicant concerning his religion when he applies for admission to the college, but the college authorities soon learn a boy's faith after the college opens, because boys who are not Protestants properly ask to be excused from attending chapel on Sunday. Consequently, the college authorities learn the religion of all who are enrolled. For the past 10 years more than 40 percent of the students at Union College have been Catholics and Jews. These boys are most welcome, and we cite the fact merely to prove that Union is strictly nonsectarian in every sense of the word.

Union College operates on a cash receipts and disbursements basis. In the fiscal year ended June 30, 1949, expenditures in round figures amounted to $1,779,000, and income from all sourses amounted to $1,783,000. Tentative closing figures for the year ended June 30, 1950, show that cash receipts exceeded cash disbursements by about $10,000. These figures include no charges for depreciation. The budget for the year which will end June 30, 1951, has been balanced, at least "on paper," but no provision has as yet been made for any general increase in salaries to the teaching staff. The trustees are hopeful that gifts for current expenses in the coming year will make it possible to grant raises which will at least keep pace with the ever-increasing cost of living.

Frank Bailey, the treasurer of the college since 1902, has worked miracles in the investment of endowment funds. In the fiscal year ended June 30, 1949, he reported the collection of cash income equivalent to 6.1 percent on the book value of investments held at the end of the year; and in the fiscal year just ended earnings will be on a comparable basis. The trustees admit that they know of no one who will equal Mr. Bailey's performance when his services are no longer available to the college.

Faced with rising costs of operation and the probability of diminishing returns from endowment income, the trustees of the college in early 1945 embarked upon a venture which offered no appreciable immediate net income, but which would provide a large income for the college in future years. This venture involved the formation of "Union's Real Estate Corp.," a wholly owned corporate subsidiary (hereafter referred to as the "subsidiary") which was exempt from Federal income taxes under section 101 (14); the purchase by the subsidiary, with borrowed funds, of the fee to seven stores located in five different States, from Allied Stores, Inc., and its subsidiaries (hereafter generally referred to as "Allied"); and the leasing of the stores to the former owners for a period of 30 years with an option to the tenants to renew the leases for one additional 30-year term. No salaries are paid by this or the other subsidiary to any director or officer.

WHY THE ALLIED DEAL WAS MADE

The viewpoint of Allied Stores, Inc.

In 1944 Allied owned the seven stores which had a depreciated book value of about $16,000,000, subject to mortgages aggregating $8,000,000. The properties were "proved locations" which Allied wanted to occupy in the future. The Allied directors knew that at the end of the war they would need large sums of money to modernize the buildings (scarcity of labor and materials during the war has prevented such work) and they also estimated that additional "cash working capital" would be needed to pay for the larger inventories which would have to be carried after the war. In 1944 bankers did not regard store buildings as good security for bank loans and at the same time they regarded mortgage debts as actual obligations. Accordingly, Allied decided "to clean up its balance sheet" by eliminating these two factors. The only way it could get rid of the debt and continue to occupy the properties was by the sale of the properties under a lease-back arrangement.

In 1944 negotiations were begun by Allied with Prudential Life Insurance Co. and others for the placing of a larger mortgage on the properties and for their sale in January 1945, prior to the end of the Allied fiscal year on January 31, 1945. At that time Prudential appraised the seven properties at an aggregate of about $24,000,000 but Prudential did not have the legislative authority in 1944 to buy real estate. It could then only lend money secured by a mortgage or buy bonds. If the Prudential had had the power to own real estate in 1944, probably Union would never have had a chance to enter the picture.

In January 1945 it was orally agreed between the parties that the seven parcels would be sold for $16,650,000 and that the subsidiary would obtain $12,000,000 from Prudential by selling it a bond issue for that amount and would obtain the balance of the purchase price and the expenses of the sale by a bank loan from Guaranty Trust Co. The college paid $25,000 cash for 100 percent of the capital stock of the subsidiary. Although the minds of the parties met in January 1545, the deal was so complex that the closing of title did not occur until June 1, 1945.

The college viewpoint

Annexed hereto and marked "exhibit A" is a schedule of the annual rents which will be paid by Allied and how they will be spent. For the first full year they are $1,141,000 and they are gradually reduced until the thirtieth year when they are $562,000.

At the closing of the title on June 1, 1945, the total rents to be received until 1965 were assigned by the subsidiary to a corporate fiduciary as security for the repayment of the cash borrowed and interest thereon; and the only moneys which will be received by the subsidiary until 1965, when the bond issue now owned by Prudential matures, will be the amounts set forth in the column entitled "Expense and Reserve." The latter sums are available for the subsidiary and the brokers who consummated the sale. Out of the moneys paid to the subsidiary, all its State corporate income, capital stock, and franchise taxes which now amount to upwards of $8,000 a year must be paid. It is estimated that the subsidiary will pay taxes at the State level exceeding $300,000 during the first 30-year period.

When the bond issue matures in 1965 there will be an unpaid balance of principal in the amount of $4,000,000 due, which presumably can be refinanced, because in 1944 the seven properties were appraised by the Prudential in the amount of $24,000,000 and presumably in 1965 they will be worth much more than $4,000,000.

At the end of 30 years the subsidiary will own the properties free of all liens. If the tenants exercise their options to renew the leases for an additional 30-year term (a most likely event), they will pay to the subsidary annual net rents aggre-

gating $240,000 or 2 percent of the appraised value of the land, whichever is the greater. That will mean income to the college equivalent to 5 percent on about $5,000,000.

Some practical results of the transaction

After the elimination of the $8,000,000 mortgage debt and the substitution of $8,000,000 cash for its equity in the real estate, Allied was able to change its $21,000,000 of 5 percent preferred stock to $20,000,000 4 percent preferred, and to borrow substantial additional sums from banks. In 1948 Allied borrowed $25,000,000 at 3⅛ percent on its unsecured notes. Thus it obtained the requisite cash to finance, in part, its modernization program and to carry the larger inventories which had increased from about $30,500,000 in 1945 to $52,000,000 in 1950.

THE ALLIED DEAL RESULTED IN NO SUBSTANTIAL LOSS OF TAXES TO THE FEDERAL GOVERNMENT

In the fiscal year ended January 31, 1945 (the last full year when Allied owned the seven properties), Allied took as depreciation on those properties a total of $258,685 and in that year it paid $330,244 of interest on the $8,000,000 mortgages, or a total of $588,929 which it used as deductions from its gross income in computing its Federal taxes. In the first full year after the deal was closed (February 1, 1946, to January 31, 1947) Allied paid $1,141,000 in rentals to the subsidiary. These rentals were also deductible by Allied in computing its Federal taxes and were $552,000 more than would have been deducted if the deal had not been made. Since the subsidiary is exempt from Federal taxes, it would appear that the Federal Government had been deprived of the taxes on $552,000. But that is not the whole story. Out of the gross rents received by the subsidiary, it paid $420,000 interest to the bondholder and $103,537 interest to the Guaranty Trust Co. The latter paid taxes on that profit. These two sums aggregate upwards of $523,000 so that there was a difference of moneys earned which were subject to taxes of less than $30,000. If the argument is made that no part of the interest paid to Prudential (the present bondholder) is taxable because insurance companies do not now pay income taxes, the answer is that that is the result of the tax laws and regulations which, in practical effect, free insurance companies from income-tax liability. Furthermore, the $12,000,000 in bonds could be readily sold today at par or better by the Prudential to private investors, and if that were done the income received by such persons would certainly be subject to individual income taxes.

There is still more to the tax story. The $8,000,000 cash net proceeds of the sale of the seven properties became part of the cash working capital of Allied. To be sure, the funds were mingled with other cash funds belonging to Allied and therefore cannot be traced to any particular store or department and credited with earning any specific part of the gross profit reported by Allied but since 1945 Allied has earned, before taxes, the following approximate percentages on its net current assets of which that $8,000,000 was a part: 1946, 48 percent; 1947, 25 percent; 1948, 28 percent; 1949, 21 percent.

This could never have occurred if the Allied balance sheet had not in the first instance been improved by the sale and lease-back arrangement; and in all fairness, in computing the over-all tax results, there should be taken into consideration the fact that Allied earned annually an average of over 30 percent on all or a substantial part of that $8,000,000 which would not have been earned if Allied had continued to own the properties and on those earnings Allied paid taxes. Whatever that figure is, it certainly is far in excess of the direct tax advantage of $552,000 which Allied obtained as a result of the lease-back deal.

NO SUBSTANTIAL INCOME TAXES CAN BE COLLECTED FROM UNION'S REAL ESTATE CORPORATION BY FEDERAL LAWS ENACTED AFTER 1945. THE ONLY EFFECT OF SUCH LEGISLATION WILL BE "TO WIPE OUT THE EQUITY" BELONGING TO THE SUBSIDIARY

Attention is again called to the fact that at the time of closing of title, the subsidiary assigned to a corporate fiduciary all of the rents which it would thereafter receive until the bond issue matures in 1965. That is a valid agreement, made for a good consideration, and cannot be set aside or affected by subsequent legislation. Under the terms of the assignment, the corporate fiduciary collects the rents and then pays out interest and amortization payments on the moneys borrowed. After those payments have been made, the unexpended balances are

the amounts set forth in the column marked "Expense and Reserve" in exhibit A. During that 20-year period the moneys available for unsecured creditors (and taxes) will aggregate about $380,000 or an average of about $19,000 a year. During the years 1951 to 1956, those payments aggregate less than $50,000 or an average of less than $10,000 a year. A substantial part thereof is payable to the brokers who negotiated the deal and they of course will pay personal income taxes on those sums. More than the balance must be used by the subsidiary to pay taxes at the State level.

Annexed hereto and marked "Exhibit B" is a copy of the balance sheet of the subsidiary (Union's Real Estate Corp.) dated December 31, 1949, and a copy of the Income and Surplus Statement for the year ended December 31, 1949.

If the proposed legislation taxing any part of lease-back rentals is enacted, in March 1952, when the officers of the subsidiary are required to file an income-tax return covering the operations of the subsidiary for the year 1951, they will prepare such return on a "cash basis" and will report that the subsidiary received, or was entitled to receive, in 1951 only that small part of the rentals mentioned in the column marked "Expense and Reserve." If that report is accepted, there will be no taxable income received by the subsidiary, because State income taxes paid by the subsidiary and commissions payable by it will exceed the amount set forth under "Expense and Reserve."

If subsequently the Treasury Department insists, contrary to the fact, that the rentals were collected by the assignee for the benefit of the subsidiary and not for the benefit of the secured creditors, the Treasury Department will no doubt claim that the taxable income of the subsidiary for 1951 will be substantially the amount set forth in the Income and Surplus Statement for the calendar year 1949 (exhibit B) or $360,000. A Federal tax at 40 percent on that "paper profit" will amount to $144,000.

An examination of the balance sheet of the subsidiary (exhibit B) shows that the only current asset which the subsidiary had on December 31, 1949, was $16,942.71 cash (the unexpended balance of $25,000 cash paid for the capital stock by the college) and a small special deposit in the amount of $11,546.40 which represented money payable by the assignee for "Expense and Reserve." On the liability side, in addition to the long-term debt, there are deferred commissions payable in the amount of $36,996.98. The current asset situation of the subsidiary at the end of 1951 and until 1965 will be no better than in 1949.

If such a claim by the Treasury Department should eventually be upheld, obviously, there will be no substantial assets available from which Federal income taxes can be paid. Under such circumstances, in due course a warrant will be issued by the collector. This will result in the collection of no money, but it will constitute a "default" under the trust indenture which secures the 12,000,000 bonds now held by the Prudential. If Prudential so desires, it will then have the authority to force the trustees under the trust indenture to foreclose the mortgage and "wipe out the equity" of the subsidiary.

If the Prudential should thus acquire title to the seven properties, the Federal Government will still collect no substantial income taxes, unless the present concept of the taxing of income of insurance companies shall be changed. A radical departure in tax legislation relative to insurance companies is hardly foreseeable because of the serious effect it would have on the amount of "dividends" paid by insurance companies, resulting in lower premiums for the millions of Americans who choose life insurance as a means of saving and protection for their families.

At the closing of the title on June 1, 1945, Allied and Prudential also executed a document known as "a supplemental lease" which covers the situation which shall exist if there is a default in the mortgage and the trustees foreclose the mortgage. In that supplemental lease, Prudential agrees to allow Allied to continue to occupy the seven properties under the same terms existing in the present leases, except that the tenant agrees to pay as additional rent, over a period of 5 years, the disbursements incurred by the trustees in foreclosing the mortgage plus interest thereon; and in that document Allied is given the option to repurchase the seven stores for the amount of the outstanding bonds plus interest and expenses.

The only practical effect of the proposed legislation will be to cut off the prospective benefits which Union College hopes to derive from the Allied deal in future years, and allow Prudential to gain the benefit of Union's equity which has thus been cut off; or, if Allied so elects, to allow Allied by the expenditure of a little more than $12,000,000 to repurchase the property which it sold in 1945 for $16,650,000.

The Abraham & Straus deal

From the time that Abraham & Straus was first started as a dry-goods store over 70 years ago, it has never owned the land on which its store was located. The Messrs. Abraham and Straus who started the business formed a separate partnership, known as the Abrast Co., which owned the land; built the first store; and leased it to the dry-goods company. In the early 1900's the real-estate partnership was incorporated, with the same name, and since that time the dry-goods company has been its tenant.

After World War I a new lease, with options for two renewals, was signed and since that time the tenant has practically rebuilt the entire building.

The descendants of the original Messrs. Abraham and Straus remained the stockholders of Abrast Co., and on three occasions after March 1913 large cash disbursements were made by Abrast to its stockholders and the Treasury Department held those payments to be "returns of capital." By 1947 substantially all of the stockholders of Abrast had received cash returns of capital aggregating the full value of their stock. Accordingly, if they thereafter sold their stock, the total net sales price thereof would constitute a "long-term capital gain."

In 1947 the leases covering the Abraham & Straus properties provided for net rentals aggregating $500,000 a year until 1954, with a provision that thereafter periodically the rents could be fixed by appraisers with a "floor" of $500,000. At that time Equitable Life Assurance Society appraised the properties at upwards of $15,000,000.

In 1947 the stockholders of Abrast began negotiations for the sale of their stock. Federated Department Stores, Inc., which had acquired control of A & S in 1929, posed with the probability that strangers would become the landlord and wishing to eliminate the possibility of rentals being increased after 1954 by the appraisal procedure, commenced negotiations which resulted in Union College forming another subsidiary which purchased the properties for a total sum of $9,110,000. The funds were raised by selling an $8,250,000 bond issue to Equitable; the subsidiary borrowed $500,000 from a commercial bank; and Union College loaned the subsidiary an additional $360,000. The stock of Abrast was purchased on December 1, 1947; a new lease was signed with the dry-goods company; and Abrast was then immediately merged into the subsidiary which thus became the owner of the premises, subject to the lease and the encumbrance above set forth. The new lease provides for lower rentals after 1954 thus reducing the deductions which the tenant can take in computing its income taxes.

At the closing of title, the rentals to be paid for the full 30-year term were assigned to a bank, as assignee for the benefit of the bond holders, the lending bank and Union College. Not one penny of excess cash will be available for general creditors or to pay Federal income taxes until 1958. After that date the subsidiary will receive approximately $50,000 a year which will be available for the use of the college if it is not subject to Federal taxation.

The Abrast stockholders received approximately $4,600,000 cash for their stock.

THE ABRAHAM & STRAUS DEAL RESULTED IN NO SUBSTANTIAL LOSS OF TAXES TO THE FEDERAL GOVERNMENT

The Abraham & Straus deal differs in many respects from the Allied transaction. In the latter, the new rentals exceeded the deductions for depreciation and mortgage interest payments which Allied could take before it sold the properties. Abraham & Straus, Inc., never owned the land and was always a tenant. In the new lease made on December 1, 1947, the old provision for a possible increase in rents by appraisal was eliminated. The annual net rent of $500,000 continues, as in the old leases, until 1954 but, for the next 4 years thereafter, the rent is reduced $45,000 a year and after 1958 it is reduced $85,000 a year for the next 19 years. These lower rentals will, of course, increase the tenant's profits.

Annexed hereto and marked "Exhibit C" is a copy of the balance sheet of this subsidiary (Union's Holding Corp.) dated December 31, 1949, and a copy of the Income and Surplus Statement for the year ended December 31, 1949.

Here again, in 1952, the officers of the subsidiary will file an income-tax return covering the operations of the subsidiary for the year 1951 on a "cash basis." They will report that they received not 1 cent of income because, in this transaction, there is no excess equivalent to the "Expense and Reserve" in the Allied deal. The total rents aggregate the exact costs for interest, amortization, and corporate fiduciary fees. If that report is accepted as filed, there will be no taxable income received by the fiduciary.

On the other hand, if the Treasury Department contends, as suggested supra in the discussion of the Allied deal, that the assignee of the rents is acting for the benefit of the subsidiary and not for the benefit of the secured creditors, the taxable income of the subsidiary for 1951 will be substantially the amount set forth in the Income and Surplus Statement for the calendar year 1949 (exhibit C) or $50,000. The Federal tax on that "paper profit" will amount to about $20,000.

Under the foregoing hypothesis, until 1958 when the loans made by the Commercial Bank and Union College have been paid in full, the taxable income of the subsidiary will never exceed approximately $50,000. In the meantime, however, the taxable income of the tenant will increase $45,000 annually in 1954 and $85,000 annually in 1958. Accordingly, if the subsidiary remains tax-exempt, the only taxes which the Federal Government will "lose" will be taxes of approximately $20,000 a year for 4 years ending 1954 or an aggregate of $80,000.

As an offset against that small loss in taxes, the Federal Government sometime between December 1, 1947, and March 15, 1948, presumably collected upwards of $1,000,000 in taxes on the long-term gains of the stockholders who sold their stock for about $4,600,000.

NO SUBSTANTIAL INCOME TAXES CAN BE COLLECTED FROM UNION'S HOLDING CORPORATION THROUGH THE PROPOSED LEGISLATION. THE ONLY EFFECT WILL BE THE "WIPING OUT OF THE EQUITY" IN THE REAL ESTATE BELONGING TO THE SUBSIDIARY

Since the rents payable by the tenant for the entire 30-year period of the lease have been assigned to a corporate fiduciary for the benefit of the three institutions which loaned the subsidiary the purchase price, at least until 1958 there will never be a time when the subsidiary will have over approximately $1,000 of cash from which taxes can be paid.

If a warrant is finally issued by the collector of internal revenue, that will be a "default" under the trust indenture which secures the bond issue. If the Equitable still holds those bonds and so desires, it will have the authority to force the trustee under the trust indenture to foreclose the mortgage and wipe out the equity of the subsidiary.

GENERAL CONCLUSIONS

President Truman has recommended the reduction of certain excise taxes and has stated that he will approve any bill effecting that result, provided additional revenue is obtained to make up "the losses in taxes" resulting from the repeal or reduction of excise taxes. He has suggested, among other things, an increase in the "rates of corporation taxes" and "the plugging of certain loopholes" in the existing income tax laws.

One of the alleged "loopholes" described by the Treasury Department is the present law giving tax exemption to educational institutions which, through a wholly owned corporate subsidiary or by a "foundation" composed of its friends, purchase (1) "commercial enterprises" and (2) "real estate" with borrowed money; and repay those loans out of the tax-exempt income of the commercial enterprise and the lease-back rentals.

American colleges have owned and rented real estate at fixed rentals and used the net income therefrom for college purposes for over 100 years. Taxes have always been paid, at least in the eastern United States, at the "local level"; i. e., to the cities, counties, and States where the income-producing real estate was located whether the tax is based on the assessed value of the real estate, or the net income derived from the rentals.

Colleges have acquired title to real estate in the following three ways:

(1) *By grant from the State.*—For example: most of the land owned by Columbia University and now improved and known as Rockefeller Center was given to Kings College by the State of New York. (The history behind the gift is interesting: originally, Union College raised the money to build its first buildings through a lottery which was authorized by the New York State legislature. The lottery was so successful that the officials of Kings College (now Columbia) sought permission from the legislature to run another lottery for its benefit. By that time that New York State Legislature decided that lotteries were not advisable, and, to satisfy the Kings College officials when they were denied the privilege of running a lottery, the legislature passed an act donating this land to Kings College.) Today Columbia University receives net rentals of approximately $3,000,000 annually from this land; and under the proposed legislation no part of it will be taxed because the rentals are not lease-back rentals.

(2) *By gifts or devises from friends of the colleges.*—Many colleges throughout the United States today own real estate which has been thus acquired and which is not used for college purposes. The net income from such properties will not be taxed by the proposed legislation.

(3) *By outright purchase with endowment funds.*—Any one who follows the real-estate news of the New York newspapers knows that the large colleges, with large endowment funds at their disposal, for decades have been and are still continuing to buy office buildings and apartment houses with endowment funds. Most of those properties are paid for in cash because colleges do not like to sign bonds and mortgages. Under the proposed legislation, the net income from the rents from those properties will not be taxed because they will not be "unrelated business net income."

Although American colleges have benefited from their tax-exempt status since the enactment of the Federal income-tax law in 1913, it is only in the past few years that some few colleges, directly or indirectly, have attempted to increase their potential endowment income through the purchase of commercial enterprises and through the making of lease-back agreements where the tenant pays, as rent, a percentage of the tenant's income. In substance, both of these transactions are the same and in this memorandum, wherever we speak of "lease-back rentals," we mean rentals in definite amounts of dollars which are agreed upon at the time the leases are made.

It is submitted that the fixed income from rents is quite different from the variable income which may be received from commercial enterprises. For example, when Union's Real Estate Corp. signed a lease with Jordan-Marsh Co. in Boston, one of the Allied stores, Union College was not competing with any other owner of real estate. There was no landlord across the street who could possibly have supplied Jordan-Marsh with the same type of space

That situation is quite different from the one which exists where a commercial enterprise is purchased. Of course, the most talked about case is the purchase of the Mueller macaroni factory and business by a foundation acting for a tax exempt institution. It is conceivable that the day may come when the Mueller Co. could present a serious threat to other macaroni manufacturers if, because of its tax exemption, it should reduce prices to such an extent that other macaroni manufacturers who pay Federal taxes could not stay in business.

We are not taking the position that tax exemption should be denied in the Mueller case, or in other cases where commercial enterprises have been purchased; but we do take the position that, if tax exemption is denied where commercial enterprises are purchased, it does not necessarily follow that tax exemption should also be denied in lease-back rental cases where the rents are for stipulated sums and are not based on the profits of the tenant. The profits of a noodle factory, which can vary with the times, are quite different from rents stipulated for years in advance and it will be quite consistent for Congress to treat them differently in tax legislation.

The proposed legislation is unfair for another reason: namely, it will injure colleges, like Union, with small endowments, and will not necessarily hurt colleges with large endowments. For example, it has recently been reported in the public press that Connecticut Boola Inc., a wholly owned subsidiary of Yale, recently purchased Macy's new nine-story building in San Francisco for $4,500,000; and promptly leased the store back to Macy's for 31 years at an average annual rental of $240,000. About 80 percent of the purchase price was obtained by a mortgage or bond issue from an insurance company, and presumably the balance was supplied by Yale from endowment funds. If the proposed new legislation is passed Yale has sufficient funds to buy the bonds from the insurance company holding them. After that has been done, no part of the "lease-back rentals" will be deemed "unrelated business net income," and all of the net income will be exempt from Federal corporate income taxes.

Union College does not have enough endowment money to buy the $12,000,000 of bonds still outstanding in the Allied deal, or the upwards of $8,000,000 bonds still outstanding in the Abraham and Straus deal. Accordingly, Union College will not be able to get the tax advantages which other colleges with larger endowments can acquire if the proposed new tax legislation is enacted.

There is one more somewhat anomalous situation which will exist if the proposed legislation taxing any part of lease-back rentals is adopted. One of the excise taxes which it is proposed shall be reduced is the tax on the cost of food and liquor sold in cabarets and night clubs. It has been reported that the proposed reduction in that particular excise tax would result in a loss of revenue to the Treasury Department of about $50,000,000 and that the Treasury Depart-

ment has also estimated that the "plugging" of the particular tax "loophole" which exists as a result of the tax exemptions of lease-back rentals will amount to approximately the same figure.

With all due deference to the rights of cabaret owners to make money and to pay high salaries to their entertainers, who in turn presumably pay high income taxes, we submit that it is nothing short of scandalous to make up tax losses of that nature by taxing any income connected directly or indirectly with the income of colleges which educate boys and girls without governmental aid at tuition charges which represent approximately 60 percent of the cash cost of their educations.

We have a large stake in the existence of strong, independent educational institutions. On the whole, their records are good and they are serving well. Educational institutions have assumed the tremendous responsibility of training citizens to meet the harsh requirements of daily living. Delimitation of the present tax exemptions should be preceded by a thorough consideration of the broad social and economic problems involved.

Respectfully submitted.

CHARLES FOSTER BROWN,
Attorney for Union College, New York, N. Y.

Dated: July 11, 1950.

EXHIBIT A.—*Union's real-estate corporation—Schedule of lease rentals to be paid by Allied to Fidelity Union Trust Co., as assignee of the rents, and the disposition thereof for interest and amortization payments*

Date of rent payment	Period covered		Amount of lease rental	$12,000,000 S. F. Bond Issue 3½ percent to June 1, 1950 3¾ percent to June 1, 1965		$4,750,000 2¾ percent bank loan		Expense and reserve	Balance of loans		
	From	To		Interest (pay. Feb. 1 and Aug. 1)	Amortization (pay Feb. 1)	Interest (pay Feb. 1 and Aug. 1)	Imortization (pay. Feb. 1)		Prudential Insurance Co.	Guaranty Trust Co.	Total
June 1, 1945	June 1, 1945	Jan. 31, 1946	$780,000	[1] $70,000 00		[1] $18,631.25	$685,000	$6,368.75	$12,000,000	$4,065,000	$16,065,000
Feb. 1, 1946	Feb. 1, 1946	Jan. 31, 1947	1,141,000	420,000.00		103,537 50	600,000	17,462.50	12,000,000	3,465,000	15,465,000
Feb. 1, 1947	Feb. 1, 1947	Jan. 31, 1948	1,123,000	420,000 00		87,037.50	600,000	15,962 50	12,000,000	2,865,000	14,865,000
Feb. 1, 1948	Feb. 1, 1948	Jan. 31, 1949	1,108,000	420,000.00		70,537.50	600,000	17,462.50	12,000,000	2,265,000	14,265,000
Feb. 1, 1949	Feb. 1, 1949	Jan. 31, 1950	1,092,000	420,000.00		54,037.50	600,000	17,962.50	12,000,000	1,665,000	13,665,000
Feb. 1, 1950	Feb. 1, 1950	Jan. 31, 1951	1,075,000	425,000.00		37,537.50	600,000	12,462 50	12,000,000	1,065,000	13,065,000
Feb. 1, 1951	Feb. 1, 1951	Jan. 31, 1952	1,059,000	450,000 00		21,381 25	575,000	12,618 75	12,000,000	490,000	12,490,000
Feb. 1, 1952	Feb. 1, 1952	Jan. 31, 1953	1,042,000	448,406 25	$85,000	6,737 50	490,000	11,856.25	11,915,000		11,915,000
Feb. 1, 1953	Feb. 1, 1954	Jan 31, 1954	1,027,000	435,750.00	590,000			1,250.00	11,325,000		11,325,000
Feb 1, 1954	Feb. 1, 1954	Jan. 31, 1955	1,009,000	413,906.25	575,000			20,093.75	10,750,000		10,750,000
Feb. 1, 1955	Feb. 1, 1955	Jan. 31, 1956	995,000	391,875.00	600,000			3,125.00	10,150,000		10,150,000
Feb. 1, 1956	Feb. 1, 1956	Jan. 31, 1957	901,000	369,375 00	600,000			21,625 00	9,550,000		9,550,000
Feb. 1, 1957	Feb. 1, 1957	Jan. 31, 1958	979,000	346,875 00	600,000			32,125.00	8,950,000		8,950,000
Feb. 1, 1958	Feb. 1, 1958	Jan. 31, 1959	958,000	324,375 00	600,000			33,625.00	8,350,000		8,350,000
Feb. 1, 1959	Feb. 1, 1959	Jan. 31, 1960	937,000	301,875.00	600,000			35,125.00	7,750,000		7,750,000
Feb. 1, 1960	Feb. 1, 1960	Jan. 31, 1961	915,000	278,906.25	625,000			11,093.75	7,125,000		7,125,000
Feb. 1, 1961	Feb. 1, 1961	Jan. 31, 1962	894,000	255,468.75	625,000			13,531.25	6,500,000		6,500,000
Feb. 1, 1962	Feb. 1, 1962	Jan. 31, 1963	872,000	232,031.25	625,000			14,968.75	5,875,000		5,875,000
Feb. 1, 1963	Feb. 1, 1963	Jan. 31, 1964	851,000	208,593 75	625,000			17,406.25	5,250,000		5,250,000
Feb. 1, 1964	Feb. 1, 1964	Jan. 31, 1965	828,000	185,156.25	625,000			17,843.75	4,625,000		4,625,000
Feb. 1, 1965	Feb. 1, 1965	Jan. 31, 1966	807,000	[2] 136,718.75	625,000			45,281.25	4,000,000		4,000,000
			20,483,000	6,954,312 50	8,000,000	399,437.50	4,750,000	379,250.00			
Feb. 1, 1966	Feb. 1, 1966	Jan. 31, 1967	785,000	[3] 165,625.00	500,000			119,375.00	3,500,000		3,500,000
Feb. 1, 1967	Feb. 1, 1967	Jan. 31, 1968	764,000	121,875.00	500,000			142,125 00	3,000,000		3,000,000
Feb. 1, 1968	Feb. 1, 1968	Jan. 31, 1969	741,000	103,125.00	500,000			137,875.00	2,500,000		2,500,000
Feb. 1, 1969	Feb. 1, 1969	Jan. 31, 1970	716,000	84,375.00	500,000			131,625.00	2,000,000		2,000,000
Feb. 1, 1970	Feb. 1, 1970	Jan. 31, 1971	680,000	67,500.00	400,000			212,500.00	1,600,000		1,600,000
Feb. 1, 1971	Feb. 1, 1971	Jan. 31, 1972	653,000	52,500.00	400,000			200,500 00	1,200,000		1,200,000
Feb. 1, 1972	Feb. 1, 1972	Jan. 31, 1973	632,000	37,500.00	400,000			194,500.00	800,000		800,000
Feb. 1, 1973	Feb. 1, 1973	Jan. 31, 1974	612,000	22,500.00	400,000			189,500 00	400,000		400,000
Feb. 1, 1974	Feb. 1, 1974	Jan. 31, 1975	562,000	7,500.00	400,000			154,500.00			
Feb. 1, 1975	Feb. 1, 1975	May 31, 1975	181,000					181,000.00			
			26,809,000	7,616,812.50	12,000,000	399,437.50	4,750,000	2,042,750.00			

[1] Interest from June 1, 1945, to Aug. 1, 1945, received by the trustee on June 1, 1945, but not payable to bondholders and noteholders until Aug. 1, 1945.
[2] Includes interest from Feb. 1, 1965, to June 1, 1965, received by the trustee on Feb. 1, 1965, but not payable to bondholders until June 1, 1965.
[3] Represents interest from June 1, 1965, to Aug. 1, 1966.

EXHIBIT B.—*Union's real-estate corporation—Properties leased to Allied Stores—balance sheet, Dec. 31, 1949*

ASSETS		
Land, 7 cities, cost		$9, 597, 300. 00
Buildings, 7 cities, cost	$7, 073, 672. 40	
Less, amortization	1, 080, 699. 95	
		5, 992, 972. 45
Lease costs, general, less amortization		16, 097. 23
Cash, Guaranty Trust Co		16, 942. 71
Special deposit, Fidelity Union Trust Co		11, 546. 40
Deferred charges, less amortizations:		
Debt expense, Prudential (bonds)	$27, 884. 30	
Debt expense, Guaranty (loan)	2, 047. 68	
		29, 931. 98
Organization costs		971. 22
Total assets		15, 665, 761. 99
LIABILITIES AND CAPITAL		
First mortgage bonds (Prudential)		$12, 000, 000. 00
Loan payable (Guaranty)		1, 665, 000. 00
Commissions payable (deferred)		36, 996. 98
Capital stock (200 shares)	$25, 000. 00	
Surplus (earned since May 31, 1945)	1, 938, 765. 01	
		1, 963, 765. 01
Total liabilities and capital		15, 665, 761. 99

Income and surplus, 1 year ended Dec. 31, 1949

Income: rentals, 7 stores		$1, 092, 000. 00
Expenses:		
Amortization, building costs (buildings in 7 cities)	$235, 789. 08	
Amortization, lease costs, general	633. 33	
Taxes	8, 391. 23	
Annual fee, bond trustee	1, 500. 00	
Annual fee, deposit account	200. 00	
Law expense	319. 68	
Commissions on lease rentals	11, 617. 90	
Miscellaneous expense	1, 003. 60	
Deductions:		
Interest, Prudential	420, 000. 00	
Amortization, debt expense, Prudential	2, 488. 78	
Interest, Guaranty	49, 125. 00	
Amortization, debt expense, Guaranty	2, 073. 36	
Total expenses and deductions		733, 141. 96
Net income, 1949		358, 858. 04
Surplus balance, Jan. 1, 1949		1, 579, 906. 97
Surplus balance, Dec. 31, 1949		1, 938, 765. 01

EXHIBIT C.—*Union's holding corporation—Property leased to Abraham & Straus—Balance sheet, Dec. 31, 1949*

ASSETS		
Land		$5,000,000.00
Leases, other contracts, and lessee's improvements	$4,110,000.00	
Less: Reserve for amortization 25/360ths	285,416.67	
		3,824,583.33
Cash in bank		1,056.45
Assignee of rents		41,750.00
Total assets		8,867,389.78
LIABILITIES AND CAPITAL		
First mortgage 3½–4 percent S. F. bonds		8,042,000.00
Bank loan (Commercial National Bank & Trust Co. of N. Y.)		341,832.65
College loan (Union College)		356,271.46
Liability re Income tax, Abrast Realty Co		1,706.45
Capital stock, $1 p. v., 1,000 shares		1,000.00
Surplus		124,579.22
Total		8,867,389.78

Statement of income and surplus, 1 year ended Dec. 31, 1949

Income: Rent		$501,000.00
Deductions:		
Interest, first mortgage bonds	$283,797.50	
Interest, bank loan	13,729.12	
Interest, college loan	14,298.64	
Amortization, lease costs	137,000.00	
Trustee's fees	1,000.00	
Auditing expense	650.00	
Total deductions		450,475.26
Net income		50,524.74
Surplus, Dec. 31, 1948		74,054.48
Surplus, Dec. 31, 1949		124,579.22

Senator KERR. The committee will now recess until 2:30 this afternoon.

(Whereupon, at 1 p. m. the committee recessed to reconvene at 2:30 p. m.)

AFTERNOON SESSION

(The committee reconvened at 2:30 p. m., upon the expiration of the recess.)

The CHAIRMAN. The committee will come to order. We are running behind today, and we will have to make some progress now.

The next witness is Mr. Stuart Hedden. Mr. Hedden? Will you have a seat, sir, and identify yourself for the record, please?

STATEMENT OF STUART HEDDEN, TRUSTEE, WESLEYAN UNIVERSITY, MIDDLETOWN, CONN.

Mr. HEDDEN. Thank you, Mr. Chairman. My name is Stuart Hedden. I am a trustee of Wesleyan University of Middletown, Conn., and chairman of the finance committee of that board of trustees.

I have been allowed 5 minutes. I wish to emphasize three objections to H. R. 8920, so I will speak directly.

The CHAIRMAN. Yes, sir, you may do so. We are, of course, not going to cut you off if we are not compelled to.

Mr. HEDDEN. First, and this is a point, Senator, which has been more ably made by Mr. Stassen and Mr. Davidson, one cornerstone of our great free America is the privately endowed college and university. Heads of our great State universities have frequently stated that the academic freedom of their institutions is made possible largely by the standards set in the privately endowed colleges. Up to now the public interest in the fiscal freedom of these colleges has been consistently recognized. This bill, if not amended, will accomplish a major revolution in that time-honored policy. It will introduce the revenue collector into the front office of every college in America. It provides an opening wedge toward the socialistic intervention of Government into our colleges, as it gives Government a voice in college accounting. Under this bill, every college can be required to file tax returns, with attendant increased costs in administrative and legal overhead.

None of this is necessary, even if you decide to tax business investments of colleges.

Without removing the exemption of the colleges you can tax the "macaroni cases" as independent foundations. No college board of trustees will subject the endowment directly to the risks of a nonrelated business without the insulation of an intervening corporation. Direct ownership of a nonrelated business would also be ultra vires under most college charters. Colleges as well as churches should therefore be excluded from 421 (b) (1).

The treasury has set out to stop three so-called tax loopholes: (*a*) the accumulating foundation, (*b*) the nonrelated business purchase (both of which this bill would cover even if colleges were continued exempt under 421 (b) (1)), and (*c*) the purchase and lease-back without substantial investment. If this is a loophole, the act should be much more strictly drafted to cover it and it alone. I submit, however, that the tax loophole in the lease-back situation is not in the income the college receives—which is de minimis in substantially all cases—but in the rent deduction the lessee receives in excess of its presale depreciation charge and in the capital loss it takes. There and there alone is where legislation should seek to plug the leak.

2. The House committee report stated, on page 36:

> the problem at which the tax on unrelated business income is directed here is primarily that of unfair competition.

If this is the true purpose of this legislation, it can be achieved by allowing a credit against the proposed tax to the extent that funds are actually devoted to the exempt purpose. It makes no difference to your competitor who pays the 41-percent tax whether you pay a 41-

percent tax or pay a 1-percent tax and pay the other 40 percent over to a college. Such a change in your bill would still prevent the accumulating trust of the Textron type.

My third and final point is as to the university and college press. This act does not specifically define these operations as related. The House committee report states, at page 37: "Income from a university press would be exempt in the ordinary case. * * *"

But I fear the "in the ordinary case" language and believe that the Senate should protect a press owned by a college and dealing only with educational publications, and not force the successful press to litigate its exemption with the Treasury Department. I read from a Department letter to our own Wesleyan University Press:

> Your activities consist of composing, compiling, editing, illustrating, printing, and publishing educational books, periodicals, and miscellaneous other materials instructional and educational in character. Your principal publications are books and weekly periodicals, prepared in conformity with standards of leading educators, designed for distribution to pupils, teachers, and schools, and are used mainly in classroom work in the elementary schools. Your financial statement for the fiscal year ended September 30, 1949, shows receipts mainly from sales and small amounts from investments and miscellaneous sources. Expenditures were made for production, administration, and miscellaneous expenses, and purchase price payments.

That is a Treasury finding of fact, gentlemen. Yet the Department which makes this finding has to date denied this press exemption. The Department attitude, if you do not specifically cover the educational and college press in your law will be that it is exempt only if it is unsuccessful.

In closing, I wish to express my appreciation of the opportunity of appearing here. To supplement these remarks I have prepared a brief, outlining three proposed amendments, which I touched on in this statement, discussing those amendments briefly but more fully than time allows here, and I would like to submit that for the record, with your kind permission.

The CHAIRMAN. We would be glad to have it in the record, Mr. Hedden.

(The brief referred to follows:)

BRIEF SUBMITTED BY STUART HEDDEN, CHAIRMAN OF THE FINANCE COMMITTEE OF WESLEYAN UNIVERSITY, MIDDLETOWN, CONN.

This brief is submitted, through the courtesy of your distinguished chairman, to supplement my testimony of July 11, 1950, a copy of which is appended.

Below are three proposed amendments to H. R. 8920 which I believe are desirable and to which I respectfully direct you attention:

I: FIRST PROPOSED AMENDMENT

Title III, part 1, section 421 (b) excludes churches but does not exclude educational institutions.

Suggestion.—Amend line 20 (p. 97), by adding after "church", the words "or educational institution". (By later language in the act these words are qualified to limit their application to institutions exempt under sec. 101.)

Argument.—H. R. 8920 as drawn departs for the first time in the American legislative history from the well-established public policy of treating education and religion alike for tax purposes. Why? Not to prevent further "macaroni cases", because the amendment proposed above would not exempt separate business corporations or foundations. Failure to enact this amendment would subject all colleges and universities to the possibility of having to file tax returns to establish that there was no nonrelated income. Further, the act as drawn will certainly increase the administrative expense of every college. Our accounting

and legal expenses will become commensurate with those under which many businesses are staggering. This departure from long established policy is fraught with danger to free privately endowed education. The act as drafted is not only revolutionary, it is unnecessary and it serves little Treasury purpose.

It serves little Treasury purpose because it is inconceivable that college trustees will subject their endowments to the risks of unrelated business esterprises without the insulation of an intervening corporation.

There is only one situation of which the Treasury has complained where a direct investment by a college is involved, and that is the purchas-lease-back situation. But in these situations the revenue to the purchasing colleges is negligible. To call that revenue a "major tax loophole" is preposterous, and to plug it by removing the flat exemption of our colleges is a dangerous departure. It is too short a step, once the free tax exemption of our colleges is removed, to taxing other college income.

I do not approve of the lease-back investments. They do provide a tax loophole, but not where this act seeks to plug it. The loophole is in the rent deduction granted to the seller-lessee. The plug is to deny any rent deduction as an operating charge in excess of the depreciation allowed the seller-lessee prior to the sale and lease. There is also another way to plug this revenue leak. In many cases the seller-lessee never loses complete dominion of the property, or does not do so until a remote period, sometimes 60 to 90 years. It is quite possible, under existing law, to deny in such cases the fact of a sale; to treat the sale, in other words, as a fiction and to deny the seller capital gain or loss treatment. This will effectively stop such transactions. It is the straightforward way to do it, and avoids the dangers to our educational system inherent in removing the free tax exemption of the colleges.

(NOTE.—None of the above applies to the independent foundation, even if college owned. The suggested amendment could be made, the exemptions of the colleges left undisturbed, and cases like the "macaroni case" would still be taxed, once, under this act.)

My own college has no special ax to grind in relation to this recommendation. We have no unrelated income, own no unrelated real estate, have no lease-back situations. Nevertheless, I consider this the most important of the three recommendations herewith submitted. The implications of opening up the colleges as a source of Federal revenue are terrible to contemplate for one who believes as I do that the public interest in the fiscal well-being of our institutions of higher learning is of equal importance with the public interest in the fiscal well-being of the Treasury.

Double taxation.—I believe failure to adopt the above amendment may subject colleges with nonrelated income from business operating foundations to double tax action on this income.

Section 421 (a) (1) imposes a tax on supplement U net income of organizations described in 421 (b) (1), which exempts only churches and not colleges. Supplement U income is defined in 421 (c) (1) as nonrelated income. Where the business owning foundation is an obvious instrument of the college, as in most cases it will be, the application of the well-established doctrine used continually by the Department of "looking through the corporate fiction" would permit—even require if applied—double taxation of such income.

II: SECOND PROPOSED AMENDMENT

Title III, part 1, section 422 (b) is so broad that it would leave open to argument the question of whether a college press is a related or unrelated activity.

Suggestion.—Add after section 422 (b) (2) (line 24, p. 102) a semicolon, the word "or," and a new paragraph 3 reading: "(3) which, if carried on by a religious or educational corporation described in section 101 (6), is substantially entirely engaged in the preparation, editing, printing, or distribution of religious or educational publications."

Argument.—There are now over 40 college or university presses in America, at least 9 of which have separate corporate status, and at least 9 of which are financially self-supporting and earning surpluses.

The functions performed by these presses vary widely, but the language above certainly is the minimum definition of the kind of operation which should be tax-exempt. Nicholas Murray Butler once put the case well (quoted from page 24, C. Kerr, A Report on American University Presses), "A university has three functions to perform: It is to conserve knowledge; to advance knowledge; and to disseminate knowledge. It falls short of the full realization of its aim unless,

having provided for the conservation and advancement of knowledge, it makes provision for its dissemination as well".

I realize that Chairman Doughton's report of this bill states, page 37, "Income from a university press would be exempt in the ordinary case. * * *" What is meant, however, by the qualifying "in the ordinary case"? The Treasury may disagree with the statement of George Parmly Day, then treasurer of Yale University, in 1914 (quoted from Kerr as above, p. 12): "The function of a university press cannot properly be described as either printing or publishing for the benefit of its own university * * * but as something more than either of these activities, or indeed both combined. The function of a university press in fact is nothing less than to render distinct service to the world in general, through the medium of printing or publishing or both, and in such ways to supplement the work of education which commands the devotion of the university whose name the press bears."

I urge that it is to the law and not to the arbitrary decisions of the changing personnel of the Bureau of Internal Revenue that the university presses and religious presses are entitled to look for their specific exemption. It is a simple matter to make this clear, by the above-proposed amendment. Failure to do so may not only subject some presses to taxation—and it is a long-recognized public policy that they should not be taxed—but will increase the cost of all university and religious presses by requiring auditing and legal expense not generally envisioned, and the filing of returns which alone are a major burden.

In urging this amendment, unlike the first above, I am pleading specially. My college has acquired with a substantial investment (the largest single investment we have ever made) a university press. Just as the Cornell Press got its start by acquiring the successful Comstock Press, the Syracuse Press its start by acquiring several successful publications of IBM, and the Stanford Press its start by acquiring the Quelle plant, we have acquired a former profitable private press (of which the president was a Wesleyan alumnus and trustee and the Treasurer's son a Wesleyan alumnus), which deals exclusively in educational publications sold exclusively to pupils and educators. The Treasury has itself found the following facts relating to our Wesleyan University Press:

"Your activities consist of composing, compiling, editing, illustrating, printing and publishing educational books, periodicals and miscellaneous other materials instructional and educational in character. Your principal publications are books and weekly periodicals, prepared in conformity with standards of leading educators, designed for distribution to pupils, teachers, and schools and are used mainly in classroom work in the elementary schools. Your financial statement for the fiscal year ended September 30, 1949 shows receipts mainly from sales and small amounts from investments and miscellaneous sources. Expenditures were made for production, administration, and miscellaneous expenses, and purchase-price payments."

Yet the Department has to date denied us an exemption, despite the clear language of 101 (6); although our press is a nonstock foundation which by charter can profit only the college; although we are incorporated under a Connecticut statute which is not available to a business operated for profit; and although our managing board are all Wesleyan officers and include no former owners of the press.

We and other presses similarly situated should not be put to the expense of litigating for an exemption which Congress intended us to have, and for the future the amendment suggested above should make our position clear. The decision as to what publishing is related to the function of the college is one you can safely leave as in the past with the college press, not with an everchanging and sometimes avaricious department of Government.

III. THIRD PROPOSED AMENDMENT

Chairman Doughton stated in his report on this bill, page 36, "The problem at which the tax on unrelated business income is directed here is primarily that of unfair competition."

Believing as I do in free private enterprise with equality of opportunity, I agree there is a problem involved if business foundations are permitted to be tax-free.

Suggestion.—Add at the end of 421 (a) (1), the words: "*Provided, however,* That there shall be deductible as a credit against any tax imposed by this subsection (a) (1) any amount actually used during the taxable year by any organization described in subsection (b) (1) for the purpose for which such organization is exempt, except as provided in this supplement, from taxation under this chapter by reason of paragraphs (1), (6), or (7) of section 101."

Argument.—Such amendment would reduce to unimportance the competitive advantage of an unrelated business, but would not deny the right of the owner of a business to devote it entirely to charitable purposes. It would prevent abuses such as those Textron was accused of fostering, by taxing the accumulating charitable trust where the charitable use is remote in time. Competitionwise, it would solve the problem Chairman Doughton spoke of, as the tax-free competitor who did not pay 41 percent out of its charity would pay any deficiency to the Government; in either case, the drain on the resources and the effective cost of doing business would be the same to the taxpaying business and the tax free competitor.

The problem of unfair competition is not involved in any way in continuing the direct exemption of the colleges, as suggested in amendment I above, and is negligible in the case of university presses, which have long been exempt and have been the cause of no complaints on this score. The problem is involved directly in the "macaroni case" and similar cases. I do not like to appear to defend the macaroni case and similar purchases, because I believe they evidence poor judgment in the purchasers. I do not believe any college or university can successfully operate over a period of years a nonrelated business. If I am correctly informed, at least one of the New York University purchases has already become a problem child of serious dimensions. There is little real danger of many colleges jumping into this field; few trustees would take the risk. However, when these investments were made the law was clear, by Supreme Court decision, that the destination and not the scource of income determines its tax-free status, and for Congress to reverse this well-established policy (as the Treasury Department has done without congressional authority) and apply the law to consummated transactions, smacks too much of ex post facto regulation to be reconciled with any high sense of justice.

A solution which ignores the competitive differential but gives the institutions which, relying on the law as it is now understood, have made nonrelated investments, the bargain to which in justice they are entitled, would be to amend section 302 relating to the effective date of part 1, by specifically excluding income from organizations acquired for religious, charitable, or educational purposes prior to the enactment of this law.

CONCLUSIONS

1. Educational institutions exempt under section 101 of the code should be continued exempt, and any tax loophole or unfair competition which the Senate concludes to be serious enough to demand legislation should be treated in other ways equally effective revenuewise, as suggested above.

The implications of placing any direct tax on our colleges are too serious to be justified by any fiscal expediency.

2. University presses, church presses, and other similar publications of religious or educational nature should be specifically granted the exemption which in the public interest has been granted to them under every previous revenue act.

3. If the primary purpose of title III is as stated by the House committee to prevent unfair competition, it can be effectively done without foreclosing sources of income to our colleges, whose fiscal well-being is fundamentally important to our people, by allowing a distribution to a college to replace a tax in a college-owned business.

4. However unwise the moves of some colleges have been, they were made in good faith to further the public interest in education, under the law as it was understood at the time, and justice requires that the rules not be changed now to cover past transactions.

The CHAIRMAN. Did I understand you to say that the Wesleyan Press published under the name of the college, or is it a separate entity?

Mr. HEDDEN. It is not owned directly by the college. It is owned by a foundation consisting of five trustees, all of whom are trustees of the college. The college put up the initial purchase sum, which, incidentally, was the largest single investment the college has ever made in any security. The charter, which is a Connecticut charter, under a provision of Connecticut law not available to a profit-making

corporation, a nonstock corporation, provides that no trustee or officer of the press can have any salary or emolument, and that all profit, if any, of the press accrues directly to the university, and in the event of dissolution all property must go to the university. The press is an independent foundation simply to insulate the college from the risks of the business.

The CHAIRMAN. Yes, sir. Are there any questions of Mr. Hedden?

Senator BUTLER. Do you have an extra copy of that material?

Mr. HEDDEN. I have one extra copy, Senator, which I will be glad to give to you.

Perhaps you will permit me to say, in reference to some of the educators this morning, that a university is not like a business. It doesn't have a lawyer on its campus. Its lawyers generally are many miles away in another city, its nearby principal city. This House bill, even when the colleges were alert to send for it, didn't reach any of us until a week ago. There hasn't been much time to prepare testimony for this committee. I hope you will consider the testimony of the educators and of myself in that light.

The CHAIRMAN. Thank you very much, Mr. Hedden.

Mr. HEDDEN. Thank you, Mr. Chairman.

(The following material was submitted for the record:)

HARVARD UNIVERSITY,
Cambridge, Mass., June 28, 1950.

Hon. LEVERETT SALTONSTALL,
Senate Office Building, Washington, D. C.

DEAR SENATOR SALTONSTALL: During the illness of President James B. Conant of Harvard, but with his full knowledge and authority, I am writing you to express the position of this university in regard to H. R. 8920, and more particularly title III thereof "Treatment of Income From, and Gifts and Bequests to, Certain Tax-Exempt Organizations," and title VI, chapter 8A, section 1311, respecting withholding tax on dividends receivable to exempt institutions.

Our concern relates principally to that portion of the bill which would tax the net income of organizations otherwise exempt under section 101 (6) in respect to business enterprises directly carried on by such institutions in their own names. The treasurer of Harvard University has testified before the Ways and Means Committee of the House at hearings respecting this proposed legislation that it is unwise investment policy for such an institution to engage in such unrelated businesses, and the Association of American Universities has made a similar policy statement. We believe that few governing boards of universities would be willing to accept the business risks and liability which would be involved if such business enterprises were to be owned directly by the university rather than by a separate corporation or foundation. Any effort to tax the income of the university itself, or some part of it (as distinguished from taxing the income of a wholly owned or majority controlled corporation conducting an "unrelated business"), would violate the tax-exempt principle which we feel strongly it is in the public interest to maintain inviolate. We believe that instances of the operation of "unrelated businesses" by universities directly, and not through the medium of a separate corporation, are not significant in the general picture, either in number or in size, and that they do not justify this serious first inroad, proposed in H. R. 8920, upon the tax-exempt status of the income of educational and other charitable institutions.

We believe that the public interest would be far better served if the exemption were, in this regard, preserved unchanged.

We call your attention also to the fact that the proposed withholding tax in respect of corporate dividends will work a serious hardship upon educational institutions in that it will interrupt, for a matter of months to the very substantial extent of 10 percent, the regular flow of income. We urge that the withholding provisions be revised to permit dividend-paying corporations to pay without deduction to stockholders who have furnished certificates to the effect that the dividends are free from income tax under the Internal Revenue Code. The

Government would, of course, retain all its rights against the charitable corporation stockholder, and the possibility of abuse would appear to be exceedingly remote.

We enclose for your consideration the report of the Committee of the Association of American Universities on Financial Support and Taxation and particularly ask you to read paragraphs numbered 4 and 5, from the middle of page 2 to the middle of page 3, The Operation and Ownership of Business and Commercial Enterprises.

We also enclose a news release given to the morning papers on Friday, May 19, 1950, by the news service of Massachusetts Institute of Technology (President Killian of M. I. T. being the chairman of the committee of the Association of American Universities which prepared the report above mentioned).

Finally, we also enclose a copy of the statement by Paul C. Cabot, treasurer of Harvard University, presented to the Ways and Means Committee of the House on February 10, 1950.

Sincerely yours,

EDWARD REYNOLDS,
Administrative Vice President.

ASSOCIATION OF AMERICAN UNIVERSITIES—REPORT OF THE COMMITTEE ON FINANCIAL SUPPORT AND TAXATION

The committee met in New York on January 30, 1950, and on April 23, 1950. The following members were present: Presidents Darden (first meeting only), Dodds, Killian, Painter, and Stassen. Chancelor Hutchins was absent from both meetings. A preliminary draft was circulated among the members of the association. The comments received have been carefully considered by the committee.

The members present unanimously reached the following conclusions and recommendations:

(1) The financial stability of our universities is dependent upon their being exempt from taxation on income or property used for educational purposes. Any impairment of the long-standing principle of tax exemption would be a fatal blow to our educational system. The critical need at the present time is for positive measures to conserve and increase the income and resources of these institutions if they are adequately to meet the educational needs of the Nation. Instead of efforts to tax these institutions we need through Government tax policy to protect their resources and to stimulate their support through private philanthropy.

The committee believes that the Association of American Universities should mobilize its forces vigorously to defend the tax-exemption principle and to support changes in the revenue laws which would encourage private philanthropy.

(2) The committee believes that it would be wise for our educational institutions to refrain from engaging in various types of transactions. These are aften referred to by those who seek to impair the tax exemption as furnishing a basis for taxation.

(3) The committee believes that in addition to investing its funds, it is proper for an educational institution to carry on a variety of other activities which primarily serve its students and members. Such activities aid the educational objectives of the institution and cannot properly be distinguished from the overall operations of the institution. The committee believes that it is impractical, if not impossible, to segregate these activities. If the educational institution is to continue to be exempt from income tax, it must be wholly exempt from such taxes, and any effort to tax one part and not another places in jeopardy the whole principle of tax exemption.

THE OWNERSHIP AND OPERATION OF BUSINESS AND COMMERCIAL ENTERPRISES

(4) The committee believes, however, that a different situation arises when a manufacturing or mercantile business is carried on by a separate corporation or trust which would certainly not be entitled to tax exemption, if all its property and income were not dedicated to some university, and when such manufacturing or commercial business has no significant connection with the educational or scientific work of the university other than the attribute of producing income for the university.

The committee believes that it is sound policy for a university not to seek tax exemption for such a separate entity; and not to enter into a transaction involving such a separate entity if the advantage of the transaction depends upon the separate entitv being free of Federal income tax.

The conditions of the preceding paragraph being satisfied, the university should then continue to be free from income tax on the dividends or other distributions of income by such separate entity just as the university is free from income tax on other income.

The committee believes that the taxation of such separate entities would cover practically all the business investments which have been subject to criticism. Few boards of trustees of a university would be willing to accept the liability which would be involved if such business enterprises were to be owned directly by the university, rather than by a separate corporation or foundation. If there should be any change in the revenue laws designed to tax such buiness operations, it should not be aimed at the university which receives income from the separate entity. Any effort to tax the university or some part of it would violate the tax-exemption principle.

(5) Although the committee believes that a university should not be subject to tax on any earnings which it may derive from an operation carried on directly by the university, nevertheless the committee believes it is neither proper nor in the public interest for a university to carry on directly any manufacturing or mercantile business having no significant connection with the educational or scientific work of the university other than the attribute of producing income for it.

The committee believes that an educational institution should continue to be free from income tax on rents and royalties from its interests in real estate.

LEASE-BACKS

(6) There has been criticism of transactions in which an educational institution has directly or indirectly bought a business plant and leased it back to the seller. The committee believes that many such transactions are unobjectionable. It may often be wise for a company to sell its plant to acquire cash, and the sale may not be possible unless the seller leases back the plant either because the seller needs occupancy for a period or because no buyer would pay the price if the plant had no tenant. There is no more objection to a university than to anyone else becoming the owner of such a plant. The exemption of the university from income tax on the rental received does not differ from its exemption from income tax on dividends or on rentals from other real estate. Any sound basis for criticism must rest on some special aspect of the particular transaction other than the tax-exempt status of the buyer.

To avoid jeopardizing the larger interests involved, the committee believes that it is wise for a university to refrain from purchasing property directly or indirectly in a transaction in which such property, or the real-estate portion thereof, is to be leased back to the seller with an option in the seller to repurchase the property; and that it is also wise to refrain from directly or indirectly making such a purchase and lease-back in a transaction in which the university supplies no subsubstantial part of the purchase price from its funds other than funds received in the transaction or from money borrowed on the specific transaction.

ENCOURAGING PHILANTHROPY

(7) The committee believes that the association should take such action as it deems appropriate to secure a change in the Federal income-tax law permitting the deductible charitable gifts of an individual in any year to be free of the present 15 percent limit.

(8) The committee urges that universities take such action as they deem appropriate to secure the enactment by various States of amendments to their corporation laws authorizing business corporations to make charitable donations.

(9) The committee believes that universities should take such action as they deem appropriate to obtain an amendment of the Federal income-tax law so that charitable corporate gifts within the present 5 percent limit, instead of being deductible on the tax return of the donor corporation, should to the extent of 50 percent of the gift be a credit against the corporate tax. The deduction at present allowed in effect reduces the tax by 38 percent of the gift.

MEMBERS OF THE ASSOCIATION OF AMERICAN UNIVERSITIES

Brown University, Providence, R. I.
California Institute of Technology (M), Pasadena, Calif.
Catholic University of America, Washington, D. C.
Clark University, Worcester, Mass.
Columbia University, New York, N. Y.
Cornell University, Ithaca, N. Y.
Duke University, Durham, N. C.
Harvard University (M), Cambridge, Mass.
Indiana University, Bloomington, Ind.
Johns Hopkins University, Baltimore, Md.
McGill University, Montreal, Canada.
Massachusetts Institute of Technology, Cambridge, Mass.
New York University, New York, N. Y.
Northwestern University, Evanston, Ill.
Ohio State University, Columbus, Ohio.
Princeton University (M), Princeton, N. J.
Stanford University, Stanford University, Calif.
State University of Iowa, Iowa City, Iowa.
University of California, Berkeley, Calif.
University of Chicago, Chicago, Ill.
University of Illinois, Urbana, Ill.
University of Kansas, Lawrence, Kans.
University of Michigan, Ann Arbor, Mich.
University of Minnesota, Minneapolis, Minn.
University of Missouri, Columbia, Mo.
University of Nebraska, Lincoln, Nebr.
University of North Carolina, Chapel Hill, N. C.
University of Pennsylvania, Philadelphia, Pa.
University of Rochester, Rochester, N. Y.
University of Texas, Austin, Tex.
University of Toronto, Toronto, Canada.
University of Virginia, Charlottesville, Va.
University of Washington, Seattle, Wash.
University of Wisconsin, Madison, Wis.
Vanderbilt University, Nashville, Tenn.
Washington University, St. Louis, Mo.
Yale University, New Haven, Conn.

STATEMENT FROM THE NEWS SERVICE, MASSACHUSETTS INSTITUTE OF TECHNOLOGY, CAMBRIDGE, MASS.

Measures to increase financial support for universities and discourage investments which might jeopardize the tax-exempt status that educational institutions now enjoy have been recommended by the Association of American Universities, Dr. Henry M. Wriston, president of Brown University and of the association, announced today.

Duscussing the economic problems raised by steadily increasing costs of operation and the decrease in returns on endowments which have caused widespread financial distress in universities, Dr. Wriston cautioned universities in search of acutely needed new sources of revenue to avoid investments which might place them in the position of taking improper advantage of their tax-free status. The amount of such "loophole" investments has been grossly exaggerated, said Dr Wriston, and the effect on tax revenue has been negligible.

The recommendations are based on the report of a committee of the association, which includes 37 leading American and Canadian educational institutions, which has just completed an intensive study of financial and taxation problems. The members of the committee were President James R. Killian, Jr., of the Massachusetts Institute of Technology, chairman; President Colgate W. Darden, Jr., of the University of Virginia; President Harold W. Dodds of Princeton University; President Theophilus S. Painter of the University of Texas; and President Harold E. Stassen of the University of Pennsylvania.

In presenting the report, Dr. Killian, chairman of the committee, emphasized the committee's disapproval of tax-free ownership of mercantile and manufacturing businesses by educational institutions when such activities are unrelated to the purposes of education.

Emphasizing that the future financial stability of universities is dependent upon exemption from taxation on income or property used for educational purposes, the committee warned that "any impairment of the long-standing principle of tax exemption would be a fatal blow to the educational system."

The critical need, the committee reported, is for positive measures to conserve and increase the income and resources of these institutions if they are to meet the educational needs of the youth of the Nation. It stressed the importance of a Government tax policy which will not only protect university resources but stimulate increased support through private philanthropy.

The committee recommended that the Association of American Universities take vigorous measures to defend the fundamental tax-exemption principle and to support changes in the revenue laws which would encourage private philanthropy.

"The report," Dr. Wriston said, "seeks to set up an investment policy which would provide revenue and at the same time avoid investments which might be construed as unfair competition with taxpaying organizations."

In making its recommendations the committee reported its belief "that, in addition to investing its funds, it is proper for an educational institution to carry on a variety of other activities which primarily serve its students and members. Such activities aid the educational objectives of the institution and cannot properly be distinguished from the over-all operations of the institution. The committee believes that it is impractical, if not impossible, to segregate these activities. If the educational institution is to continue to be exempt from income tax, it must be wholly exempt from such taxes, and any effort to tax one part and not another places in jeopardy the whole principle of tax exemption."

Discussing the problem of ownership and operation of business and commercial enterprises by educational institutions, the committee warned against transactions in which tax exemption might be claimed for an organization which would ordinarily be subject to taxation.

The committee believes, however, that a different situation arises when a manufacturing or mercantile business is carried on by a separate corporation or trust which would certainly not be entitled to tax exemption if all its property and income were not dedicated to some university and when such manufacturing or commercial business has no significant connection with the educational or scientific work of the university other than the attribute of producing income for the university.

"It is sound policy," the committee believes, "for a university not to seek tax exemption for such a separate entity; and not to enter into a transaction involving such a separate entity if the advantage of the transaction depends upon the separate entity being free of Federal income tax.

"If those conditions are satisfied," the report continued, "the university should then continue to be free from income tax on the dividends or other distributions of income by such separate entity just as the university is free from income tax on other income.

"The committee believes that the taxation of such separate entities would cover practically all the business investments which have been subject to criticism. Few boards of trustees of a university would be willing to accept the liability which would be involved if such business enterprises were to be owned directly by the university, rather than by a separate corporation or foundation. If there should be any change in the revenue laws designed to tax such business operations, it should not be aimed at the university which receives income from the separate entity. Any effort to tax the university or some part of it would violate the tax-exemption principle."

Although the committee believes that "a university should not be subject to tax on any earnings which it may derive from an operation carried on directly by the university, nevertheless the committee believes it is neither proper nor in the public interest for a university to carry on directly any manufacturing or mercantile business having no significant connection with the educational or scientific work of the university other than the attribute of producing income for it.

"The committee believes that an educational institution should continue to be free from income tax on rents and royalties from its interests in real estate."

There has been criticism of transactions, said the report, in which an educational institution has directly or indirectly bought a business plant and leased it back to the seller. The committee believes that "many such transactions are unobjectionable. It may often be wise for a company to sell its plant to acquire cash, and the sale may not be possible unless the seller leases back the plant either because the seller needs occupancy for a period or because no buyer would pay the price if the plant had no tenant. There is no more objection to a university than to anyone else becoming the owner of such a plant. The exemption of the university from income tax on the rental received does not differ from its exemption from income tax on dividends or on rentals from other real estate. Any sound basis for criticism must rest on some special aspect of the particular transaction other than the tax-exempt status of the buyer.

"To avoid jeopardizing the larger interests involved, the committee believes that it is wise for a university to refrain from purchasing property directly or indirectly in a transaction in which such property, or the real-estate portion thereof, is to be

leased back to the seller with an option in the seller to repurchase the property; and that it is also wise to refrain from directly or indirectly making such a purchase and lease-back in a transaction in which the university supplies no substantial part of the purchase price from its funds other than funds received in the transaction or from money borrowed on the specific transaction."

The committee recommended that the association take action to secure a change in the Federal income-tax law permitting the deductible charitable gifts of an individual in any year to be free of the present 15-percent limit. The report also urges that universities seek the enactment by various States of amendments to their corporation laws authorizing business corporations to make charitable donations.

"Universities should take such action as they deem appropriate," the committee believes, "to obtain an amendment of the Federal income-tax law so that charitable corporate gifts within the present 5-percent limit, instead of being deductible on the tax return of the donor corporation, should to the extent of 50 percent of the gift be a credit against the corporate tax." The deduction at present allowed in effect reduces the tax by 38 percent of the gift.

Statement of Paul C. Cabot, Treasurer of Harvard University, Before Ways and Means Committee

I am glad to have this opportunity to state to the committee briefly the views of Harvard University on the question of the exemption of charitable institutions from the Federal income tax. Of course, I have no authority to speak for any other university or college, nor the endowed hospitals, medical institutions, or religious organizations that are vitally interested in this matter, but I think it is safe to assume that most would take about the same position that we do.

It would be difficult to overstate the importance of the contribution to American education, and so to American democracy, by the endowed universities and colleges. There are approximately 872 [1] of them, of 4-year college rank, in the United States. In the academic year 1948–49, the last for which reliable figures are available, they enrolled altogether approximately 1,990,361 [1] young men and women. These institutions include, in addition to general education at undergraduate level, many of the principal professional schools in the Nation—medicine, law, engineering in all its branches, the sciences, education, business, and the rest. Many of these institutions—Harvard is a conspicuous example—are engaged, as they were throughout the war, in research projects of incalculable importance to the national defense and ultimately to the scientific advancement and welfare of mankind. These projects are undertaken under contract with Federal departments and agencies on a cost basis, and without profit to the research institution.

Indeed, with few exceptions, these endowed colleges and universities receive no direct aid from government—State or Federal—apart from the ancient exemption from taxation. They are dependent for the funds needed to carry on their work of education and research not only on tuitions but in very large part upon the private gifts of public-minded citizens, both graduate and nongraduate, through which their endowments have been built. I think I need not labor the point with this committee that the endowed universities and colleges have long since justified, by their unparalleled public service to education, the freedom from taxation which is so essential to their survival.

For some years there has been a growing discussion about certain aspects of this tax exemption currently available to charitable institutions as provided in the Revenue Code. Recently the President, in his tax message to the Congress, referred further to the matter in suggesting that legislation be enacted to prevent certain practices and abuses which are possible under existing laws.

I think that there are two general categories that need serious consideration, and at least in one case may justify remedial legislation. The two categories to which I refer are (1) the ownership and operation of a manufacturing or commercial enterprise by an educational or charitable institution which is in no way or is only remotely connected with the normal affairs of the owning charitable institution, and which manufacturing or commercial enterprise does not pay Federal taxes on its income, and (2) the practice of some charitable institutions of buying properties from businesses and leasing such properties back to the selling corporation. I am informed that these two practices are legal under present laws. Nonetheless, Harvard University has never indulged in such practices.

[1] According to 1950 edition of World Almanac ,as certified by American Council on Education.

At this point I think it would be well to point out that although these two practices have had considerable publicity, it is my personal opinion that the first practice has not been indulged in to any considerable extent. Also, at this point I would like to point out that the first practice above referred to is, in my opinion, infinitely more harmful and, I think, far less in keeping with the spirit of tax exemption than is the second practice.

I cannot believe that it is sound public policy to exempt from Federal taxation the income of manufacturing and commercial enterprises merely because they are owned by charitable institutions. It is easy to see that two businesses that are directly competitive cannot in fact compete if one of them must pay 38 percent of its earnings as a Federal income tax and the other pay nothing.

In this connection, however, it must be pointed out that from time immemorial the endowed educational institutions have invested in real estate, from which they collect the rents. It does not seem to me that this stands on the same footing with the ownership of a manufacturing enterprise. For reasons both historical and practical, I urge that any amendment passed to meet the point I have been discussing should leave intact the exemption for rents from real estate. It follows therefore that the legislation covering this abuse must be skilfully drawn and only make those businesses that now are exempt from taxation, subject to tax, where the business is of significant size and where its adtivities are in no way related to the charitable purposes of the tax-exempt owner.

An ill-conceived, half-considered or loosely drawn amendment will severely penalize the genuine, worthy charitites. The line must be drawn with care and skill between the business enterprise, properly speaking, and those many activities carried on as necessarily incidental to education. At Harvard, our dining halls and restaurants throughout the University feed about 5,132 [2] students. It is an undertaking of major proportions, larger than many restaurant businesses. But we do not feed the public and we do not conduct the operation for the purpose of profit. I take it that no one would seriously argue that that is the kind of "business" we are considering here. But any amendment on this point must skillfully avoid language which would leave the issue in doubt. I could multiply examples, all common, in varying degree, to all universities and colleges. At Harvard, we house about 5,809 [2] students. That is a necessary incident to the accomplishment of the object for which we exist. Surely we are not in the hotel business in so doing. We do other things that the business world does. We operate a press and a publishing office, both in direct furtherance of our educational purpose. Any amendment must be drawn so that these, and the other activities directly incidental to education, continue to enjoy the exemption from taxes so vital to our continued existence.

I should like to point out here that in his testimony before this committee on February 3, the Secretary of the Treasury is reported to have recommended that the income derived by charitable institutions from the operations of businesses which are clearly unrelated to the primary functions of the charity be taxed at their regular corporation income tax rates. I think there can be no doubt that the Secretary was not proposing that the income received by the charitable institution should be subjected to a tax, but rather that the income earned by the business itself should be taxed.

The second practice above referred to and commonly known as the sell-lease practice is certainly not at all in the same category as the first practice so far as detriment to our economy and the spirit of tax code is concerned. Although, as I have stated above, Harvard has never indulged in this practice either, I do know of other universities and charitable institutions that have so indulged and whose responsible officers have steadfastly defended the practice from every point of view. I do not intend to go into a prolonged discussion of the economics of the sale and lease-back, but it seems to me that the case is not substantially different whether the buyer-lessor is an educational institution or an insurance company, unless it can fairly be shown that the seller-lessee got a substantially better deal because he dealt with a tax-exempt institution. It might be difficult to prove statistically that anything of the sort exists. And this financing device may possibly have advantages in the over-all economic picture sufficient to justify its continued use. Doubtless there are aspects of the sale and lease-back that deserve consideration from the point of view of the Federal income tax. What I wish to emphasize here is that the problems are, generally speaking, not peculiar to the use of the arrangement by charitable institutions. Much has been written on the subject and believing it may be helpful to you I refer you to an article by William L. Cary published in volume 62 of the Harvard Law Review.

[2] Present figure.

Harvard having refrained from indulgences in these practices would welcome a clear-cut and well considered determination of public policy on both these points.

I do not think that it is necessary to tell you gentlemen that without tax exemption all of the churches, hospitals, and educational institutions would be forced to go "to the wall' or at least be most seriously crippled in their great and important work for the people of this country.

It follows, therefore, that legislation must be most carefully and skillfully drawn so that we will not be in a position of "burning down the house to kill the rat." As an example, I am told that last year at least two bills were introduced into the House aimed at correcting either one or both of the situations I have referred to herein. In one of these bills there was amongst other things a provision that all trusts and corporations organized for charitable purposes should pay out to their beneficiary each year at least 75 percent of that year's income. On the face of it such a provision sounds innocuous. Nonetheless, I venture to state that it would play havoc with many legitimate organizations. It certainly would in the case of Harvard. In Harvard we have a number of funds that have been left to us by past generous donors who amongst other things have specified in their wills or deed of gift that income shall accumulate over the years until such time as the fund has grown to a size necessary to do a certain specified job, such as providing a chair for a professor or a scholarship for a poor boy. Obviously such a provision is legitimate, and such gifts should be encouraged, and obviously it was the intention of the Congress to give such a situation the benefit of tax exemption; and yet the bill of last year would in this instance have destroyed that. I urge, therefore, that in drawing remedial legislation, the greatest care shall be taken not to harm or destroy that essential tax exemption without which these great institutions could not survive. I hope that this committee will at the time of the drafting of the words of such legislation permit me and my associates an opportunity of going over the wording and helping, if such be possible, in any way that we can.

Since preparing the statement that I have just read to you, I have had an opportunity to read the Treasury Department supplemental statement of February 6 on tax-exempt organizations. On the whole I agree with what it is aiming at but there are, I believe, at least two serious matters that they must have overlooked.

The first is their proposal to tax undue accumulation of income in a charitable fund. I have, in my prepared statement, already pointed out the great harm such a proposal could do. A possible suggestion to get at the abuse they are aiming at would be to have a provision that those charitable trusts, etc., that have a large proportion of their assets invested in the control of a single company shall be subject to tax on that proportion of their income above a certain percentage repaying for reserves, contingencies, etc., that they fail to pay out to the charitable institution which is the beneficiary of the trust. This would permit accumulation in most of the worthy cases while making the abuse of this particular set-up difficult. Most of the cases of abuse involve the use of accumulation to finance a single business or group of related businesses.

The Treasury statement in covering the lease-back arrangement suggests that the rent shall be taxed in the same proportion that the debt bears to the original cost. We are strongly opposed to this proposition. First, it would be possible under it to levy an income tax on an operation that in its entirety ran in the "red" and had no income. I know of no other operation similarly placed.

It is unsound and very dangerous to start taxing even in part these charitable institutions. Once the process is begun there will be no end of it. The remedy lies in taxing the selling or renting organization.

At this time when most hospitals, universities, and other charities are heavily in the "red" and their very survival in doubt, no encroachment whatsoever should be made on their tax-free status.

PROVIDENCE, R. I., *July 8, 1950.*

SENATE FINANCE COMMITTEE,
Senate Office Building, Washington, D. C.:

We propose to the Senate Finance Committee that the exemption provided for colleges in the proposed section 424 (A) (1) (B) of the Internal Revenue Code (p. 106, lines 14 to 18 of the bill) be amended as follows, by the addition of the underscored language:

(B) An educational organization which normally maintains a regular faculty and curriculum and normally has a regularly organized body of pupils of students in attendance at a place where its educational activities are regularly carried

on, or an organization primarily engaged in providing retirements benefits for the employees of such education organizations:

The parallel provisions of paragraph (B) of the proposed addition to section 101 (6) (p. 115, lines 21 to 25 of the bill) should also be amended to include the same language.

ROBERT J. SLAVIN,
President of Providence College.

MEMORANDUM RE PROPOSED CHANGE IN EFFECTIVE DATE OF TITLE III, PART 1, OF H. R. 8920 (TAXATION OF BUSINESS AND OTHER INCOME OF CERTAIN TAX-EXEMPT ORGANIZATIONS)

I. STATEMENT OF PROBLEM

Section 302 of the House bill, as presently drawn, leaves to litigation the question of whether or not the unrelated business income of an exempt organization is taxable for tax years prior to the effective date of part 1.

Prior to the decision of the Tax Court in *C. F. Mueller Co.* v. *Commissioner* (Docket No. 21600, May 25, 1950) it was generally considered by educational institutions that the case of *Roche's Beach, Inc.* v. *Commissioner* (96 F. (2d) 776) and other cases and rulings, settled the law in favor of tax exemption so long as all of the income of a business was necessarily devoted exclusively to charitable purposes. The majority in the Mueller case declined to follow the Roche's Beach case. In other words, the inferior court refused to follow the appellate court. Judge Opper in his dissenting opinion pointed out that the Roche's Beach case "had been relied on by numerous courts in more than a dozen decisions." He thought that since this matter has been reexamined by Congress on numerous occasions without change, the "unbroken line of repeated and identical adjudication" should be changed by Congress and not by the Tax Court.

Presumably the Tax Court will be reversed by the Circuit Court of Appeals. But in the meantime, many universities and other charitable organizations are in a severe dilemma. Many have made no tax returns; many have no reserves to pay back taxes; almost all could pay back taxes only by increasing existing deficits. Even charities not affected by this bill in the future are affected as to past years by the Mueller decision: for example, religious organizations and colleges which are actively in the rental business.

II. PROPOSED CHANGE IN SECTION 302 OF PART 1

It is submitted that the House version of section 302 should be redrawn substantially as follows:

"SEC. 302. EFFECTIVE DATE:

"(a) IN GENERAL.—The amendments made by this part shall be applicable only with respect to taxable years beginning after December 31, 1951.

"(b) TAX EXEMPTION FOR PRIOR YEARS IN CERTAIN CASES.—Organizations which in any taxable year beginning prior to January 1, 1952, carry on a trade or business for profit, no part of the net earnings of which inure to the benefit of any private shareholder or individual and all of the net earnings of which inure to the benefit of one or more organizations of a kind described in subparagraph (A), (B), (C), or (D) of section 424 (a) (1) of the Internal Revenue Code, shall be exempt from taxation under chapter 1 of the Internal Revenue Code (or the corresponding title of the applicable prior revenue law) for such taxable year.

"(c) SAVING PROVISIONS.—Except as provided in subsection (b), the determination as to whether an organization is exempt under section 101 of the Internal Revenue Code from taxation for any taxable year beginning before January 1, 1952, shall be made as if section 301 (b) of this act had not been enacted and without inferences drawn from the fact that the amendment made by such section is not expressly made applicable with respect to taxable years beginning before January 1, 1952."

The proposed section confirms the Roche's Beach case for past taxable years and thus protects established charitable organizations which have in good faith relied on that case and the numerous other cases which have followed it.

The proposed section would also give established organizations an additional year to change to other forms of investment.

III. SPECIAL REASONS WHY IMPACT OF BILL SHOULD BE MODERATED

The amount involved in possible tax liability for past years is relatively small. The real objective of the bill is to prevent the spread of a plan which might involve a substantial loss of revenue in the future.

An additional reason for moderating the impact of this bill on the few colleges directly affected is that this bill is imperfect and incomplete and permits some organizations to continue practices not morally or legally distinguishable from those prescribed.

For example, the unrelated business income of religious organizations is still to be exempt, including the income of a church school if the school is owned and operated by the church. Furthermore, rentals, even though based on a percentage of profits, are exempt if the college has incurred no debt.

The plan followed by the alumni and friends of New York University in setting up foundations for the benefit of the university was forthright and aboveboard. The companies acquired were acquired in good faith under what was thought to be the law at the time. Indeed, the first foundation (Ramsay Corp.) received a Treasury letter of exemption. The university is not opposed to a change in the law if the change is made prospectively, and with equal application to all, and with a reasonable time given to enable the university to adjust itself to the new impost.

New York University is a large school, doing a great public service, and is in desperate need of revenue. Last year it enrolled some 68,000 students and had an operating budget of $20,000,000, but it had less than $300,000 from its endowment of $12,000,000. New York University has no State or city support. It has purchased expensive land on the East River and on Washington Square for the new medical center, its law center, and its proposed library. It has started construction of buildings in reliance on income from certain feeder organizations. A retroactive change in the law would cause severe hardship on the university and its thousands of deserving students.

In his dissenting opinion in the Mueller case, Judge Opper wrote as follows:

"The nightmare of wholesale tax avoidance is an understandably difficult one for the tax collector to escape. But it seems to me that section 101 with the interpretative gloss placed upon it by judicial and administrative precedent was intended to guard against the unreal charity, the masquerading educational institution, the qualified or conditional gift, and not as here a forthright financial transaction by a genuine and respected institution of learning. * * *"

While New York University is the school most seriously affected by this bill, many other schools are affected by this bill and by the implications of the Mueller decision. A code of investment practice for the future is acceptable to most schools, but liability for the past would be a severe burden for many and disastrous for some.

If a change in the law must be made, it should be drawn to cause as little hardship as possible.

RUSSELL D. NILES,
Dean, School of Law, New York University.

BATES COLLEGE,
Lewiston, Maine, July 11, 1950.

Senator OWEN BREWSTER,
Senate Office Building, Washington, D. C.

DEAR SENATOR BREWSTER: In your many capacities in the Washington scene, I know that you are a member of the Senate Finance Committee.

If my information is correct, I understand that your committee will soon be considering the proposed Revenue Act of 1950, H. R. 8920. I believe that through some inadvertence, this bill as drafted appears to impose a 41-percent tax upon substantially all of the investment income of the Teachers Insurance and Annuity Association of America. Because of the importance of this association to the security of college professors, I hope that your committee will remedy this error before the bill is submitted to the Senate for a vote. I understand that an appropriate amendment to bring about this result has been suggested by the TIAA. I wish to add my support to this proposed amendment, so that the tax does not apply to "an organization primarily engaged in providing retirement benefits for the employees of educational organizations."

Sincerely yours,

CHARLES F. PHILLIPS, *President.*

ASSOCIATION OF COLLEGES AND UNIVERSITIES
OF THE STATE OF NEW YORK,
Hamilton, N. Y., July 10, 1950.

The Honorable WALTER F. GEORGE,
Chairman of Senate Finance Committee,
United States Senate, Washington, D. C.

MY DEAR SENATOR: In enclosing herewith copy of my telegraphic message in support of the amendment to H. R. 8920 proposed by the Teachers Insurance and Annuity Association, may I take this opportunity to express the grave concern which America's colleges and universities must feel over other aspects of the bill. I refer in particular to title III, part 1, sec. 421 (b), from the application of which churches are specifically excluded while educational institutions are not.

To the best of my knowledge educational and religious institutions have hitherto been treated uniformly with respect to their exemption from certain taxes. Any departure from this policy must seriously and adversely affect that great free enterprise of learning which the independent colleges and universities of America have developed without direct recourse to the taxing power. At a moment when inflated costs are seriously straining our resources, such a departure from traditional policies would be peculiarly damaging not only to us as nonprofit institutions but also to the kind of public service which it is our mission to render.

If in certain instances questionable practices or abuses have crept into the picture of college and university financing, I am confident that you can count on the cooperation of the colleges and universities to see that they are corrected in ways which do not penalize all colleges and universities indiscriminately as H. R. 8920 threatens to do. Indeed, such questions have recently been the object of intensive study and constructive reports both by the Association of American Universities and the Association of American Colleges. These studies indicate that our educational institutions are not directly engaging in business enterprises unrelated to education and that in the few instances in which there is involvement it is through the medium of a separate corporation. To the taxation of such separately organized (subsidiary) corporations I, for one, would offer no objection. Nevertheless, as it stands, the bill would compel all institutions to file elaborate returns, thus diverting to bookkeeping, accounting and legal expense funds sorely needed for the basic enterprises of teaching and research.

I, for one, have little fear that the Congress of the United States would by deliberate intent make any move at this time which could seriously handicap colleges and universities in the performance of their vastly important obligations to the youth of this country. I would further expect that you and your associates on the Senate Finance Committee would be alert to detect in proposed legislation such sections or clauses as might inadvertently have this effect. I venture to call the matter to your attention only because matters which otherwise would not escape your attention might conceivably do so in view of the natural and proper preoccupation with the critical situation in Korea which bears so heavily upon you and your Senatorial colleagues. Certainly as trustees of these educational institutions we would be very much to blame if the present bill were to pass without amendment because we had failed to call the facts to your attention.

Faithfully yours,

EVERETT CASE.

HAMILTON, N. Y., *July 10, 1950.*

The Honorable WALTER F. GEORGE,
Chairman of Senate Finance Committee,
United States Senate, Washington, D. C.:

Earnestly urge that Senate Finance Committee study and support amendment to H. R. 8920 submitted by Teachers Insurance and Annuity Association. Primarily engaged as they are in providing retirement benefits for college and university faculties, their ability to protect the interests of and meet their obligations to these deserving beneficiaries would be seriously impaired, if not indeed crippled, were they to be subject to tax on their investment income imposed by H. R. 8920 as it stands. I am satisfied that application to TIAA of such a tax must be inadvertent, for the Congress would never intentionally subject them or their beneficiaries to such a penalty. On the assumption that the amendment they have proposed fairly obviates this difficulty, I strongly commend it to your favorable attention as a matter of great importance to our colleges and universities and their teachers.

EVERETT CASE,
President, Colgate University.

DARTMOUTH COLLEGE,
Hanover, N. H., July 8, 1950.

The Honorable CHARLES W. TOBEY,
Senate Office Building, Washington, D. C.

DEAR SENATOR TOBEY: The trustees of Dartmouth College have authorized me to write to you to express the position of this college in regard to H. R. 8920, the new tax bill which is currently being considered by the Senate Finance Committee. Dartmouth College is particularly concerned about the possible dangers to educational institutions created by title III of this bill, "Treatment of Income of, and Gifts and Bequests to, Certain Tax-Exempt Organizations," and by title VI, chapter 8A, section 1311, imposing withholding taxes on dividends payable to all stockholders, including tax-exempt institutions.

TITLE III

Title III of H. R. 8920 proposes to impose the regular corporate tax rates on income of tax-exempt organizations (other than churches) arising from business enterprises which are unrelated to the exempt purposes of the organization. While Dartmouth College does not own or operate any such businesses either directly or indirectly and does not intend to acquire any such businesses, we are deeply concerned over what appears to be a serious departure from the long-standing exemption of educational institutions from Federal income tax. This departure is especially serious today when all colleges and universities face grave financial problems.

H. R. 8920 subjects the income of a business unrelated to education to the corporate tax rates whether the business is owned and operated directly by a college or whether the college receives the benefit of the profits of the unrelated business indirectly through a subsidiary or affiliate. It is this latter situation involving subsidiaries and affiliates, which are themselves tax exempt, which constitutes an abuse of the tax-exempt privilege. Dartmouth College, along with other leading educational institutions, approves completely of the proposal in the House bill to correct this abuse by taxing the income of these subsidiaries or affiliates at the regular corporate rates.

On the other hand, it is believed that the instances where colleges and universities directly own and operate businesses unrelated to their educational purposes are few and far between. Dartmouth College feels strongly that educational institutions themselves should not under any circumstances operate such businesses. This feeling is believed to be representative of the great majority of American colleges and universities today. Hence, H. R. 8920's provisions in this respect appear unnecessary and constitute an unwise inroad in the fundamental policy of tax exemption.

This distinction between direct ownership and operation and benefiting indirectly through a subsidiary or affiliate is an important one. As a matter of logic, which seems to be the position of the House, it would appear at first glance that the tax should be imposed in either case. In practical terms, however, the distinction is real and different treatment in the tax bill can be justified as a matter of wise legislative policy.

It is our feeling that if subsidiaries and affiliates operating unrelated businesses for the benefit of tax-exempt organizations are taxed, the danger of educational institutions operating such businesess directly is exceedingly remote and will occur only in a few isolated instances. The resaon for this feeling is that trustees of educational institutions simply will not authorize direct ownership and operation of unrelated businesses. The major and very practical restraining factor is that such an investment policy exposes all the assets of the educational institution, including the securities and real-estate constituting its endowments, to the claims of creditors of the unrelated businesses. The trustees of this college and those of the overwhelming majority of other colleges simply will not sanction such a practice.

In addition, the direct ownership and operation by a college of a business which is unrelated to its educational purposes would, in the case of most institutions, be beyond its corporate powers. Appropriate action to enjoin such investments can properly be taken in a great majority of cases. Furthermore, section 101 (6) of the Internal Revenue Code confers the tax exemption only on those educational organizations "operated exclusively" for "educational purposes". An educational institution which derived even as much as 5 percent of its income from operating businesses unrelated to education would, it seems to us, be jeopardizing its basic exemption from the Federal income tax.

The factors set forth above should be decisive in bringing educational institutions to adopt a policy of self-restraint and abstention from direct ownership and operation of unrelated businesses. It is our belief, therefore, that H. R. 8920 makes an inroad in a very basic principle, that of encouragement of higher education by tax exemption, for what we believe are wholly insufficient reasons. Certainly the evidence to date does not justify taking this very serious step and the public interest would be far better served if the exemption were preserved and only the real abuse of tax-exempt subsidiaries and affiliates eradicated.

A New Hampshire illustration will serve to show a special difficulty which will arise if H. R. 8920 is enacted. In 1807 the State of New Hampshire gave Dartmouth College a grant of 27,000 acres in Coos County on the condition that the income therefrom be used first, for the education of indigent New Hampshire youths at Dartmouth and, second, for the general purposes of the college. Over the years the college has sold standing timber from this second college grant and the grant has been one of the financial bulwarks of the college.

The college sells the standing timber in place as "stumpage." It has not itself engaged in the timber-cutting business. Nevertheless, H. R. 8920 is far from clear on whether the stumpage payments to the college are subject to taxation under its provisions. It may be that the stumpage proceeds would not be taxable because the second college grant can be shown to be related to the educational purposes of Dartmouth College, or because of the peculiar nature of the grant as a gift of the State of New Hampshire, or finally, because stumpage proceeds are akin to oil royalties, which are expressly excluded as taxable income under H. R. 8920. It is hoped very much that this one special problem can also be cleared up by a simple statement in the Senate Finance Committee's report or otherwise before the tax bill passes the Senate.

TITLE VI, CHAPTER 8A

Section 1311 of H. R. 8920 proposes a withholding tax on all corporate dividends. No procedure is provided whereby a tax-exempt institution can receive its dividends without withholding. The House Ways and Means Committee justifies this step on the basis of simplicity of administration.

In the case of Dartmouth College a 10-percent withholding on dividends for the current year would mean that approximately $75,000 will be withheld. At some subsequent time in 1951 we will be entitled to a refund. This deferment for a period of months will be an additional heavy blow to us in a financial situation which is already precarious.

It would seem that the withholding provisions could easily be revised without undue trouble to permit dividend-paying corporations to pay without withholding to stockholders who have furnished certificates to the effect that their dividends, by reason of their tax-exempt status, are free from income tax. The Government would, of course, retain all its rights against charitable corporations which are stockholders and the possibilities of abuse would seem to be exceedingly remote.

In closing may I reiterate the importance of both the above matters, not only to Dartmouth College but to other educational institutions, public and private, in New Hampshire and elsewhere in the United States.

Sincerely yours,

JOHN S. DICKEY.

MEMORANDUM PREPARED BY DARTMOUTH COLLEGE

The important facts in regard to the Dartmouth College grant are as follows:

(1) The Dartmouth College grant consists of approximately 27,000 acres of timberland in northern New Hampshire just south of the Canadian border. It was a grant to Dartmouth College by act of the legislature of the State of New Hampshire in 1807. It has been held by the college ever since, a period of 143 years.

(2) Under the terms of the grant from the State of New Hampshire the income must be used in part to assist in the education of indigent youths "whose necessitous circumstances would render it impossible for them to defray the expenses of an education * * * without such assistance," and in part for the general purposes of the college.

(3) The trustees of Dartmouth College are, under the terms of the grant, at all times "responsible to and subject to the direction of the legislature, for the faithful discharge of the trust relative thereto." Certain New Hampshire State officials, by the terms of the grant, are ex officio members of the Dartmouth board of trustees for this purpose.

(4) The Dartmouth College grant itself is unpopulated and is in a very sparsely settled area of New Hampshire. On it grow hardwoods (yellow birch and maple) and softwoods (spruce and fir). The college realizes on this timber by selling it as standing timber or "stumpage." A lumbering concern buys this stumpage on the basis of so many dollars per thousand feet in the case of hardwood and so many dollars per cord in the case of pulpwood. The college itself does not conduct lumbering operations.

(5) The Dartmouth College grant is being operated by the college in accordance with principles of scientific forest management. At the present time mature and overmature hardwoods are being cut so as to make way for the growth of softwoods, for which the area is better suited. The college employs a full-time college forester to supervise both this and recreational and other aspects of the college's use of the grant.

(6) The Dartmouth College grant is utilized by the students and faculty of Dartmouth College to a considerable extent as a recreational area, particularly in connection with the Dartmouth Outing Club and other outdoors organizations of the college. It is also used in connection with courses of instruction in the college, such as botany, geology. and surveying.

(7) The hardwood stumpage gross proceeds for the past few years have ranged from about $5,000 to $32,000 per year. No softwood has been cut recently, but on the basis of maturing softwoods it is anticipated that at present prices softwood proceeds of around $50,000 to $100,000 per annum will be realized beginning in a few years. Proceeds of cuttings since about 1905 have largely been reinvested in income-producing securities and the income from such securities only has been used for scholarships for New Hampshire boys and for general purposes. The total of proceeds thus reinvested amounts to more than $1,200,000. Mounting operating costs of the college indicate that it will be necessary to draw down these reserved proceeds over the next 10 to 20 years and to replace them with the proceeds of new softwood cuttings.

As stated above, it is not believed that the policy behind H. R. 8920 ever intended to subject the proceeds of timber cuttings on lands such as the Dartmouth College grant to Federal income taxation. The specific exclusion from taxable income of "royalties" undoubtedly is intended to cover oil and mineral royalties. Lumber, as a wasting asset, is very similar to oil and mineral products and proceeds of lumber sales are very much like oil and mineral royalties. In addition, the long and unusal history of the Dartmouth College grant distinguishes it completely from the situation at which title III is aimed. The grant came from the State of New Hampshire and Dartmouth College is still responsible to the State of New Hampshire for the administration of any proceeds realized therefrom.

H. R. 8920, it is believed would not have to be altered in any way in order to maintain the tax-exempt character of the income from the Dartmouth College grant. The report of the House Ways and Means Committee accompanying H. R. 8920 at page 38, second paragraph, refers to the provision in section 422 (a) (1) of the bill excluding "royalties" from taxable income. The report goes on to say in this paragraph that "royalties" as "passive 'income' should not be taxed where it is used for exempt purposes because investments producing incomes of these types have long been recognized as proper for educational and charitable organizations." A clarification in the Senate report to include specifically in the category of "passive income" proceeds of timber sold in place would be sufficient to continue the exemption.

JOHN F. MECK,
Treasurer, Trustees of Dartmouth College.

YALE UNIVERSITY,
New Haven, Conn., July 7, 1950.

Hon. WALTER FRANKLIN GEORGE,
Chairman, Senate Finance Committee,
United States Senate, Washington, D. C.

DEAR SENATOR GEORGE: By the time this letter reaches you President Killian, of the Massachusetts Institute of Technology, chairman of the committee on financial support and taxation of the Association of American Universities, will have expressed to you the opposition of the AAU to title III of section 423 of H. R. 8920. This is just to assure you, in view of the recent change in our administration at Yale, that we stand solidly behind the report of President Killian's committee in which, as a member of the AAU, we have already conferred. I take the liberty, also, to enclose herewith a more detailed comment on one particular feature of the bill by Mr. L. G. Tighe, treasurer of Yale University.

I have had several talks with President Killian recently and have read his prepared statement to your committee which he handed me only last night. I thought this an admirably fair statement and join with its author in the hope that out of your present deliberations may come such a broad and constructive tax policy as that suggested by Mr. Killian and his committee.

Respectfully yours,

A. WHITNEY GRISWOLD, *President.*

TREASURER'S OFFICE, YALE UNIVERSITY,
July 3, 1950.

Memorandum to President A. Whitney Griswold.

The terms of H. R. 8920 passed by the House of Representatives of the United States Congress on Thursday, June 29, came as rather a surprise. Those connected with educational institutions deeply regret the fact that the House has seen fit to pass a bill which changes the tax-exemption status of institutions of higher learning which has been in effect for so many years and without which those institutions would have not been able to develop and reach their current stature.

It is believed that section 423 of H. R. 8920 is unfair, inequitable, and confiscatory. This section is entitled "Supplement U Lease" and provides in substance that if an educational institution has purchased a piece of property on which there was a mortgage or which is later mortgaged, such educational institution must consider part of the rent as "business income" and pay a tax thereon computed by a given formula. This would appear to be unjustifiable taxation for the following reasons:

1. Many institutions have acquired properties on which there were mortgages and have leased these properties for long periods of years. When these leases were made the tax laws did not penalize such a transaction. The present bill affects contracts already made and works undue hardship.
2. One part of an institution's income is designated as "business income." While the institution might suffer an over-all loss it would still have to pay an income tax on that part designated as "supplement U income." This is the same as taxing a corporation on that part of its business which makes a profit and not allowing the same corporation to offset against such profit losses taken in another department. Such a distinction is inequitable.
3. The tax is directed at the wrong party. If the ABC corporation sells its property to an educational institution and then rents it for a term of years, the entire amount of the rent is deductible as a business expense. This means that the corporation is taking advantage of the educational institution's tax exemption and not that the institution is so doing. If the Congress sees fit to impose taxes on transactions of this kind the imposition should be on the lessee and not the lessor. The lessor gets no tax advantage because it has not been subject to taxes but the lessee may benefit.
4. The formula proposed may conceivably bring about results whereby the educational owner of the property not only receives no income from its investment but must use its general income to pay taxes.
5. The result of No. 4 above will be that all institutions which own properties that come under the supplement U lease will have to dispose of them or pay off the mortgages, if they have the money to do so. The lessee with no penalty to itself will then be able to continue to deduct its rentals as an expense of doing business and the Government will collect no additional taxes.
6. Many deserving tax-exempt institutions will lose valuable income, which they so much need especially under present conditions, and the total amount of taxes collected by the Government will be of little significance because the tax-exempt owners will have to free themselves of the burden by either paying off the mortgages, selling, or even abandoning the properties.
7. If Congress believes that these leases are a serious tax loophole, which is doubtful, there should be included in the proposed Revenue Act of 1950 a provision that that part of the rent paid by the tenant which is applied by the owner to amortize the mortgage is not deductible as a business expense of the tenant. The tax burden would then be put in the proper place and if the volume is large the tax collections would be likewise.

If a bill imposing taxes on educational institutions must be passed at the present time, section 423 of H. R. 8920 should be eliminated or revised so that the taxes fall where they should.

L. G. TIGHE, *Treasurer.*

UNIVERSITY OF MICHIGAN,
Ann Arbor, July 7, 1950.

Senator HOMER FERGUSON,
Senate Office Building, Washington, D. C.

DEAR HOMER: Dr. Ruthven and I have refrained from bothering you regarding the taxing of higher educational institutions. However, we are deeply concerned about the current turn of events. You are well aware of the fact that in these days of inflation, higher educational institutions are being asked to do more and more with less and less dollars. Our plight has become so serious that last weck we had a labor sit-down, the first serious labor trouble the University of Michigan has had in its entire history. The difficulty arose entirely from the fact that we had half a million dollars less to use during the fiscal year which started July 1, 1950, and we were not able to give wage adjustments to our hourly rated employees. They, too, have to eat and they used the only means that they knew to register a virorous protest. With industry raising wages, granting pensions, and increasing other fringe benefits, we need more income, not less, in order to deal fairly with our loyal employees.

As you doubtless know, there are provisions in the Revenue Act of 1950, as passed by the House, which for the first time would tax certain incomes of higher educational institutions. I hold no brief for any higher educational institution engaging in competitive commercial enterprise, which is unrelated to the educational activity. The University of Michigan, as a matter of basic policy, has not engaged in commercial businesses unrelated to our educational activity. For some reason the Willow Run Airport has been the subject of a number of unfortunate references in the press. I need not tell you that the Willow Run Airport is owned by a governmental body—it happens to be the regents of the University of Michigan—just as every other major airport in the country. You and I know that there are mutual advantages in the university holding title and that the airport is available to the Federal Government in case of emergency as a going concern as a result of the university having the title. Furthermore, the airport has been maintained and operated without cost to the Federal Government or the State government. In fact, we have not even had the benefit of any State aid or Federal aid since acquiring the airport. It is a mystery to me why certain individuals are under the impression that the university is making money out of the Willow Run Airport when no other major airport is truly a profitable venture. I might add in passing that the existence of the Willow Run Airport in the hands of the university has also made it possible for the university to conduct for the Federal Government a significant amount of classified research that could not have been handled without the availability of space at Willow Run.

One of the oldest sources of income to higher educational institutions is the income from rental property. I am concerned that the suggestion has been made that certain incomes from leased properties held by educational institutions be subjected to Federal income tax. There is no such thing as a profit in the operation of a higher educational institution. All of our income is used for our educational activities. I believe that, if you examine the criticized lease-back arrangements, you will find that if the educational institution has leased the property to the purchaser at a lower rental and on more favorable terms than could have been granted by a taxpaying landlord, the Commissioner of Internal Revenue has the right to evaluate that advantage as a part of the sales consideration and thus have a proper sales price on which to compute the taxable gain to the seller. It seems to me that if lease-backs have been abused the abuse is the result of the sale of the property to an educational institution and a failure to tax all of the consideration that was received therefor. The abuse is not in the rental income received by the educational institution. I think it is a great mistake in 1950, when higher educational institutions are faced with more problems than ever before in their history, that one of their oldest sources of income, rentals from owned properties, should be considered by the Congress as a base for the levying of an income tax. I can safely assert that virtually every higher educational institution in the country operates at a loss by any normal accounting standard. Doubtless there are some activities that result in a profit, but does Congress intend to select the profitable portions of the activities of higher educational institutions in order to establish a tax base and ignore the losses sustained in unprofitable public-service educational activities? I hope not.

I am concerned about another point involved in the pending legislation. Has it now reached the point that higher educational institutions are not as important to the welfare of this country as religious institutions? Has it reached the point that religious higher educational institutions are of greater importance than those higher educational institutions which recognize the fundamental concept of freedom of religion? It seems to me a dangerous precedent to start taxing higher

educational institutions and an even greater danger to exempt those who are affiliated with a religious group and tax the rest.

Higher educational institutions offered over a year ago to coöperate in the filing of financial reports with the Federal Government in order that the facts could be known to the technical staff. For reasons unknown to me, no effort has been made by the Government to assemble reliable information regarding the income and expenses of higher educational institutions. It seems to me that before the Congress starts taxing some portion of the income of higher educational institutions it would be sell for a study to be made of all the financial operations in order that adequate information may be at hand for the levying of a tax.

In summary, may I repeat that I hold no brief, and neither does Dr. Ruthven, for any educational institution operating competitive commercial businesses unrelated to its educational activities; I believe that all higher educational institutions should be treated alike in the levying of taxes; and, finally, I believe that rental income should not be taxed, even though it happens to result from a lease-back transaction.

I feel so keenly on the contents of this letter that I have taken the liberty of writing you at some length and with a full realization that probably the University of Michigan, as a State institution, is not as deeply involved in the tax threat as some of our sister institutions. However, I believe in the fundamental integrity of higher education and the importance of its role in our economy. I hope that you can lend your support to opposing the taxing of income of higher educational institutions.

Sincerely yours,

BOB.

UNIVERSITY OF MICHIGAN,
Ann Arbor, July 11, 1950.

Senator HOMER FERGUSON,
Senate Office Building, Washington, D. C.

DEAR HOMER: I am reluctant to address another letter to you regarding H. R. 8920, the proposed Revenue Act of 1950. However, it has been brought to my attention that the bill, as passed by the House, will seriously jeopardize the retirement programs of the staff members of the University of Michigan and other higher educational institutions. In 1919 the University of Michigan entered into an arrangement with the Teachers' Insurance and Annuity Association, which was then sponsored by the Carnegie Foundation, for retirement programs between members of our staff and the association. This program has continued and been enlarged for 31 years. Roughly, the university contributions cover half the cost and the contributions of the individual staff members cover the other half.

You are well aware of the fact that the University of Michigan does not have the benefit of the social-security program. The pending legislation could cut the income of the TIAA by as much as $3,000,000. I need not remind you that, with the current low interest rates, our retirement program has already received some serious set-backs. If the proposed legislation does not continue the exemption of the Teachers' Insurance and Annuity Association, which is devoted exclusively to providing annuities and insurance to the teaching staffs of educational institutions, a further drain may be placed on the inflation-reduced budget of the University of Michigan by our trying to augment the income of the TIAA as an offset. Obviously, we are not in a financial position to do this without further jeopardizing our higher educational program. I hope that you will feel as keenly on this as I do and that you will find it possible to register a protest with the Senate Finance Committee.

I have addressed the enclosed telegram to Senator George in order that he may know of our concern.

The letter I wrote you on July 7 registered a protest on a matter which probably will not affect the University of Michigan, but this letter is being written on a subject which will directly affect members of our staff and, since we are paying half the bill, will doubtless directly affect us. Frankly, I do not know where higher education is going to get the money to do its job, and I think it is most unfortunate that the Congress is considering legislation which will impair existing sources of income.

Sincerely yours,

BOB.

The CHAIRMAN. Mr. Hugh Satterlee? Will you identify yourself for the record, please, Mr. Satterlee?

STATEMENT OF HUGH SATTERLEE, ATTORNEY, NEW YORK CITY AND WASHINGTON, D. C.

Mr. SATTERLEE. I am Hugh Satterlee, a lawyer practicing in New York and Washington, and I appear on behalf of myself and also of clients who have been or may be interested in charitable organizations.

Before discussing the charitable organization point, I should like to call attention to what I think is an injustice in another portion of the bill, section 207, which deals with an amendment of section 115 (g), which provides that a redemption of stock should be treated as a taxable dividend, particularly in the case of a sole owner of the stock or a principal stockholder. That has been amended to provide that even a sale of stock of a parent corporation to a subsidiary or to an affiliated corporation will also be treated as a dividend.

Although I think that provision goes too far, I am not going to take your time to discuss the reasons why I think so, but what I want to call attention to is that this particular plugging of a loophole, if it can be regarded as such, was never discussed in the recommendations of the Treasury Department last February and was not referred to in the hearings before the Committee on Ways and Means; so that the first mention of it was in the bill as introduced in the House a couple of weeks ago. And relying on the existing law, it may be that a number of taxpayers, or not a number but some, have during the first part of this year made sales to their subsidiary corporations of stock of the parent, or to an affiliated corporation. And as the bill stands, those sales, even though made the early part of this year, with no thought of any amendment to the law, would be taxed; because the provision is that this amendment shall apply to all transactions during 1950.

There are many other provisions of the bill where so-called loopholes have been plugged, where the amendment does not become effective until after the enactment of the act. That is, it does not apply to transactions before the amendment of the act.

The CHAIRMAN. Suppose it were made effective the 1st of January next? Would you have any objection?

Mr. SATTERLEE. No, Senator. I think that would be very fair. That is section 207?

The CHAIRMAN. Section 207; yes, sir.

There is another section, here, that relates to bond amortization.

Mr. SATTERLEE. That is made applicable only to the later period; not to the period before the enactment of the act.

The CHAIRMAN. I had the impression it was made applicable from January 1. That is effective from the first of this coming year. I can not see why the Treasury would object to making that applicable to January 1 next.

Mr. SATTERLEE. I think there are several such sections which should not be retroactive.

As to the matter of charitable organizations, I had written this before hearing the testimony this morning, and I think it is confirmed by what has already been said. Title III of the bill would revolutionize the long existing law relating to charitable organizations and gifts to them. It covers 33 pages of the official print of the bill, and the comments on and explanation of its provisions require the same number of closely printed pages of the report of the Committee on Ways and Means. Its provisions set a new high for complicated language,

necessarily abounding in pitfalls of construction. Yet after the bill was drafted, the Committee on Ways and Means afforded no hearing to charitable organizations and their counsel, and if title III is retained in the bill as enacted no adequate opportunity would be given for study and discussion of its radical provisions. Preferably the provisions of title III should receive more mature consideration before enactment of any of them, and taxpayers should be given an opportunity to discuss the provisions with the Treasury Department legislative counsel and with the staff of the joint committee, it seems to me.

As to colleges and universities, certainly enough has been said this morning, and I shall not touch upon that.

There are other provisions, however, which I think are even more drastic than those relating to the taxation of unrelated business income. Proposed sections 424 and 425 providing for the subjection to tax under section 421 of gross investment income, less certain deductions and less an accumulation credit, are contrary to public policy and without justification. Their effect would be annually to tax all undistributed investment income in excess of a continuing reserve of 1 year's investment income.

There is an ostensible exception if income is set aside in trust for not more than 5 yeraes to be used for a specific project, provided such trust is irrevocable, and none of the trustees is connected with the organization which executed the trust.

It is rather horrifying to contemplate the inevitable result of these provisions. The trustees of a charitable organization, who ordinarily would apply its income tc causes which they deemed most worthy when and as the occasion arose, would feel compelled to make an annual distribution of investment income, even though by reasonable accumulation the purposes of the organization could be much better accomplished. A scientific society which now accumulates its income to be devoted to the most worthy project indicated by new discoveries would feel obliged each year to seek out avenues of distribution, even though not of great importance, with the result that when the opportunity for the most effective use of its funds arose they would not be available.

Obviously, the project being yet unknown, the severely limited provision for the creation of a trust would be worthless, even if the trustees were willing to delegate to others the accomplishment of the society's objects.

An art museum could not, without serious tax cost, accumulate income to purchase an outstanding work of art.

With high taxes on possible donors having already seriously cramped the means and activities of charitable organizations, it would seem unquestionably against public policy further to impair the efficient performance of their functions. If the organization's capital funds shrank materially, through losses in investments under the bill, it could not restore its position out of income. Under the existing law, if a charitable organization unreasonably accumulated its income, its exemption could surely be canceled, on the ground that it was not being operated for charitable purposes.

It seems to me that that is a perfect answer to this mumbo jumbo of taxing accumulated income. If it accumulates income for an unreasonable period, obviously it is not being operated for charitable

purposes, and therefore the Treasury can step in and cancel its exemption.

Section 301 (e) lays down detailed requirements for the continued exemption of a charitable organization, and the same requirements are involved in proposed new section 321 with respect to trusts, further complicating the already baffling section 162 of the code. Section 331 of the bill also adds the new section 3810, which disallows deductions for income, gift, and estate tax purposes of gifts to charitable organizations, unless "the instrument under which the trust or other organization is administered provides" specifically for the same restrictions provided in sections 301 (c) and new section 321 above referred to.

These restrictions, so far as of any consequence, are largely implicit in the existing law.

The chief vice of the proposed amendments is the requirement for specific inclusion in the instrument under which the organization is administered, presumably its charter. Of course—and that was remarked this morning also—no charter of any existing charitable organization, whether incorporated under a general State statute or by special act of a State legislature, contains any such specific restrictions, and unless such charters could be amended, in all cases burdensome and in some cases impossible, no gifts to the organizations would be deductible. If the statute would be satisfied by inserting such restrictions in the bylaws, it should say so.

Proposed section 3810 would also deny deductibility to gifts to a charitable organization where members of the family of the contributor comprise the majority of the trustees of the charitable organization and control at least 50 percent of the stock of the corporation whose stock is the subject of a gift. This provision is apparently intended to prevent a contributor of stock in a corporation controlled by his family from retaining control through a charitable organization of which members of the family are trustees. Why this is reprehensible or contrary to public policy is far from clear. It seems extraordinary to me that the Treasury Department representative stated this morning that the reason was that a gift of stock in a corporation of that character was not a true gift.

If, however, for devious reasons of its own, the Treasury wants to prevent a charitable corporation from benefiting from a gift of stock in a corporation controlled by trustees of the organization, the deduction of such a gift should surely be allowed, where the gift of stock, if made to strangers, would not impair the previously existing control of the corporation by the donor and his family. It would certainly be silly to deny the deduction of a gift of 1 percent or 10 percent of the stock of a corporation by a donor whose family, after such gift, continued to own the majority of the stock of such corporation.

In short, and in conclusion, the provisions of title III are at best controversial, and if adopted without mature consideration would be likely to cripple the usefulness of legitimate charitable organizations, with no sufficient compensating advantage in curbing a few organizations lacking in bona fides.

And I should like permission, if you please, to file a written statement.

The CHAIRMAN. You may do so.

(The statement referred to follows:)

STATEMENT BY HUGH SATTERLEE

My name is Hugh Satterlee. I am a lawyer, practicing in New York and Washington. I appear on behalf of myself and of clients who have been or may be connected with charitable organizations.

Title III of H. R. 8920 would revolutionize the long existing law and policy relating to charitable organizations and gifts to them. It covers 33 pages of the official print of the bill, and the comments on and explanation of its provisions require the same number of closely printed pages of the report of the Committee on Ways and Means (pp. 36 to 44, 107 to 131). Its provisions set a new high for complicated language, necessarily abounding in pitfalls of construction.

Yet after the bill was drafted the Committee on Ways and Means afforded no hearing to charitable organizations and their counsel, and if title III should be retained in the bill as enacted no adequate opportunity would be given for study and discussion of its radical provisions. To be sure, at the hearings in February and March before the Committee on Ways and Means of the House proposals were made and opposed with respect to the taxation of exempt organizations, chiefly as to their unrelated business income (hearings, pp. 18, 165, 494, 500, 505, 554, 571, 582, 583, 584, 587, 780, 808, 811, 2530, 2613, 2627, 2743); but the reduction of general proposals to concrete terms is another matter. The actual provisions of title III should receive mature consideration before enactment of any of them. Here, certainly, needless haste would make needless waste.

Title III is contained in sections 301, 302, 321, 322, 331, and 332 of the bill. It provides principally for—

1. Taxation of charitable organizations (other than churches), as well as labor and agricultural organizations, and business leagues, on their unrelated business income, including rents from leased property subject to indebtedness (new secs. 421, 422, 423);
2. Taxation of charitable organizations (other than religious organizations, schools and colleges, and organizations publicly supported) on their accumulated investment income, less a reserve of 1 year's gross investment income (new secs. 421, 424, 425, 426);
3. Forfeiture of exemption of charitable organizations (other than those excepted in paragraph 2 above) unless operated in accordance with specified restrictions (sec. 301 (c));
4. Disallowance of deduction for income, gift and estate tax purposes of gifts to charitable organizations (other than those excepted in paragraph 2 above and fraternal societies) if "the instrument under which the organization is administered" does not provide for the same restrictions referred to in paragraph 3 above and if in the case of a gift of stock of a corporation members of the donor's family control the corporation and comprise a majority of the trustees of the donee organization (new sec. 3810); and
5. Restriction of deductions for charitable contributions under section 162 (a) of the code by trusts (sec. 321).

1. The taxation of the net income of an entirely unrelated trade or business carried on for profit by a charitable organization, whether directly or indirectly through a separate corporation, in theory seems plausible. Where the business is conducted by a separate corporation it is simple enough to tax its net income like that of any other business corporation (see sec. 301 (b)), while distributions by it to the charitable organization would be free from tax like dividends and interest from other investments.

But practically the attempt by statute to draw a narrow line of demarcation in the case of income derived directly from activities of the charitable organization between income within the scope of its charitable objects and purposes and income from an unrelated trade or business is so impossible that the result of such an attempt would be seriously to hamper charitable institutions in the exercise of their legitimate functions. Their trustees would necessarily be inclined to forego any activity, however in their judgment proper and beneficial to the institution, if there were the slightest chance that the Treasury would question it. It is vastly more important that charitable organizations be permitted to function without harassment and control by the Government than that the excesses of a few be penalized.

Similar considerations are applicable to taxation of rents under a lease of property for the acquisition of which indebtedness exists.

2. As regards taxation of unrelated business income the principle may be sound, as indicated above. On the other hand, the subjection to tax of gross investment income, less certain deductions and less an accumulation credit, is drastic, contrary to public policy and without justification. After setting up an

initial reserve of 1 year's investment income, all undistributed investment income of each year would be taxed. There is an ostensible exception if income is set aside in trust for not more than 5 years to be used for a specific project, provided such trust is irrevocable and none of the trustees is connected with the organization which created the trust. No discretion is permitted the responsible trustees of a charitable organization as to the timing of gifts.

It is horrifying to contemplate the inevitable result of these provisions. The trustees of a charitable organization, who ordinarily would apply its income to causes which they deemed most worthy when and as the occasions arose, would feel compelled to make an annual distribution of investment income, even though by reasonable deferment the purposes of the organization could be much better accomplished. A scientific society, which now accumulates its income to be devoted to the most worthy project indicated by new discoveries, would feel obliged each year to seek out avenues of distribution, even though not of great importance, with the result that when the opportunity for the most effective use of its funds arose they would not be available. Obviously, with the project yet unknown, the severely limited provision for the creation of a trust would be worthless, even if the trustees were willing to delegate to others the accomplishment of the society's objects. An art museum could not accumulate income to purchase an outstanding work of art. If an organization's capital funds shrank materially through losses in investments, it could not restore its position out of income.

With high taxes on possible donors having already seriously cramped the means and activities of charitable organizations, it would seem unquestionably against public policy further to impair the efficient performance of their functions by such a senseless penalty on the exercise of unfettered judgment by the trustees. Under the existing law, if a charitable organization accumulated its income for reasons other than the most effective achievement of its objects, its exemption could unquestionably be canceled, on the ground that it was not being operated for charitable purposes.

3. No charitable organization is to be considered to be operated exclusively for charitable purposes unless it be operated in accordance with the following provisions:

"(i) no part of its income or corpus is loaned to;

(ii) no compensation, other than a reasonable allowance for salaries or other compensation for personal services actually rendered is paid by it to;

(iii) no part of its services is made available on a preferential basis to;

(iv) no substantial purchase of securities or any other property is made by it from; and

(v) no substantial part of its securities or other property is sold to;"

a substantial contributor, or any officer or trustee, or any brother or sister, spouse, ancestor, or descendant of any such person, or any corporation controlled by any such person through 50-percent stock ownership.

This requirement, much of it implicit in existing law, if reasonably and fairly administered would in most cases not interfere with the proper activities of a charitable organization. However, clause (iii) needs clarification. Clauses (iv) and (v) should admit of some exception where it could be shown that the purchase or sale was advantageous to the organization.

4. Gifts now deductible for income, gift and estate tax purposes are denied deduction unless "the instrument under which the trust or other organization is administered provides" for the same restrictions specified in 3 above and "such instrument provides that no part of the income or corpus of such trust or organization may be paid to any trust or organization to which a gift or bequest would not be a deductible gift or bequest under this subsection."

The vice of the proposed amendment is the requirement for specific inclusion of the restrictions in the instrument under which the organization is administered, presumably its charter, and in the charter of any donee organization. Of course, no charter of any existing charitable organization, whether incorporated under a general State statute or by special act of a State legislature, contains any such specific restrictions, and unless such charters could be amended, in all cases burdensome and in some cases impossible, no gifts to the organizations would be deductible. If the statute would be satisfied by inserting such restrictions in the bylaws, it should say so.

Deductibility of gifts of stock to a charitable organization would also be denied where members of the family of the contributor comprise a majority of the officers or trustees of the organization and control at least 50 percent of the stock of the corporation whose stock is the subject of the gift. This provision is apparently

intended to prevent a contributor of stock in a corporation controlled by his family from retaining control through a charitable organization of which members of his family are trustees. Why this is reprehensible or contrary to public policy is far from clear. It would seem that stock might be especially valuable to a charitable organization where its trustees were in control of the corporation issuing the stock. A Treasury representative has taken the extraordinary position that a gift of stock in such circumstances is not a gift. If that be so, the proposed provision is superfluous.

If, however, for devious reasons of its own, the Treasury wants to prevent a charitable organization from benefiting from a gift of stock in a corporation controlled by trustees of the organization, the deduction of such a gift should surely be allowed where the gift of stock, if made to strangers, would not impair the previously existing control of the corporation by the donor and his family. It would be absurd to deny the deduction of a gift of 1 percent or 10 percent of the stock of a corporation by a donor whose family, after such gift, continued to own a majority of the stock of such corporation.

5. In the case of a nonexempt trust under existing law any part of the gross income paid or permanently set aside for charitable purposes is fully deductible. The proposed amendments in the bill are apparently designed to complement the other provisions of title III by imposing similar restrictions, and obviously their enactment, in any form, is conditional upon the adoption of such other provisions.

In conclusion, the enactment of title III in its present form would constitute a blow to charitable organizations generally, which would inevitably weaken or cripple their ability to accomplish their legitimate charitable objects and purposes. In any event, no portion of title III should be enacted in any form or at any time without mature consideration and careful revision in the light of the real problems and exigencies of charitable organizations.

Senator KERR. Mr. Chairman, I would like to ask the representative of the Treasury what their estimate of the probable income under title III is.

Mr. KIRBY. We estimate that in a full year's operation, and after it really takes effect, it would save a hundred million dollars in revenue.

Senator KERR. Is that estimate in the record?

Mr. KIRBY. Yes, it is.

Senator KERR. Is it broken down as to the sources from which the various parts come?

Mr. KIRBY. I am not sure it was broken down on the House side. It is in the committee report of the Ways and Means Committee.

Senator KERR. A breakdown of the estimate?

Mr. KIRBY. No, the hundred million figure.

Senator KERR. But the breakdown is not?

Mr. KIRBY. It is not.

Senator KERR. Is there one in existence?

Mr. KIRBY. Yes, I think there is.

Senator KERR. Would it be all right for that to be furnished, Mr. Chairman?

The CHAIRMAN. Yes, Senator.

Senator BUTLER. May I ask Mr. Kirby, while he is available, if it is true, as indicated by several of the witnesses, that they knew nothing about many of these provisions in the tax bill until the bill was published, a week or two ago?

Mr. KIRBY. These provisions follow the recommendations, and quite specific recommendations, of the Secretary, which were presented to the Ways and Means Committee back in February. Of course, this bill was not available to anyone of the public until it was

reported out by the Ways and Means Committee, and that was just a short while ago. I don't know when they actually got the first drafts.

Senator BUTLER. It seems to me that a great many items that have been referred to here today especially are of just about as much importance as the excise phase of the tax bill; and the hearings apparently were all on excise taxes and things of that sort, but not on any of these matters.

Mr. KIRBY. Oh, I know a number of the colleges were represented, and charities, on the House side, in public hearings; and a full pamphlet was devoted to the charitable and educational problems by the Treasury Department, presented on the House side. So there was no surprise.

Senator BUTLER. That was not in regular session, was it?

Mr. KIRBY. That was attached to the public presentation made by the Secretary, and it was read to the committee in the public hearings.

These problems are really fairly old. The Department had a similar position and made similar recommendations back in 1942 to the Ways and Means Committee.

The CHAIRMAN. I will now call on Senator Flanders and Mr. Griswold. Mr. Griswold, you may come around.

Senator Flanders, you wished to have something to say?

STATEMENT OF HON. RALPH E. FLANDERS, A UNITED STATES SENATOR FROM THE STATE OF VERMONT

Senator FLANDERS. Yes. I wish to introduce Mr. Griswold, Mr. Chairman.

When I was elected to the Senate in 1946, I resigned all of my business connections, offices, and directorships, except two. I felt that the job of being a Senator was a full-time job. But I kept two business connections, which seemed to me to have a public interest. One was the directorship of a mutual life-insurance company, and the other is the American Research & Development Corp., on whose behalf Mr. Griswold is appearing.

I may say just a word about that. While I was president of the Federal Reserve Bank in Boston, it became very clear to me that there were billions upon billions of dollars of fiduciary capital held in New England and elsewhere, and that there was a great dearth of risk capital. And so, with some other interested men, of whom Mr. Griswold was one, we sought for and devised a means of safely and properly applying fiduciary capital to risk undertakings, and the result of that undertaking was the formation of the American Research & Development Corp., and I am speaking merely to emphasize the fact that in my judgment that undertaking has a large measure of public interest involved in it.

The CHAIRMAN. Thank you very much, Senator Flanders.

Senator FLANDERS. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Griswold, we will be glad to hear you now.

STATEMENT OF MERRILL GRISWOLD, CHAIRMAN OF EXECUTIVE COMMITTEE OF AMERICAN RESEARCH & DEVELOPMENT CORP.

Mr. GRISWOLD. Mr. Chairman and honorable members of the Finance Committee:

My name is Merrill Griswold. I am chairman of the executive committee of the American Research & Development Corp., which was formed 4 years ago to supply venture capital to new and worthwhile enterprises.

When the Investment Company Act of 1940 was under consideration, a provision to encourage the formation of venture capital companies like the American Research & Development Corp. was written into it. This is section 12 (e). However, except for American Research & Development Corp., section 12 (e) of the Investment Company Act has been almost a dead letter. The reason for this is that venture capital companies are not able to secure the benefit of the conduit method of computing income taxes which is granted to all other regulated investment companies by sections 361 and 362 of the Internal Revenue Code.

Sections 361 and 362 of the Internal Revenue Code permit regulated investment companies to distribute their entire net income to their shareholders, including capital gains, so that the income tax is paid by the shareholders when they receive the income from the investment company. Thus, for tax purposes, the Government treats the shareholders of regulated investment companies as if they were partners. This is what is referred to as the "conduit" method. It is of particular benefit to mutual-investment companies.

Section 361, however, limits the application of the conduit method for computing income taxes to those regulated investment companies only which own 10 percent or less of the stock of any other company, as far as 50 percent of the investment company's assets are concerned. The committee will readily perceive that this 10-percent restriction nullifies the conduit method as far as venture-capital companies are concerned. A venture-capital company, when it finances a new enterprise, must provide a substantial portion of the capital for the enterprise, and cannot do this if it may not own more than 10 percent of the stock of the new enterprise.

When this anomaly was explained to the Investment Subcommittee of the Joint Committee on the Economic Report, the subcommittee included in its recommendations to Congress the suggestion that section 361 of the code be amended to correct the situation. I am informed that Senator O'Mahoney wrote to this committee recommending the change.

A venture-capital company of the sort contemplated by the Investment Company Act of 1940 is a very different thing from an ordinary regulated-investment company such as a mutual investment trust. Ordinary regulated-investment companies have no difficulty in qualifying under section 361 because the fundamental policy of an investment trust is to achieve safety through diversification. Investment trusts invest only in blue-chip securities—safe, seasoned, and of proved earning power. Moreover, a regulated-investment company would rarely have occasion to own more than 10 percent of the stock of any

company in which it invested. Venture-capital companies are not ordinary investment companies. By definition they are companies formed to supply venture capital to new enterprises which are long on hope but short on past performance.

Any investor, even if he believes in the future of venture-capital companies, will think twice before putting money into an operation when he knows he will have to pay a double income tax on any profit which his investment yields, including full rates on any capital gains that may be distributed to him. If he puts the same money in an ordinary investment company which buys blue-chip securities, he will have to pay only one income tax, and will only pay half rates on capital gains.

The administration has shown great interest in dealing with the problem of financing small business and providing venture capital. Senator O'Mahoney's bill, S. 2975, and the administration bills, S. 3625 and H. R. 8566, have been introduced in this Congress to deal with this problem and are now pending before the banking committees. The amendment that I am proposing is wholly within the spirit and policy of these bills. In fact, the tax provisions of S. 3625, the administration bill, section 208 (c), permit the Board of Governors of the Federal Reserve System to lift the restrictions of section 361 for investment companies formed under the proposed administration plan. Even the watchdogs of the Treasury, therefore, know that section 361 in its present form is an obstacle to the successful financing and operation of venture-capital companies.

In closing, I would like to emphasize one final point of importance. The change in section 361 advocated by the Joint Committee on the Economic Report will not bring about a reduction in tax revenues. If a venture-capital company makes profits, the profits will be taxed to the shareholders. If the operations of a venture-capital company successfully bring into being new enterprises which make a profit, these new enterprises will be taxed on their profits at the regular corporate rate. Accordingly, the amendment should increase tax revenues in the long run.

I would like leave to insert in the record a prepared statement which deals at greater length with the technical aspects of the proposed amendment, and gives the exact wording which is necessary.

In that connection, I should like to add that the exact wording has been approved by the Joint Economic Committee and has been discussed and I understand approved by the Securities and Exchange Commission.

There is one more word I should like to add. In the State of Maine they have recently gotten up a venture-capital company called the Development Credit Corp. of Maine. That is largely financed by the local banks and savings banks, and Mr. Maxwell, who is the president of that company, has authorized me and requested me to say that they also favor this specific amendment.

The CHAIRMAN. You may offer your fuller statement for the record. That statement contains the specific amendment that you are proposing?

Mr. GRISWOLD. Yes, sir.

(The information referred to follows:)

STATEMENT BY MERRILL GRISWOLD, CHAIRMAN OF THE EXECUTIVE COMMITTEE OF AMERICAN RESEARCH & DEVELOPMENT CORP.

The Subcommittee on Investment of the Joint Committee on the Economic Report in its report dated March 23, 1950, recommended:

"That venture-capital corporations be treated as investment companies for tax purposes."

If this recommendation is followed by Congress, paragraph 3 of section 361 of the Internal Revenue Code should, we think, be amended by inserting at the end of A, in the said paragraph, the following:

"* * * except in the case of a registered management investment company which engages principally in the business of furnishing capital to industry, financing new enterprises and purchasing securities of issuers for which no ready market is in existence, and the engagement in such business and activities is stated to be a fundamental policy in the registration statement filed by such company pursuant to section 8 (b) of the Investment Company Act of 1940, and * * *"

Section 361 is the section of the law which allows certain investment companies to operate on the "conduit" theory. The reason why venture-capital corporations cannot now operate on the "conduit" theory is that one of the provisions in section 361 is that a company cannot qualify if it owns more than 10 percent of the stock of another company, so far as 50 percent of its assets are concerned. Since venture-capital companies, when they finance new enterprises, are likely to provide a substantial portion of the capital required, they, therefore, will practically always own more than 10 percent.

If this amendment is adopted it will, for reasons I will explain, provide a tremendous stimulus for obtaining venture capital to finance new small businesses. Also, this amendment will increase, rather than decrease, the revenue of the Government. I will undertake to explain why both these conclusions are true, and also why the particular wording above for an amendment is recommended.

VENTURE CAPITAL—DESIRABILITY OF DIVERSIFICATION

Recent advances and discoveries in the arts and sciences portend an era of new devices, processes, and products which should lead to new enterprises and the recasting of old ones. The opportunities for the formation of small business corporations that carry on new enterprises are very many.

Because of the risks inherent in the development of new products and enterprises, students of finance and the sciences and Government officials have repeatedly pointed to the necessity of attracting, what is commonly referred to as venture or risk capital.

The best way to attract substantial amounts of risk capital from the public is to make possible diversification of risk. Everyone recognizes that a goodly proportion of new enterprises do not succeed and that, therefore, it is extremely risky to put all one's eggs in one basket. The Securities and Exchange Commission recognized this fact in 1940 by providing in section 12 of the Investment Company Act of 1940 for the creation of venture-capital corporations, which would be able to secure diversification of risk by spreading their investments over a considerable number of separate enterprises.

VENTURE-CAPITAL PROFITS SHOULD BE TAXED AS CAPITAL GAINS

If people invest in new enterprises where the risk is great, they do so in the hope of making capital gains, because capital gains are only taxed one-half as much as ordinary income and under no circumstances more than 25 percent.

Wealthy individuals are in a position, which ordinary investors are not, to invest in a considerable number of separate new enterprises on the theory that the losses inevitable in the case of some of them will be more than offset by successes in others. When they make successful investments of this kind, they can realize capital gains and be taxed on them as such. Ordinary investors, however, cannot afford to go into a large number of new enterprises. Therefore, a good way for them to invest is to participate in a venture-capital corporation which will diversify their risk. But the trouble is that if such a venture-capital corporation realizes gains and distributes such gains to the stockholders, not only must the corporation first pay a tax thereon but the stockholders later have to pay full taxes on their share of such capital gains when distributed, instead of merely having to pay capital-gain taxes. It is unfair that ordinary investors, when they provide venture capital, should not have a similar opportunity to that enjoyed by wealthy investors as regards the taxation of capital gains. It is also unfor-

tunate that wealthy investors should be discouraged from also investing in venture-capital corporations because of their inability to get the benefit of the capital-gain tax rate on any capital gains that may be realized and distributed. The result has been that it has proved difficult for venture-capital corporations to raise capital either from wealthy investors or ordinary investors.

It is true that American Research & Development Corp. was able to raise a certain amount of capital in spite of the nonapplicability of section 361, but since the time that company was formed some 4 years ago, not only have there been no more similar companies organized, but it has been more difficult than it should have been for American Research & Development to increase its capital. This company has succeeded only because of the prodigious efforts and enthusiasm of a very limited number of individuals and institutional investors, and notwithstanding the entire lack of incentive from the standpoint of taxation. It is our firm belief that if the tax situation is corrected other venture-capital companies will be organized.

DIFFICULTIES IN RAISING VENTURE CAPITAL

Few people realize how difficult it is to raise capital for venture-capital purposes. The New England Council conducted a meeting some years ago to see if they could induce investments of this character. The conference was attended by officials of savings banks, trust companies, insurance companies, investment trusts, investment bankers, etc. I recall that every speaker enthusiastically endorsed the desirability of venture capital being provided. But I also recall that every speaker said it was inappropriate for his particular industry to help in providing this kind of capital. The universal attitude was "Let George do it". But there appeared to be no angel "Georges." Everyone agreed that the principle involved was splendid. But when they got down to brass tacks, it appeared that it wasn't the "principle but only the money that mattered," and they didn't want to be the people to put up the money.

It must be recognized that if the Government wants investors to risk their capital in backing new small businesses, every proper incentive must be given them. If they are to be encouraged to invest in venture-capital corporations, one of the best possible incentives would be to amend the tax law so that if they receive dividends derived from capital gains such capital gains should be taxable to them, when they receive them, as capital gains.

"CONDUIT THEORY"—ORDINARY INVESTMENT COMPANIES

I happen to be familiar with the growth of mutual investment companies after 1936 when the Revenue Act was first amended to tax such companies and their shareholders on the "conduit" theory. If such a company in any year elects to be taxed under sections 361 and 362 of the Revenue Act and to comply with the conditions prescribed, and it then distributes its entire net income, including capital gains, to its stockholders, the Government looks for the tax solely to the stockholders receiving the income. While income from dividends and interest, when distributed, is taxed at the full rates, any capital gains which are distributed are taxable at the lower rate applicable to capital gains. The Government collects the same tax, no more or no less, that it would have collected if the assets had been owned by all the shareholders, as if they were partners. The result of this legislation has been an extraordinary growth in mutual investment companies in recent years, and in this way the ownership of American securities has been spread among hundreds of thousands of stockholders. There are today probably over a million stockholders of investment companies. The Treasury lost no revenues as a result of the adoption of the "conduit" theory of taxation for investment companies, because it collects full taxes from the stockholders on distributions made from earnings from dividends received, and full capital-gain taxes on distributions made from capital gains. If that change in the law had not been made, there is no question that today there would not be any open-end investment companies because double taxation is impracticable when investment companies act merely as "conduits."

INCREASE IN TAX REVENUE IF "CONDUIT THEORY" IS EXTENDED TO VENTURE-CAPITAL COMPANIES

If the same treatment is extended to venture-capital corporations, which are themselves a kind of investment company, the Government will actually be the gainer in the amount of taxes collected. Every venture-capital corporation

69474—50——39

that may be organized will be instrumental in creating or helping 10, 20, or 30 more new industries. For instance, many of the new enterprises, backed by American Research & Development Corp., would never have been formed if American Research & Development Corp., which is a venture-capital corporation, had not been in existence. Since each new company, if successful, will pay taxes to the Government at the regular corporate rates, this will mean new revenue to the Government. Nor will the Government lose any revenue that it would have received if section 361 is amended so as to make practicable the formation of more venture-capital corporations. This is because if people are given this incentive to create more venture-capital corporations, the entire income from dividends or capital gains will be taxed to the stockholders receiving same, i.e., at the full rate on dividends derived from regular income and at capital-gain rates on distributions therefrom.

We are not suggesting the entire elimination of this 10 percent requirement in section 361 because, in the case of ordinary investment companies, it is undoubtedly a desirable restriction. Otherwise, there would be danger of ordinary investment companies getting a controlling influence in the affairs of too many established corporations. It was solely to prevent this that the restriction was imposed. The amendment, as proposed, applies only to management investment companies which engage principally in certain of the type of business described in section 12 (e) of the Investment Company Act of 1940.

REPHRASING OF PROPOSED AMENDMENT

It is not easy to word a statutory definition of a venture-capital corporation. The only statutory definition with which I am familiar is that contained in this section 12 of the 1940 act, which reads as follows:

"Corporations engaged or proposing to engage in the business of underwriting, furnishing new capital to industry, financing promotional enterprises, purchasing securities of issuers for which no ready market is in existence, and reorganizing companies or similar activities."

This language was devised by the Securities and Exchange Commission for the express purpose of encouraging the formation of venture-capital corporations, but this section of the Investment Company Act proved to be almost a "dead letter." No venture-capital corporation, so far as I know, had been organized pursuant to this section, with the sole exception of American Research & Development Corp.

In the amendment we have proposed on page 1 of this memorandum, we have not used the exact language in section 12 (e) above quoted, but instead have used the following shorter language:

"* * * except in the case of a registered management investment company which engaged principally in the business of furnishing capital to industry, financing new enterprises, and purchasing securities of issuers for which no ready market is in existence, and the engagement in such business and activities is stated to be a fundamental policy in the registration statement filed by such company pursuant to section 8 (b) of the Investment Company Act of 1940, and * * *"

We have no objection to the identical language in section 12 (e) but deem it unnecessary to include any reference to underwriting or the reorganizing of companies, etc.

CONCLUSION

It is my belief if venture-capital corporations are to be formed much of the capital must be obtained from both wealthy investors and ordinary investors, for all the capital cannot be obtained from institutional investors, such as insurance companies, investment companies, educational institutions, etc. It must be made attractive for both ordinary and wealthy investors to subscribe risk capital for venture-capital corporations. The chances of their subscribing capital will be greatly enhanced if they are allowed to treat as capital gains, for tax purposes, any capital gains which such a company distributes to them as stockholders.

If this change is not made, it is going to be extremely difficult to obtain adequate amounts of risk capital for this purpose from private investors.

Mr. GRISWOLD. May I also leave with you for the record, Senator, a short description of this Maine credit corporation, rather than read it to you, which will tell you who they are and how they function?

The CHAIRMAN. Yes, sir.

Are there any questions?

Thank you very much, Mr. Griswold.

Mr. GRISWOLD. Thank you, sir.

(The material referred to follows:)

[Excerpt from Fortune, March 1950]

THE HUNT FOR RISK MONEY

The whole problem of venture financing is particularly acute in New England because the region has so much obsolete plant. Over much of the country, the risk-capital shortage is discussed as a limitation on expansion. New England businessmen share this concern, but they also worry about the grim old buildings that obviously cannot maintain present production rates a great deal longer.

President Roy Little, of Textron, has proposed that Rhode Island set up an industrial building authority that would issue up to $20,000,000 in tax-exempt bonds and use the proceeds for building factories for lease to industry. It is interesting that Rhode Island's Democratic Governor, John Pastore, no admirer of Mr. Little, has come out against this proposal, while in New Hampshire, Republican Governor Sherman Adams is calmly contemplating far larger sums of Government money for a steel mill. Harry Burton, president of Lonsdale mills, has called for a privately sponsored bond issue for industrial development in Rhode Island, and Fair Dealer Pastore will go along with this.

A new venture-financing idea is now exciting Maine bankers, of all people. Arthur Maxwell, president of the First National Bank of Biddeford, has taken the presidency of the Development Credit Corp. of Maine, authorized by State law to run a risk credit pool. If all eligible institutions join up, the pool will amount to about $1,250,000. National banks are permitted to put in 2.5 percent of capital and surplus, and savings banks and loan associations can come in up to 2.5 percent of reserve and guaranty funds. The corporation is specifically limited to loans no single member bank would make. "We are not going to throw our money away, but we are not going to run from a risk either," Mr. Maxwell explains. "Some of our bankers," he concedes with a certain relish, "are going to be scared out of their wits by this."

Mr. Maxwell went from the Biddeford High School to "sweeping the floor" at the First National about 30 years ago and has been with the bank ever since. He talks with a good deal of urgency about New England's need for imaginative financing and industrial diversification. Biddeford and Saco, really one town, are entirely dependent on textiles: a Bates plant, a Pepperell plant, and the Saco-Lowell (textile machinery) shops. At one time during the "inventory recession" of 1949, nearly 3,000 of the community's 33,000 people were out of work. Mr. Maxwell agrees that there is a lot of hard thinking going on in New England business, but he wants to see much more. "If there is anything I detest in the New England character, it's that damned smugness."

The CHAIRMAN. I will call upon Mr. Earle. Mr. C. E. Earle; I understand there is some reason why Mr. Earle has to get away early.

You may be seated, Mr. Earle. Please identify yourself for the record.

STATEMENT OF C. E. EARLE, SECRETARY-TREASURER, THE COUNCIL FOR INDEPENDENT BUSINESS, AND PRESIDENT, BRECO MANUFACTURING CO., BALTIMORE, MD.

Mr. EARLE. Mr. Chairman and members of the committee, my name is C. E. Earle. I am secretary-treasurer of the Council for Independent Business, and am president of the Breco Manufacturing Co. of Baltimore, Md., a small company manufacturing pneumatic equipment for industrial uses. I am also director of the Earle Research Laboratory.

Small and independent men and women who are engaged in the production of wealth in this country under the protection of our

patent system are very much alarmed because paragraph (C) of section 209 of the bill, H. R. 8920, if enacted in a law, would prohibit an inventor from treating his patent as a capital asset.

Gentlemen, just let me read the new definition of a capital asset as set forth in this bill.

> (1) CAPITAL ASSETS.—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include—
>
> * * * * * * *
>
> (C) a patent or copyright; an invention or design; a literary, musical, or artistic composition; or similar property; held by—
>
> (i) a taxpayer whose personal efforts created such property, or
>
> (ii) a taxpayer in whose hands the basis of such property is determined, for the purpose of determining gain from a sale or exchange, in whole or in part by reference to the basis of such property in the hands of the person whose personal efforts created such property;

We have discussed this provision with patent attorneys, inventors, engineers, lawyers, and just plain businessmen. Without an exception, the reaction was that we had either misread or misinterpreted the provision. Not one could believe that a bill denying an inventor the right to treat his patent as a capital asset, had already passed the House of Representatives.

It is a fundamental belief in this country that a man who creates wealth from something new and useful should be rewarded by society for that contribution. The idea that a bill could be passed depriving the inventor of a large part of the fruits of his labor is so foreign to our conception of what is right and fair, that the American people just cannot believe it could happen here. None of us can understand the philosophy behind the type of thinking that has injected such limitations into this bill.

The founding father believed so strongly in the importance of rewarding the creator of new things that they put it in the Constitution. Article 1, section 8 of the Constitution declares:

> The Congress shall have the power to promote the Progress of Science and useful Arts, by securing for limited times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries.

and the Congress of the United States has exercised this power to the great benefit of the people of America by setting up a patent system for this purpose. Now it appears there are those who want us to turn our backs upon the philosophy of the founding fathers and penalize inventors rather than reward them.

Let there be no doubt as to who is the target—for, mark you, it says, and I quote "a patent—held by a taxpayer whose personal efforts created such property." This applies then to the creator of the invention.

Senator KERR. Mr. Earle, do you understand by that that if the inventor held it for a time and sold it he would have to pay taxes as though it were income, and if the purchaser from him then held it 6 months and sold it at a profit he would be taxed on it as though it were a capital gain?

Mr. EARLE. That is right. That is just what we are complaining about, sir.

The CHAIRMAN. Is that the correct interpretation of this provision, Mr. Kirby?

Mr. KIRBY. I think so. I did not follow the example exactly.

The CHAIRMAN. It does not permit the patentor himself to capitalize as a capital gain his invention?

Mr. KIRBY. That is correct. At the present time a person who is a professional inventor who sells his patent or copyright is taxed at the regular rates.

The CHAIRMAN. Just as a regular gain, on ordinary income?

Mr. KIRBY. Yes. It was to reach those that do not make this a profession.

The CHAIRMAN. I see. All right.

Mr. EARLE. We would certainly agree that a man who is a professional in inventing things should be entitled to consider that his patents are the fruit of his trade and are to be taxed as ordinary income.

The CHAIRMAN. You could get around that very easily, could you not, Mr. Earle?

Mr. EARLE. You can by selling it, sir. That is the only way.

The CHAIRMAN. Could you not create a corporation and put it in the corporation?

Mr. MCGREGOR (Frank R. McGregor, executive vice president, Council for Independent Business). The second section says it is treated the same way as if it were in the hands of the original inventor, if you transfer it without selling it. And you must sell it at a reasonable price.

The CHAIRMAN. It must be an actual sale?

Mr. MCGREGOR. It must be an actual sale for value.

The CHAIRMAN. You may proceed with your statement, Mr. Earle. I just wanted to see what the issue was.

Mr. EARLE. Under this provision, the man who buys an inventory from the inventor is privileged to treat it as a capital asset. If, after buying a patent from the inventor, the money man sells it at a fat profit, he can take advantage of the capital-gains tax as set forth in this act. In other words, the entrepreneur who buys a patent can treat it as a capital asset, but the man who created the patent by his own thinking and personal efforts, is prohibited from so doing.

None of us can understand how a patent, a piece of property which is not held for sale to regular customers in the ordinary course of business, can be in one man's hands a capital asset, yet in another man's hands, not a capital asset.

It is a well-known fact that very few inventors have the money to practice their patents. In order to profit from the patent, the inventor must either sell it or license its use—usually an exclusive license which the courts have held is equivalent to a sale.

Our patent system is responsible, to a large degree, for the tremendous and rapid growth of the industrial phase of our economy. Although the individual inventor has never been properly rewarded for his advanced thinking, vision, and personal efforts, he deserves the major part of the credit for this great progress. His type of thinking should be encouraged rather than discouraged.

Invention does not thrive on adversity. The old notion that great discoveries are made by starving geniuses in a garret is romantic, but it is just not true. Invention increases as the prosperity of the country increases and it fades and diminishes in bad times and during war periods.

Attached hereto is a graph entitled "Trend of Inventive Thinking in the United States, 1900–50."

It shows graphically the effect of depressions and wars on our inventive capacity. It also shows the trend of our inventive ability during the last 50 years.

The graph is based upon the annual number of patent applications for each 10,000 of population in the United States. For example, in 1900, when the population was 76,000,000, patent applications averaged 5.5 for each 10,000 of population. In 1949—now, mark this—with a population of 150,000,000, and with infinitely more technical knowledge, the average was 4.4.

As the twentieth century began to unfold, you will observe the number of creative technological ideas considered worth patenting increased until war broke out in Europe when they declined slightly. When the United States entered the war in 1917, you can see what happened to the inventive mind. With the close of World War I, inventive thinking skyrocketed until we hit the recession of 1921.

After this recession was weathered, inventors again were on the march until we hit the big depression in 1929. You will remember that things started to get better in 1933 and 1934 and so did the creative production of inventors. When Mr. Hitler moved into the Rhine, Austria, and Czechoslovakia, and we had an undeclared war in Europe, the effect of this disturbance on the inventive genius of America is shown here, and the negative curve reaches its depth in the midst of World War II. Here it starts to rise again, probably due to the increase in technology of war developments and production. So we were well on our way again until the cold war broke out in Europe and now we find ourselves again on the downward path. It is now proposed to pass a bill that will undoubtedly accelerate the speed of this descent.

Senator MILLIKIN. Mr. Chairman, may I ask: Are there any statistics on individual independent patent applications, as distinguished from patent applications from corporations and from employee of corporations?

Mr. EARLE. Yes, sir. It will average somewhere between 45 and 50 percent of the total applications from individual inventors.

Senator MILLIKIN. Purely individual?

Mr. EARLE. Yes, sir. And, you understand, this change in this act does affect the patents held by companies or by individuals who are employed by companies to do research and development work. Practically all of the companies have an arrangement with their employees for purchasing or some other means of transferring, and that is not covered by this revenue act.

Mr. McGREGOR. And the big fundamental discoveries are almost always by individuals; not by groups or laboratories.

Senator MILLIKIN. There is a lot of perfecting, I assume, that goes on in corporate laboratories.

Mr. McGREGOR. Oh, yes.

Mr. EARLE. But most of the important patents in this country have been created by individuals, and in many, many cases, and I would say over 98 percent of the cases, the individual himself has not had the funds to practice his own patent and has consequently been forced to either sell his patent or lease it, many, many times under unfavorable circumstances.

Senator MILLIKIN. It is the lack of funds that brings that coincidence between applications in good times and bad; is that correct?

Mr. EARLE. Yes, sir.

The attached graph definitely establishes that technical creation does not flourish in barren soil. Observe, if you will, what happens whenever the economy is disturbed either by wars, rumors of wars, or other factors. The inventor is discouraged and inhibited so that his creative impulses cease to function normally. The inventor flourishes and brings forth fruit when he feels that he is being nurtured in an atmosphere of freedom and a soil rich in opportunity.

The experts who wrote this provision call it plugging up a loophole. Permitting an inventor to get some reward for his invention is not my idea of a loophole. As for "plugging up," it will certainly effectively plug up the inventor's desire to create new and better things for our people to enjoy. In addition, it will accelerate the further establishment of corporate control of inventions, thus encouraging monopoly and penalizing the small-business man.

It is estimated by the tax experts that the capital-asset amendment will yield a maximum of a million dollars. To get that million, they have lumped together a lot of strange bedfellows—musical compositions, copyrights, literary creations, other artistic works and inventions.

If patents produce their proportionate share, it will only amount to a couple of hundred thousand dollar. For this comparatively picayune sum we would discourage our individual inventor by putting a ceiling over his opportunities, thus inhibiting his desire to create by depriving him of the major part of the reward, which is already pitifully small. So the end result will be to deny the economy of this Nation many inventions potentially worth millions of dollars, to say nothing of the loss of potent stimuli to our industrial developments.

In the name of the individual inventor who forms the base upon which our gigantic industrial system has been built, and in the name of small and independent businessmen throughout the Nation, we respectfully and urgently request you to delete the words "a patent or an invention or design" from lines 1 and 2, page 63, paragraph (C), section 209, of H. R. 8920.

Senator KERR. You said up there that you estimated $1,000,000 from musical compositions?

Mr. EARLE. Yes, sir; and copyrights.

Senator KERR. This does not comprehend musical compositions, does it?

Mr. EARLE. Yes, sir; it covers that.

Senator KERR. A patent or invention or design?

Mr. EARLE. No, sir. That has nothing to do with it. That is why we could not understand why they lumped patents along with this particular thing. In one case the patent is an industrial tool, and in the other case it has more bearing on the social side of things. They might call it a cultural veneer. I don't like to use those words, but it is a very fine cultural veneer that is absolutely desirable in our type of economy.

I can't see any reason for tying those together in the same category as the invention, because the invention is wholly an industrial tool.

The accompanying graph also depicts another important and potentially dangerous trend—creative thinking in technology is declining at an alarming rate in the United States. And that, gentle-

men, you can very well see. In 1900, 11 people out of every 20,000 individuals applied for patents. When you take into consideration that it is only about 50 percent of those patents that are actually granted, you can see what a very small inventive potential we have got even to start with. In 1900, as I said, it was 11 people out of every 20,000, or 5.5 percent. In 1949, with 150,000,000 people, and with a much greater amount of technology in the world, we only have 4.3. So our inventive capacity, particularly, as you can see, from 1930, has been on a steady decline.

In the greatest industrial nation on earth, inventive thinking is on the decline. Since all technological advance is originally founded on creative thinking, we can well ask ourselves, how long will we continue to be the greatest industrial nation on earth if we permit our inventive genius to dry up? Yet this is exactly what is happening. If we don't do something to change this trend, eventually our country will lose its place as the leading industrial nation.

I realize that this is a broad statement. But it is true, and we might as well face the facts. Something must be done to encourage our inventors to expand their activities. The question is, what can we do? And the answer is to encourage inventors by increasing rather than decreasing their reward. What I have already asked you to do is to refrain from discouraging inventors. Now I urge you to do something to reverse the trend indicated by the graph during the past two decades.

Operators of oil wells and mines receive a depletion allowance because it is recognized that the country needs the oil and the minerals and wants to encourage these operators to drill wells and open mines.

I might add, too, that, in addition to oil being depleted, what we need in the oil industry and in the gas industry and in the mine industry is a lot of stimuli to encourage men to wildcat or to go out and do other kinds of exploratory work. That is absolutely necessary. And I think that in this case of patents we ought to do something like that.

Senator MILLIKIN. There used to be an old saying in the mining country: "Never limit the prospector's profit." And that was responsible for a lot of mining development in this country.

Mr. EARLE. The depletion allowance is based on the fact that the supply of oil in a given area will eventually be exhausted, and the same is true of minerals. Of course, they would be exhausted if you discouraged them from continuing to drill and wildcat. That is why they give them this allowance. However, not one penny is given to an inventor for depletion, although his patent can last only 17 years. He usually has much less than 17 years to reap the harvest of his patent because it almost always takes from 5 to 10 years to get it operating. And, gentlemen, how well do I know that! In two of my patents, one of which is a medical drug. it took me years to get them through. We could not start until we got those. Then I tried to practice, myself, and I couldn't get the money together to do it, and I finally had to turn it over to the company. The patent is 11 years old, and the company that is practicing it now under license to me is up to the magnificent sum of $46,000 a year. The patent has about 6 years more to run.

Mr. MCGREGOR. How much do you get out of it?

Mr. EARLE. I get about 2½ percent. It runs about a thousand dollars a year, or something like that. It is insignificant.

An oil well or a mine might continue to produce for 50, 75, or 100 years.

Therefore, if the operators of oil wells and mines are entitled to a depletion allowance, surely the inventor is entitled to a depletion allowance even greater than these others. It is recommended therefore that section 204, "Percentage depletion," paragraph (4), be amended by adding section (v):

(v) in the case of patents, 33⅓ per centum of the gross income therefrom during the taxable year excluding from such gross income the amount of expenses incurred by the taxpayer.

Senator MILLIKIN. How can you establish the capital value of an invention before it gets to be a going thing?

Mr. EARLE. That is just what cannot be done. You have to struggle along. For example, take the grease patents of which I hold the basic patents. I went around for 2 or 3 years and talked to all the oil companies. They were not interested in it. I didn't have the money to go out and practice it and set up a selling organization all over the United States, nor did I have the wherewithal to go out and contact all the companies that were manufacturing greases. Consequently, I finally had to lease my patent to a company that had the money and the funds to go out and practice the patents. Now that patent is 8 or 10 years old, and it finally is beginning to earn some money for me. It probably will earn considerable in the next few years.

Senator BUTLER. Was there any testimony rendered on this point, Mr. Earle, before the Ways and Means Committee?

Mr. EARLE. No, sir. We were caught flatfooted, sir, and there was no testimony on it.

Another thing is that some of the gentlemen who were on the committee did not even know that this provision was in the law.

The CHAIRMAN. Thank you, Mr. Earle.

Mr. EARLE. Thank you, sir.

The CHAIRMAN. I wish to insert into the record at this point a statement submitted by Mr. Allan H. W. Higgins in opposition to the taxation of the proceeds of all sales of patents and copy rights by inventors and authors as ordinary income and not as capital gains.

(Mr. Higgins' statement follows:)

STATEMENT SUBMITTED BY ALLAN H. W. HIGGINS, TAX ATTORNEY, BOSTON, MASS.

The provision of section 209 (a) of H. R. 8920, Revenue Act of 1950 as passed by the House of Representatives and now before the Senate, providing for the taxing of the proceeds of all sales of patents and copyrights by inventors and authors as ordinary income (i. e., ordinary compensation) and not as capital gain, is discriminatory, arbitrary, and a great discouragement to inventive and creative genius in the United States.

There may be a justification for taxing a royalty as ordinary income, but surely when the patent or copyright is sold in toto and no rights retained therein, such a transaction should be treated as the sale of a capital asset. Under present law a tenuous distinction has sometimes been drawn by the courts as to whether the inventor or author is in the business of inventing or writing. If he is, some courts say, the proceeds of the sale of a patent or copyright by such a person is ordinary income. Where, however, the inventor or author is not in the business of inventing or writing then the courts have held that the sale of an invention or copyright is the sale of a capital asset. Rather than amending the Internal Revenue Code so

as to tax all such transactions as the receipt of compensation, the law should be amended to tax all of them as capital gains.

In these times, when it is so important for the United States to keep the lead in new scientific development in all fields, inventors, especially, should be given every encouragement possible rather than be subjected to a new arbitrary tax provision which will dull and discourage their inventive genius.

Even with respect to royalties from inventions, where the patent is licensed and not sold in toto, there is, in fact, a strong basis for contending that the inventor, like an oil or mineral developer, should be granted a 27½ percent incentive depletion allowance. The argument advanced for such an allowance to the oil and mineral people is that it encourages prospecting and wildcatting and, thus, the development of our natural resources. Should not inventors receive a similar incentive in order that the United States may be paramount in scientific development?

If a mechanic builds his own house or boat and sells it after he has owned it 6 months, the transaction is treated as the sale of a capital asset. Why, if an inventor goes through the throes of inventing something and securing a patent thereon, should he be treated worse, for tax purposes, than the mechanic who has built his own house or boat and later sells it?

Moreover, section 209 (a) of the bill, in providing for the new section 117 (a) (1) (C) (II) of the Internal Revenue Code, goes even further than the Treasury Department has ever sought to go in any litigated case by providing that capital-gains treatment shall be denied to "a taxpayer in whose hands the basis of such property is determined for the purpose of determining gain from a sale or exchange, in whole or in part, by reference to the basis of such property in the hands of the person whose principal efforts created such property." In other words, if an inventor conveys a patent to a corporation in exchange for stock of the corporation and the corporation sells the patent after holding the same for 6 months, nevertheless the proceeds from such sale will not be treated as a long-term capital gain from the sale of a capital asset, but as ordinary income, taxable in full at ordinary corporate rates. On the other hand, if the corporation buys the patent from the inventor and the corporation, after 6 months, sells the patent, then the corporation will have a long-term capital gain.

Such a discrimination where inventors are involved is a road block against some of the greatest creative minds in the United States.

It is submitted that the Senate Finance Committee and the Senate of the United States should not only strike the arbitrary provisions of section 209 (a) from H. R. 8920 but also should insert in the Internal Revenue Code a provision to provide inventors with the same incentive as is now given to oil and mineral developers; namely, a flat 27½-percent depletion allowance against all royalties received.

This is a time in our history for the Government to lend encouragement to the great inventive minds in this country, rather than to discourage them.

The CHAIRMAN. The next witness is Mr. Clarence D. Laylin. You may identify yourself for the record, if you will, Mr. Laylin.

STATEMENT OF CLARENCE D. LAYLIN, LAWYER, COLUMBUS, OHIO, REPRESENTING THE COUNCIL OF STATE CHAMBERS OF COMMERCE, AND THE OHIO CHAMBER OF COMMERCE

Mr. LAYLIN. Mr. Chairman, my name is Clarence D. Laylin. I live in Columbus, Ohio, and am a lawyer. I had the honor to testify before the Committee on Ways and Means of the House of Representatives concerning the subject matter of the bill now before this committee. I then represented and now represent the Council of State Chambers of Commerce, consisting of some 32 autonomous State business organizations, and the Ohio Chamber of Commerce, one of its constituents. I have been admonished not to repeat here what was said there, and shall therefore confine my statement to certain conclusions respecting the bill in hearing which follow from the general positions there outlined, and our reasons then given.

For some time the State chambers of commerce have favored, in principle, the repeal or reduction of excessive wartime excise taxes and the removal of discriminations from the selective excise system. They have, with some variations in detail, vigorously urged action in that direction, as long overdue. I do not know what the position of any State chamber of commerce would be today in the face of the threatening international situation. I respectfully suggest that this committee will know best what ought to be done, or left undone, in that regard, under present conditions.

The several State chambers, each acting separately, emphatically oppose singling out the corporation income-tax rates for increase. They have always favored, and still favor, preferential treatment of small-income corporations, so long as the standard rate remains so high; but they are committed to the notch principle for the accomplishment of this purpose, believing that the present high marginal rate can be ameliorated without destroying the system. They have always opposed and still oppose any corporate rate structure which savors of general graduation. Therefore, I think they would object to the House bill, which has that practical effect, in spite of the very simple way in which it is achieved. Actually, not many of them have acted upon the specific proposal, because of the limited time afforded for consideration of all the aspects of this important feature.

The State chambers have also been opposed to the acceleration of payments of corporation income taxes. Most of their corporate members are relatively small, and acceleration would be burdensome to them—indeed would represent an increase in cash outlay for most of them—while yielding no permanent benefit to the Government.

Senator MILLIKIN. Mr. Chairman, may I ask the witness how he would handle the notch provision and dispose of the inequities?

Mr. LAYLIN. It is a mathematical problem, of course, and it is impossible to have the notch system without the last rate being higher than the standard rate.

I have here two examples that have been worked out, not by myself but by someone who knows more about it than I do, which show notches of $5,000 instead of an abrupt leap to a 53 percent or comparable higher rate. The thing can be worked out, we believe. True, and I must make this concession, to work it out on that basis involves consideration of a different break point for the standard rate than the one we have under existing law.

Senator MILLIKIN. Wherever you have a breakpoint in the notch system, you have some inequity, do you not?

Mr. LAYLIN. We don't think so; not if the intervals are small enough. The trouble with the present notch system is that the 53 percent rate applies to all income between $25,000 and $50,000.

Senator MILLIKIN. That is where you do your graduating?

Mr. LAYLIN. That is right; under the present law.

As I started to say, the State chambers have also been opposed to the acceleration of payments of corporation income taxes. Most of their corporate members are relatively small, and acceleration would be burdensome to them—indeed would represent an increase in cash outlay for most of them—while yielding no permanent benefit to the Government. While some of the chambers have not yet considered the House bill's proposal to spread the adjustment over a 5-year period, I feel sure that most of them would still object.

The proposal to withhold a part of the tax on dividends has taken the State chambers by surprise. I cannot say that many of them have acted; but the council's committee on Federal taxation, of which I am chairman, opposes the bill's withholding provisions very vigorously. The committee believes them unnecessary, in that more rigid reporting should be adequate to deal with such tax avoidance or inadvertence as now exists; believes them unduly expensive in compliance; and feels strongly that the refund problems which they engender are very serious, and the the practical result may well be that money may be thus taken from many who do not owe anything, and kept.

Two other features of the House bill with respect to which the several State chambers of commerce have taken no separate actions seem very objectionable to our committee. One is those provisions of section 209 of the bill which would treat as capital losses dispositions and abandonment of property used in business. The other is the discriminatory treatment, by the House, of the respective interest rates on refunds and deficiencies. I am sure this committee has already heard from others ample reasons for our committee's objections to these provisions.

The bill does contain several provisions which the State chambers would be glad to support, if they could be separated from the objectionable features to which I have referred and others which I have not time to discuss. Taking the bill as it is, and consistently with their long matured convictions, they would undoubtedly oppose those objectionable provisions. Speaking for our committee, as distinguished from the chambers, I must say that we feel, and very frankly, that the bad outweighs the good.

And, Mr. Chairman, I should like to supplement this statement by a statement for which I was originally solely responsible, as a matter of information, but which I now can say represents the views of the committee of which I am chairman. I would like to leave that for the record.

The CHAIRMAN. You may do that. Yes, sir.

(The statement referred to follows:)

PROPOSED CORPORATE RATE INCREASE UNSOUND

The tax bill passed by the House of Representatives on June 29 would radically modify the corporate rate structure. It would do away with the little understood "notch" principle and apply rate graduation to all corporations. It would also single out corporations with incomes above $167,000 for higher taxes. As the minority of the Ways and Means Committee declared, "This bill raises the top corporate rate from 38 percent to 41 percent—the highest rate ever imposed, even in wartime."

Several months ago the Ways and Means Committee of the House began to work on a tax revision bill to reduce wartime excises and correct a number of tax inequities. The committee worked under difficulties. It faced a large budget deficit, the threat of a veto by the President and the coming congressional elections. And so the committee, with a minority objecting, came out with what is regarded by many business men, economists, and tax students as an unsound proposal to revise the corporate tax rates. Some excise relief is no doubt necessary. But to compensate for the loss of revenue involved, the excessive and increasing spending of the Federal Government should be curtailed.

PROPOSAL WOULD INCREASE TAXES ON INVESTORS AND CONSUMERS

Raising $433,000,000 annually from increased corporate taxes would take that sum out of the pockets of investors and consumers. It is a myth that taxes on corporations are taxes on nobody.

A tax on corporate income is an indirect tax on investors, if it is not shifted. It is a tax on consumers which raises their cost of living, if it is shifted. All taxes are paid by individual citizens indirectly if not directly.

The proposed 41 percent tax would apply to corporations supplying about 70 percent of the Nation's goods and services and providing work for many millions of employees. The stocks of these corporations are held by millions of investors, small as well as large. Not long ago the Treasury stated that nearly half of the dividends paid out by industrial corporations were received by persons with incomes below $5,000.

The recipients of dividends, which are paid from profits after taxes, must also pay income taxes on them. This is double taxation. And it is discriminatory. The personal income-tax rate now rises as high as 82 percent.

Interest received on bonds, wages, salaries, and other income of individuals is not first taxed as corporate income. Many economists and businessmen have urged that the double taxation of dividends be corrected. Instead of taking steps to lessen or remove the double taxation, however, the tax bill would increase it. Both considerations of equity and the need to remove deterrents to investment in productive enterprise are ignored, thus increasing the difficulties of providing additional employment.

Any part of the corporate income tax shifted to consumers will raise the prices of bread, meat, clothing, and other absolute necessities as well as the prices of comforts and luxuries. The consumer cannot avoid the tax by purchasing untaxed products. In fact, the tax will be so concealed that he will not know how much it is and when it is paid. A corporate tax increase is thus a trick to hide the new taxes from those who, in the final analysis, must pay them.

SELECTIVE CORPORATE DISCRIMINATION

The tax bill is an obvious discrimination against the Nation's corporations with incomes above $167,000 despite the fact that many of their stockholders have only modest incomes. Only the taxes of the larger corporations will be raised. Small corporations with incomes under $5,000 would get no relief and would continue to pay at the same tax rate. Those with incomes between $5,000 and $166,666.66 would be granted tax-rate reductions. The tax cut for this favored group of corporations ranges from a modest reduction to a maximum of 18 percent on an income of $50,000.

The excuse given for this peculiar action is that the existing rate formula for corporations with incomes up to $50,000 has been much criticised and that a revision of tax rates is necessary. Political considerations seem to have led the committee away from the paths of clear thinking.

THE "NOTCH" PRINCIPLE

The Council of State Chambers of Commerce has repeatedly gone on record in favor of the "notch" principle in corporate income taxation. It is sound because it permits such rate differentiation as may be necessary for the benefit of the smaller corporations when a high maximum rate is imposed. It also limits the rate differentiation to the smaller corporations.

The House bill would abandon the "notch" principle. By means of a proposed surtax exemption of $25,000 it would, in effect, tax the income of all corporations, large as well as small, at graduated rates. The top rate of 41 percent would nominally apply on income above $25,000. Actually, considering the effect of the lower rates on the lower income brackets and the surtax exemption, the present 38 percent over-all maximum rate would not be equalled until an income of nearly $167,000 is obtained. The proposed over-all rate of 41 percent would not be approximated until income exceeded $1,000,000. On $1,000,000 of income the tax rate would be 40.5 percent. This is the bait offered to open the door to unlimited graduation.

Eventually the income brackets of all corporations might be the same as those for individuals, and the tax rates might also be identical. With steep rate graduation, such as that now found in the personal income tax, no surer way could be found to stop corporate growth and kill private enterprise.

The "notch" principle is sound and should be retained. And it can be with the present maximum rate of 38 percent. The present formula should be revised as this organization and other business groups have recommended.

INCREASED PROFITS NECESSARY FOR INCREASED INVESTMENT

In searching for an excuse for higher corporate taxes, the committee states that profits have increased in recent years. This is true. But the investment required for financing larger plants and equipment to furnish the goods and services demanded by our population is much greater than it was before the war. The costs of plant, equipment, inventories of materials, personal services, and the various supplies and services needed in business have risen sharply with the inflated price level, along with the prices of consumer's goods and services. In 1949, according to the Department of Commerce, American business invested over $18,000,000,000 in new plant and equipment. The declining purchasing power of the dollar accounts for much of this great outlay.

As the minority report of the committee pointed out, it requires $8,000, on the average, to supply the capital facilities needed to keep one employee working in a modern plant. Studies by the National City Bank have revealed that the 100 largest manufacturing corporations of the Nation had an average investment of $12,000 for every worker at the end of 1949.

The actual profits of corporations in many cases are less than those which are found taxable. To cite merely one illustration, only the original cost of plant and equipment may be allowed for in depreciation deductions, even though replacement costs may be double or even higher.

Corporate profits in recent years have not generally been excessive in relation to the capital invested or sales. The American economy, with its greater population and its rising level of living, has been expanding tremendously. Personal income in 1950 has been flowing out at an annual rate of approximately $215,000,000,000 and may exceed the 1948 peak. So, higher corporate profits go along with the increased business, employment, and consumption. As profits increase, the tax take of the Government also increases at the present high rates.

JUGGLING CORPORATE TAX PAYMENTS

The House bill would increase revenues approximately $730,000,000 in 1951 and $800,000,000 in 1952–55 by requiring corporations, over a 5-year period, to pay their income taxes fully within 6 months after the taxable year instead of the present 12 months. This move would produce no lasting new revenues. It would increase the difficulties of those concerns not in a liquid capital position, both large and small. It would provide another excuse for the Government to keep on spending at an increasing rate by postponing the date when new tax increases would have to be voted. It is a deceptive bookkeeping device.

THE INTEREST RATE ON REFUNDS

The tax bill would reduce the interest rate on refunds from 6 to 3 percent. This would be fair and in line with the lower interest rates prevailing in recent years. But it would be more consistent if the interest rate on overassessments should be similarly reduced. Certainly additional interest should not be imposed on deficiencies when the law provides other penalties.

THE WITHHOLDING TAX ON DIVIDENDS

The House bill provides that a flat 10 percent withholding tax on dividends shall be applied to corporations. The minority points out that the bill would impose needless hardship and inconvenience on both corporations and stockholders if the withholding tax were adopted. It declares that sufficient enforcement measures will be provided by (1) requiring corporations to report all dividends paid out, not merely those exceeding $100, as in the present law, and (2) requiring taxpayers receiving dividends to itemize them. It is a question, therefore, if it would not be wise to test the adequacy of these measures before introducing a new dividend withholding tax which is of controversial revenue value.

THE NET OPERATING LOSS CARRY-OVER

The proposal to extend the present 2-year net operating loss carry-forward to 5 years for corporate and noncorporate taxpayers and to restrict the present 2-year carry-back to 1 year has generally been commended as a sound development. It should provide more equality in the taxation of concerns with fluctuating incomes as compared with concerns with stable incomes. New, small, and growing companies should particularly benefit.

But the proposal, in its present form, would deprive many taxpayers of this essential adjustment. It should be amended to remove the limitations relating to tax exempt income, allowances for capital gains and losses, percentage depletion, and the credit for intercorporate dividends. This could be done by employing statutory net income in determining the tax liability of any year.

OTHER WEAKNESSES

The tax bill also suffers from other weaknesses. The bill does nothing to eliminate the penalty tax on consolidated returns or the taxation of intercorporate dividends. It does not provide much needed improvements in the allowances for depreciation. It does nothing to provide many other needed tax reforms.

NO PERMANENT TAX RELIEF WITH A RUNAWAY BUDGET

The present tax bill is plainly a pre-election attempt to be as popular as possible with those crying for relief from the excises. It postpones but does not avert the day of final reckoning. The soaring Federal budget will take an even more serious turn if the Korean crisis deepens. In addition to the possibility of war, other pressures are pushing the budget upward. The minority of the committee pointed out that the legislation requested of Congress by the President would increase spending by $7,000,000,000 in 1951 and by $25,000,000,000 in another 5 years. This would require an annual peacetime budget exceeding $65,000,000,00 The budget is now unbalanced and the debt is rising. America's financial plight is, indeed, serious. Unless the budget is cut, taxes will go up and up. If we are to have any real tax relief, the budget must come down. This conclusion is inescapable.

WHAT PRICE TAX REVISION?

After laboring for months, the Ways and Means Committee has brought forth a tax bill seriously deficient. It gives a certain amount of excise and other tax relief at the cost of a radically new corporate rate structure with graduation applied to all corporations, higher taxes on many corporations, and other objectionable features. Taxes are reduced on one hand, but the reduction is offset by new taxes on the other. The basic difficulty arises from the failure of our Government to keep its spending within the income that could be obtained from a reasonable tax structure. It is trying to be all things to all men.

The result is a hodge-podge. Sound financial policy is sacrificed to political expediency. Would it not be better for the economy as well as business if no tax bill at all were to be adopted, under existing conditions?

The CHAIRMAN. Are there any further questions?

Senator MILLIKIN. I would like to ask one question.

I am somewhat disconcerted by the number of witnesses it affects who say they have been taken by surprise. Have not the journals, the business magazines, kept the people informed as to what was going on over there at the House Ways and Means Committee?

Mr. LAYLIN. Well, yes, Senator. May I, in partial defense of what I have said——

Senator MILLIKIN. I am not asking you to defend yourself. I mean I am surprised at the number of people who say they were taken by surprise, and I am commencing to think that too many people were taken by surprise.

This is no place to consider a tax bill in the first instance. The witnesses should have a chance to reflect their views in the House version of a bill.

Mr. LAYLIN. Senator, you will recall that in the Treasury's presentation before the Ways and Means Committee in the House, nothing was said about withholding tax on dividends. That was a development, I believe, within the Ways and Means Committee itself. There were intimations in the news that such a thing was to come forth out of the committee. Our organizations, however, as I

have said, are autonomous. They are independent of each other. You have noticed, however, that I have been quite cautious in trying to represent their position. I must be so. I dare not speak for them until they have spoken through their own organs. I note the extent to which they have spoken, and I know that they have not had time to act upon that specific proposal.

Therefore, I gave you the views of our committee rather than the views of the separate chambers of commerce.

Senator MILLIKIN. Mr. Chairman, I would like to ask Mr. Kirby: Was this something which did originate in the committee itself? This 10 percent business?

Mr. KIRBY. Yes; it was something which originated in the committee and it was not a part of the Treasury program.

Senator MILLIKIN. There is no crime in that, of course.

Mr. LAYLIN. No, but in view of that, there were no witnesses from the public on the House side that directed themselves toward the withholding on dividends, because they did not know it was coming up, I expect.

Senator KERR. Did H. R. 8920 grow out of recommendations before and considerations of the committee? Was that the situation rather than one where the committee considered the provisions of a bill that had been introduced and was pending before it?

Mr. KIRBY. Yes; the bill itself was developed within the committee, and many of the provisions were a part of the Treasury recommendation and the President's recommendation. But during the course of the work of the committee they were looking for every source to offset the excise reductions, and this withholding on dividends was a part of that.

Senator MILLIKIN. Mr. Chairman, a fellow was before a police magistrate one time for mayhem, and he had bitten off a fellow's thumb and he had bitten off his ear and he had taken a razor and cut him down the face, and a lot of other things. And the magistrate said, "Well, now, Sam, why did you do that?"

He said, "Jedge, I's tellin' you, the Lord told me to cut that man with a razor."

"Well, Sam, why did you bite off his ear?"

"Jedge, I's tellin' you, the Lord told me to bite off his ear"—the Lord being, in this case, the Treasury. So he said:

"Well, then, why did you bite off that fellow's thumb?"

He said: "Jedge, I'se tryin' to tell you. The Lord told me to do them things."

"Well, then, why did you take your thumb and gouge out his eye?"

"Well, Jedge, I must admit that that were a little idea of my own." [Laughter.]

And this is a little idea of the House Ways and Means Committee.

Mr. LAYLIN. Apparently so.

The CHAIRMAN. Thank you very much, Mr. Laylin.

Mr. LAYLIN. Thank you, Mr. Chairman and gentlemen.

The CHAIRMAN. Mr. Theodore K. Warner.

STATEMENT OF THEODORE K. WARNER, JR., ATTORNEY, CHAIRMAN OF THE FEDERAL TAXATION COMMITTEE, PENNSYLVANIA STATE CHAMBER OF COMMERCE, PHILADELPHIA, PA.

Mr. WARNER. Mr. Chairman and gentlemen of the committee, my name is Theodore K. Warner, Jr. I am a Philadelphia attorney appearing here as chairman of the Federal taxation committee of the Pennsylvania State Chamber of Commerce. I ask leave, with your permission, to file a statement subsequently, later in the week, if it will be satisfactory.

The CHAIRMAN. Yes, sir.

Mr. WARNER. Mr. Laylin spoke about not knowing the views of the State chambers. This is one State chamber that does have its views and, as you can imagine, we are very much concerned, as I notice today a lot of other people are, with the provisions of H. R. 8920.

I shall be brief because I realize you have a lot of people to hear and you have heard a lot of this before from others.

We are opposed to the proposed increase in the corporate tax rate. The proposed tax of 41 percent on corporate income is the highest rate, excluding the excess profits tax, in the history of this country. Even during World War II the incomes of corporations not subject to excess profits taxes were taxed at a maximum rate of 40 percent. Today an even higher rate is proposed.

I imagine others have stressed to you the fact that the corporate tax must be paid by either the consumer, labor or the investor. If the corporate tax can be and is passed on to the consumer, as they choose, then the proposed bill will result in the increased cost of all products. Selective excise taxes will be reduced but food and necessities would be included within the new base, or the corporate employee must share the burden, which is also undesirable.

If the tax cannot be, or is not, passed on the burden falls on the investor. Equity invested capital is presently lacking and this would provide a further deterrent. It is well known that corporate earnings of necessity are being plowed back into the property to finance new plants and equipment. The increased rates would require additional income in order to permit the retention of the required amounts.

We are opposed to the elimination of the principle of the "notch." Under the present law special treatment is provided for corporations whose incomes are less than $50,000. After that everyone pays the same rate. The proposed bill reverses the trend. The small corporation whose income is $25,000 or less pays a flat rate and everyone else pays a graduated rate. I am taking that from the charts which are in the majority report.

We favor special treatment for small business. A lot of members of the chamber are small business. However, we are seriously objecting to the introduction of a general system of graduated corporate tax rates as being the first step in the wrong direction.

Our objection to the accelerated payment of the corporate tax is that it is a disguised increase in corporate payments. In each fiscal year the corporate tax payments will be increased to 110 percent, although this does not appear to be generally recognized. Therefore it would seem that the alleged reduction in rates upon incomes over

$5,000 and less than $167,000 will in fact be effective only upon corporate incomes of over $25,000 and less than $75,000 for the reason that the fellow has this extra 10 percent on a fiscal year basis.

With respect to dividend withholding, I think Mr. Laylin has set forth our position in that we favor requiring the corporations to report all dividends paid our rather than merely those over $100, and the taxpayers to itemize the dividends they receive.

The additional administrative cost of such a proposal upon the Government and corporations would seem to warrant a trial of some other method first. In other words, let us try, first of all, the proposition of reporting entirely and the itemization before we go into this burdensome matter of withholding of dividends.

We object to the interest rate on refunds as being unfair where the 3 percent is paid on refunds and 6 percent is assessed on the deficiencies.

A particular inequity arises with respect to returns under the interrelated income and excess profits tax laws, many of which are still under audit. A change in the excess profits credit results in an overassessment of one tax and a deficiency in the other. The proposed change in the interest rate would permit 3 percent interest on the overassessment but charge 6 percent interest on the deficiency. In this situation it is conceivable that a favorable change in the taxpayer's excess profits credit could still cost him money as the result of the net interest charge.

As Mr. Laylin has mentioned, we think it is too harsh a result to provide that upon abandonment or sale of depreciable property as well as certain real property under provisions of section 209 the loss will be treated as a capital loss. In such a case taxable income never reflects the loss unless the taxpayer is so fortunate as to have capital gains.

Last year we were disappointed that a lot of the inequities that have been pointed out by various taxpayers were not omitted in the bill some of them involving substantial amounts of revenue possibly, others not so. There were the foreign tax credit, the net operating loss computation, the involuntary conversion, and a complex one of consolidated returns, corporate dividends and double taxation of individuals. However, we will cover those in our statement which we will submit. I appreciate the opportunity to be heard.

(The statement referred to above follows:)

Statement of Federal Taxation Committee of the Pennsylvania State Chamber of Commerce

My name is Theodore K. Warner, Jr. I am a Philadelphia attorney appearing here as chairman of the Federal taxation committee of the Pennsylvania State Chamber of Commerce.

The organization I represent, and the other State chambers of commerce which are members of the Council of State Chambers of Commerce, are of the opinion that in view of the seriousness of the present situation in Korea, as well as the international picture generally, no revenue bill should be enacted at this time. In addition, there are many provisions of H. R. 8920 which these groups find highly objectionable. I realize that brevity is most desirable and therefore, I shall summarize the views of our committee.

I. Corporate rates, notch provisions and accelerated payments

We are opposed to the proposed increase in the corporate tax rate. The proposed tax of approximately 41 percent on corporate incomes is the highest rate, excluding the excess profits tax, in the history of this country. During World

War II, the incomes of corporations not subject to excess-profits tax were taxed at a maximum rate of 40 percent. Today an even higher rate is proposed.

The corporate tax must be paid by the consumer, labor, or the investor. If the corporate tax can be and is passed on to the consumer, the proposed bill will result in increased costs of all products. Selective excise taxes will be reduced, but the basic cost of all items, including food and other necessities, would be higher as a result of the increase in the corporate tax rates. If the tax is not passed on in its entirety to the consumer, the corporate employee may be compelled to share the burden, an equally undesirable result. If the tax cannot be, or is not passed on, the burden falls upon the investor. Equity invested capital is presently lacking; the proposal would provide a further deterrent. Also it is well known, that of necessity, corporate earnings are being plowed back into the property to finance new plants and equipment. The increased rates would require additional income to permit the retention of required amounts.

We are opposed to the elimination of the principle of the "notch". Under present law special treatment is provided for corporations whose incomes are less than $50,000. Thereafter all corporations are subject to the same rate. The proposed bill would impose a flat tax on small corporations, and a graduated tax upon all corporations whose incomes exceed $25,000. We favor special treatment for small business; the notch provides this. We believe that an improvement should be made in the formula applying the notch principle in order to afford relief to corporations whose incomes are between $25,000 and $50,000. However, the introduction of a general system of graduated corporate rates as has been done in H. R. 8920, conflicts with sound principles of corporate taxation.

Our objection to the accelerated payment of corporate taxes is that it is a disguised increase in corporate payments. In each Federal fiscal year the corporate tax payments will be increased to 110 percent. In general it would appear that the alleged reduction in rates upon incomes over $5,000 and less than $167,000 will in fact be effective only upon corporate incomes over $25,000 and less than $75,000. Even in the case of the latter group, the asserted reductions will be materially lessened. The tax on corporations with incomes of $5,000 or less (constituting 46 percent of all corporations) will actually be increased by this proposed change. A further objection is that the accelerated payments would result in hardship for many corporations which do not have available sufficient cash with which to make the increased payments.

II. DIVIDEND WITHHOLDING

The withholding tax on dividends does not appear necessary to minimize the evasion of the personal income tax. Requiring corporations to report all dividends paid out and taxpayers to itemize all dividends should be sufficient enforcement measures.

The additional administrative costs of such a proposal upon the Government and corporations would seem to warrant a thorough investigation of the necessity for such withholding. That is, the suggested itemization of dividends upon individual returns, and the complete reporting of all dividends, should first be given a fair trial.

III. INTEREST RATE UPON REFUNDS AND OVERASSESSMENTS

In our opinion, reducing the interest rate on refunds and overassessments from 6 percent to 3 percent is unfair unless the interest rates on deficiencies is similarly reduced.

A particular inequity arises with respect to returns under the interrelated income and excess profits tax laws, many of which are still under audit. A change in the excess profits credit results in an overassessment of one tax, and a deficiency in the other. The proposed change in the interest rate would permit 3 percent interest on the overassessment but charge 6 percent interest on the deficiency. In this situation it is conceivable that a favorable change in a taxpayer's excess profits credit could still cost him money as a result of the net interest charge.

We favor an interest rate of 3 percent provided that it is applicable to deficiencies as well as refunds and overassessments.

IV. LOSS ON ABANDONMENT OR SALE OF BUSINESS PROPERTY

Section 209 of H. R. 8920 provides that upon the abandonment or sale of depreciable property, as well as certain real property, the loss shall be treated as a capital loss. In our opinion, this is unfair and inequitable in that taxable income never

reflects this loss unless the taxpayer is so fortunate as to have capital gains to be offset. In many cases the abandonment losses result from the failure of the Commissioner to grant reasonable depreciation rates with respect to the properties.

V. NEGLECTED INEQUITIES

The bill is further deficient in that it omits many technical amendments which have been advocated for years by taxpayers generally. Thus, the bill fails entirely to consider such important matters as the foreign tax credit, the computation of the net operating loss, the penalty for filing consolidated returns, double taxation of intercorporate dividends and double taxation of individual dividends. A brief discussion of these and other proposed technical amendments of the code is submitted with this statement.

VI. CONCLUSION

In conclusion, I should like to repeat that in the light of developments in Korea, and because in our opinion the many deficiencies and undesirable features of H. R. 8920 outweigh the relatively few good provisions thereof, our committee believes that the enactment of this bill would not be in the best interests of the country as a whole.

TECHNICAL AMENDMENTS TO THE INTERNAL REVENUE CODE ADVOCATED BY THE SUBCOMMITTEE ON FEDERAL TAXATION, PENNSYLVANIA STATE CHAMBER OF COMMERCE

1. *Double taxation of intercorporate dividends.*—The double taxation of intercorporate dividends should be eliminated. Since 1936, 15 percent of intercorporate dividends have been twice subjected to the corporate income tax. The earnings are taxed first in the hands of the distributing corporation and are again taxed in the hands of the recipient corporation. Such double taxation is discriminatory, inequitable and unsound; dividends should be excluded from the gross income of corporations.

2. *Penalty on filing of consolidated returns.*—The 2-percent penalty upon the filing of consolidated returns should be repealed. Consolidated returns have been provided for in the tax laws since 1921, as a means of determining the net income of a single enterprise, even though the business is carried on through two or more corporations. No special advantages are derived through the use of such returns. They are recognized and favored by both the Treasury Department and taxpayers alike, as the only practical method of determining net income in such cases, and as a method which is fair and easy to administer. The additional rate of 2 percent imposed upon those filing consolidated returns, however, imposes a penalty upon their use which in many cases compels the filing of separate returns. Such a provision clearly discriminates against the business which must be carried on through subsidiaries. Considered either from a viewpoint of equity or administrative convenience, consolidated returns should be fostered by eliminating the 2-percent penalty imposed on their use.

3. *Net operating loss.*—The net operating loss provisions should be revised and liberalized to eliminate the discrimination (1) against taxpayers having income from exempt interest or having deductions for depletion and (2) against corporations receiving dividends from domestic corporations. Under the existing provisions of section 122, governing the amount of a net operating loss deduction, taxpayers receiving income in the form of wholly or partially exempt interest, or claiming a percentage or discovery depletion allowance, and corporations which receive dividends from domestic corporations, are in most instances taxed, in effect, at the full rates on such income or are denied the full depletion allowance, by means of a reduction in the allowable net operating loss deduction.

These provisions, the effect of which is to penalize the discriminate against taxpayers sustaining net losses by denying to them the benefit of general provisions relating to exclusions and deductions, should be eliminated by appropriate amendments.

The provisions relating to carry-back and carry-forward of net operating losses should be amended to provide a 1-year carry-back and 5-year carry-forward effective January 1, 1951. Such an amendment would produce greater equity among taxpayers and would be of particular advantage to new and growing concerns.

4. *Improper accumulation of surplus.*—Section 102 should be amended in several respects. This section is intended to prevent the improper accumulation of sur-

plus to avoid the imposition of surtax on stockholders and is a penalty provision. In practice, the need for retention of earnings necessarily varies according to the particular problems and circumstances present each case. The existence and effect of such need can certainly be judged more accurately by the officers of the corporation then by the revenue agents. In those rate instances where a penalty may be justified, the penalty should be based upon the part of the net income improperly accumulated, and not upon the entire net income.

Specifically, it is recommended that section 102 be revised so that (*a*) the tax will apply only to that portion of the undistributed section 102 net income which was unreasonably accumulated; (*b*) the burden of proof will be upon the Commissioner with respect to both the fact and the amount of the unreasonable accumulation of surplus; (*c*) dividends paid within 75 days after the close of its taxable year may, at the taxpayer's election, be deducted in computing Section 102 net income for such year; and (*d*) long-term capital gains will be excluded from section 102 net income.

5. *Interest on interrelated deficiencies and refunds.*—There should be eliminated the presently existing discrepancy in the respective dates from which interest is computed on deficiencies and refunds of interrelated taxes for the same year. We have specifically in mind the deficiencies and refunds arising with respect to income and excess profits tax upon an adjustment of the excess profits credit. Under present law, interest on the deficiency is computed from the date the tax was due (March 15 in the case of a calendar year taxpayer), whereas interest on the refund is computed only from the date the overpayment was made. In the case of a taxpayer making installment payments, the overpayment ordinarily does not occur until the date of payment of the last installment. Thus, a substantial period exists in which interest is running only in favor of the Government on the deficiency, although both the deficiency and the overpayment arise from the same adjustment to the excess profits credit. Under present law, interest on the deficiency is computed from the date the tax was due (March 14 in the case of a calendar year taxpayer), whereas interest on the refund is computed only from the date the overpayment was made. In the case of a taxpayer making installment payments, the overpayment ordinarily does not occur until the date of payment of the last installment. Thus, a substantial period exists in which interest is running only in favor of the Government on the deficiency, although both the deficiency and the overpayment arise from the same adjustment to the excess profits credit. Such a situation is obviously inequitable and should be remedied by an appropriate amendment.

6. *Involuntary conversions.*—Section 112 (f), relating to involuntary conversions, should be amended to provide (1) that no gain shall be recognized from involuntary conversions in those cases where the taxpayer makes anticipatory replacement of the property converted or to be converted and (2) that a taxpayer need not trace the proceeds of an involuntary conversion into the new property acquired to replace the property involuntarily converted. In order to cover conversions which may have arisen primarily because of the war, the amendments should be effective retroactively to taxable years beginning after December 31, 1938.

7. *Reduction of interest rate on deficiencies and refunds.*—The rate of interest on deficiencies and refunds should be reduced to a more realistic level in the light of present-day conditions. The interest charged on deficiencies and granted on refunds is intended to represent a charge for the use of the money. At present an interest rate of 6 percent is not realistic, and insofar as deficiencies are concerned, imposes a penalty upon the taxpayer who has erroneously computed his taxable net income. It is earnestly recommended that the rate be reduced to one representing a reasonable charge for the use of the money, both with respect to deficiencies and refunds. We suggest that the rates should be 3 percent.

8. *Capital gains and losses.*—The deduction of capital losses should be allowed on the same basis that capital gains are taxed. Under present law all capital gains are taxable, regardless of the nature of the transaction from which they arise. Numerous restrictions are contained in section 117, however, on the allowance of capital losses. No sound reason presents itself for this difference in treatment, and it is earnestly recommended that the loss be allowed on the same basis that the gain is taxed.

9. *Taxation of small business.*—It is our recommendation that the principle of the notch rate be retained, as a fair and equitable method of taxing the income of small business. We are opposed to the adoption of a progressive rate of tax on all corporations, as being unsound in principle and unfair in application.

10. *Research and development expenditures.*—Taxpayers should be permitted, at their election, to deduct currently research and development expenditures. It is

common practice among business enterprises to make substantial expenditures for research and development in order to improve existing products, processes, and services and to bring new ones into use. At the time such an expenditure is made, it is impossible to determine whether or not a valuable asset will result therefrom; if a valuable asset does result, it is frequently impossible to determine either its cost or its useful life.

Industry should be encouraged by all possible means to continue and expand its research and development activities, as it is only through such activities that the nation can be assured of an expanding and prosperous economy. Consequently, the code should clearly state that such research and development expenditures may be deducted currently as paid or incurred.

11. *Tax benefit rule for depreciation and depletion.*—The tax benefit rule should be extended to deductions for depreciation and depletion. Congress has seen fit to extend the tax benefit rule to many deductions, and it is earnestly recommended that that rule be extended to include depreciation and depletion. To afford just and equitable treatment to taxpayers, the cost of investments must be recovered from income. Such a rule has been recognized in other countries and its adoption would provide an incentive to new industries as well as materially foster capital improvements by established concerns.

12. *Foreign tax credit.*—The provisions relating to the foreign tax credit should be liberalized in order to encourage foreign trade and investment. Under the existing provisions of section 131 (f), the allowance of the foreign tax credit is unduly limited to certain restricted situations. Thus, under section 131 (f) (1), the credit is allowed only where the domestic corporation owns a majority of the stock of the foreign corporation. Under section 131 (f) (2), the credit is allowed only in those instances where the foreign parent owns 100 percent of the foreign subsidiary. It is recommended that the provisions of section 131 (f) (1) be liberalized to permit the allowance of the credit in all cases where a domestic corporation which owns any stock of a foreign corporation receives dividends from the latter. The provisions of section 131 (f) (2), relating to a foreign subsidiary of a foreign corporation, should be amended so as to allow the credit in cases where the foreign parent owns less than 100 percent of the voting stock of the foreign subsidiary. We suggest a requirement of 20 percent ownership.

13. *Western Hemisphere trade corporations.*—Section 109 should be amended in order better to effectuate the purpose for which it was enacted, namely. to encourage trade in the Western Hemisphere and to place American corporations on an equal competitive basis with foreign firms. It is recommended that the section be amended so as to provide that income arising from the sale and shipment of goods to a foreign country shall be regarded as income arising from sources without the United States, regardless of where title to the goods passes. It is also recommended that the benefits of section 109 be extended to cover business done in all foreign countries, whether or not within the Western Hemisphere.

14. *Definition of reorganization amended.*—The definition of a reorganization, under section 112 (g), should be amended to include a transfer of substantially all the assets of one corporation to another in exchange solely for voting stock of a corporation owning all the voting stock of the acquiring corporation. Under existing law, the acquisition by one corporation of substantially all the assets of another corporation, solely in exchange for voting stock of the acquiring corporation, is a valid reorganization (sec. 112 (g) (1) (C). Frequently, however, for valid business reasons the acquiring corporation desires that the acquired business be operated by a subsidiary. Nevertheless, if the transaction is rearranged to accomplish this purpose, either by having the transferor transfer the assets directly to the subsidiary, or by having the acquiring corporation make the transfer immediately upon receipt of the assets, the tax-free character of the reorganization is destroyed.

Taxation of the transferor and its shareholders in such a situation cannot be defended on any rational grounds. It is often convenient or advisable for business reasons to conduct a business so acquired as a separate unit through a subsidiary corporation. No purpose or policy of the reorganization provisions would be violated by amending them so as specifically to cover this type of case.

15. *Sale of corporate assets followed immediately by dissolution.*—The code should be amended to provide that where a corporation sells substantially all its assets and distributes the cash received therefrom and any remaining property in complete liquidation within a period of any 12 months, gain or loss from the sale of such assets shall not be taxable to the corporation. It is our belief that the need for such an amendment is in no way diminished by the recent decision of the Supreme Court in *U. S.* v. *Cumberland Public Service Company* (decided January 9, 1950). That decision, by distinguishing the *Court Holding Company case* (324 U. S. 321) left unimpaired the rule of the latter case. Such an impor-

tant rule of tax administration should not be left to the case-by-case development of judicial interpretation, but should be clearly and definitely stated by a specific provision in the code.

16. *Deduction of certain organization expenses.*—It is recommended that organization, reorganization and recapitalization expenses be treated as a deductible item for tax purposes, either in the year incurred or amortized over a reasonably short period of years subsequent thereto, since no actual value is added to the corporate assets by such expenditures. Present law permits amortization where a corporation's charter limits its existence to a fixed term of years, but if its existence is unlimited, no deduction is allowable until dissolution. This works an unfair discrimination against many corporations, since the laws of various States determine the deductibility of such expenditures.

17. *Sections 22 (b) (9) and (10) made permanent.*—Sections 22 (b) (9) and (10), relating to the exclusion of income resulting from the discharge of indebtedness under certain circumstances and subject to certain conditions, should be made permanent sections of the code. In recent years, Congress has periodically extended these provisions. Since these sections are appropriately a part of the code in normal years as well as in war years, there would appear to be no reason for continual extensions, but rather they should be made permanent provisions.

18. *No gain or loss on purchase at foreclosure sale.*—The code should be amended to provide that no gain or loss will be recognized to a mortgagee who purchases the property at a foreclosure sale until he finally disposes of such property. The present rule, under which gain may be recognized to the mortgagee at the time he purchases the property at the foreclosure sale, is inequitable and unsound, since it is not known until the property is finally disposed of whether he has realized a gain or sustained a loss.

19. *Refund allowance where income shifted among taxpayers.*—The code should be amended so that in cases where the Commissioner shifts income among taxpayers, the statute of limitations will not constitute a bar to the allowance of a refund as a result of such shifting.

The CHAIRMAN. Mr. N. H. Seefurth.

STATEMENT OF N. H. SEEFURTH, CHICAGO, ILL., AGENT FOR THE NORTHWESTERN MUTUAL LIFE INSURANCE CO., ON BEHALF OF THE NATIONAL ASSOCIATION OF LIFE UNDERWRITERS

Mr. SEEFURTH. Mr. Chairman and members of the committee, my name is N. H. Seefurth, Chicago, Ill. I am an agent for the Northwestern Mutual Life Insurance Co. I am appearing here as a representative of the National Association of Life Underwriters which is an organization of over 50,000 life insurance agents throughout the country.

I ask your permission, Mr. Chairman, to file a written statement that we have prepared in these proceedings, but in order to conserve time I would like to summarize that statement which I believe I can do in about 5 minutes.

The CHAIRMAN. Very well, you may file your statement.

(The statement referred to follows:)

STATEMENT ON BEHALF OF THE NATIONAL ASSOCIATION OF LIFE UNDERWRITERS BY NATHANIEL H. SEEFURTH

Mr. Chairman, our national association represents more than 50,000 life-insurance agents, general agents, and managers. These individuals are the link between the 81,000,000 people in the country who own life insurance and the companies to which that public looks for payment.

We have asked permission to appear because section 201 of the bill before you changes the long-standing income-tax law relating to life insurance as determined by the Congress as well as the courts. Under the existing law, when an insured dies his beneficiaries receive the proceeds free from income tax whether these proceeds are paid at once in a lump sum or spread out over a period of years to fulfill the future needs of the beneficiaries. These beneficiaries are, in the great majority of cases, widows and children.

Section 201 of the bill before you would change this. It would tax to these beneficiaries each year a portion of insurance proceeds paid in monthly or annual installments. On page 81 of the Committee on Ways and Means Report to accompany H. R. 8920, you will find the explanation of section 201. This report refers to three possible situations, i. e.:

1. *Insurance proceeds paid in installments over a fixed period of years such as 10.*—In such case, the bill would divide the proceeds by the number of years that the payments are to run. The result would be the amount of the tax-free portion of each installment.

2. *Proceeds payable for the life of the beneficiary.*—In this case, the proceeds would be divided by the beneficiary's life expectancy at the insured's death to determine the tax-free portion of each installment.

3. *Proceeds payable for life but with payments guaranteed for a fixed period.*—In this case, the proceeds would be divided by the greater of the life expectancy or the guaranteed period to determine the tax-free portion of each installment.

In every case it is assumed that a part of each installment represents taxable interest and a part represents tax-free insurance proceeds; however, only in No. 1 where the full proceeds are to be paid in fixed installments is it certain that a beneficiary will collect more than the face amount of proceeds that would be payable at the insured's death.

Actually the big bulk of policy option settlements are covered by No. 2 and No. 3, with the majority under No. 3 (payments for life with 5, 10, 15, or 20 years certain). Under these options the beneficiary may not collect as much as the face of the policy.

We believe that the passage of section 201 would be an unfortunate reversal of a sound social policy to encourage the payment of insurance proceeds for the continuing support of the family.

In 1934, this committee in its report on the tax bill said:

"This change, made by the House, makes it clear that the proceeds of a life-insurance policy payable by reason of the death of the insured in the form of an annuity are not includible in gross income. Your committee made no change in this section of the House bill."

No good reason has been advanced to change this position. We do not believe that the social implications of life insurance need to be stressed to this committee and the types of beneficiaries reveal the public considerations involved. Wives are beneficiaries in 37 percent of the death benefits paid, children in 23 percent and husbands in 12 percent.

Actually, the majority of beneficiaries will not pay a tax because of section 201. In 80 percent of the cases, the widow or other beneficiary who receives installment payments of insurance proceeds will get a total of less than $2,000 a year. Even if one takes the extreme example used by the Treasury before the House Ways and Means Committee, the amount that the Treasury arbitrarily allocates to so-called taxable interest would be about 25 percent of the total payment. This would be more than offset by the present $600 personal exemption from income tax.

You may say, "If such small amounts are involved in most cases why do you object?" While we cannot now say that the proposed tax on installment payments will diminish the sale of life insurance, we do sincerely believe that it will retard and make more difficult the proper programing of insurance to meet the needs of most families that are the beneficiaries.

It has been the practice of the more thoughtful and trained life underwriters during the past two decades (except where circumstances dictated otherwise) to recommend to the insured or his beneficiary that the payment of insurance proceeds be spread over the years so as to meet the contingencies that are bound to arise. Many thousands of insurance policies have been so programed. Generally, payments to the widow are greatest when the educational or other needs of minor children are greatest and then level out at a lesser figure when these responsibilities have been met. When insurance payments are so planned, there is no chance that the money will be quickly dissipated through improvidence or poor advice. We think it far sounder for most widows to have an assured $50 a month for 10 years than to have, for example, a lump sum of $6,000 available for the whims of the moment.

Whether or not a man's widow will ever receive installments large enough to include taxable income in excess of her personal exemption, we know from experience that the mere change in the law will cause many men to shy away from the soundest method of providing for his dependents on his death. A tremendous amount of life insurance has been sold through sound programing ideas which might otherwise not have been sold. A man listens far more readily to plans to provide a certain sum for life for his wife and children than to plans for immediate cash for his widow to dispose of as her fancy dictates.

Not only is the social policy behind section 201 unwise but it is unsound as a revenue measure.

No figures have been made available by the proponents of this measure to indicate which income group is to furnish the estimated $5,000,000 of expected revenue. We know from our own experience on the days when we deliver the first check to a bereaved widow that the vast majority of payments are in a lump sum—from a few hundred to a thousand dollars or two. This money is quickly used up to pay the costs of burial, last illness, and current bills.

The Treasury talks at length about $100,000 policies. Naturally, we like to sell policies for that amount, but I can assure you that they are few and far between. What the Treasury neglected to say is that in many instances involving policies of that size the death proceeds are left with the insurance company at interest. This is to provide flexibility to the widow, funds for payment of estate taxes and expenses of administration and to meet the various contingencies faced by those who inherit substantial estates. The interest which is paid when the insurance proceeds are left intact with the insurance company is already specifically taxable under section 22 (b) (1) of the Internal Revenue Code.

In paradoxical fashion, other sections of the bill propose to ease the excise taxes that people pay on consumer or luxury items. Yet the loss of revenue due to these reductions is in part under section 201 to be made up by widows and children when their need for money is the greatest. For example, the bill cuts taxes on baby oils, movie and cabaret admissions, amusement devices and sporting goods, then makes up some of the loss out of what in many cases is the major source of income to American women and children when the breadwinner dies.

It is estimated that tax reductions of one kind or another will exceed a billion dollars. The estimated $5,000,000 dollars to come from section 201 is too small to justify the change as a necessary revenue measure. And when you consider that this money is to be taken from payments intended for the daily support of dependents when their need is most acute, the irony of this measure becomes complete.

Those who have sponsored the measure may think that a matter of principle or equity is involved and that many widows and children are escaping a tax burden that they should shoulder. It is our hope that this committee will not agree and will eliminate section 201 from the bill. We do not see how section 201 can be supported as a revenue producer and we think it is more important to continue to recognize the equity and practical wisdom in the policy of treating insurance as indemnity not taxable as income when paid in installments.

SUPPLEMENT TO ORAL STATEMENT

1. In support of our belief that section 201 cannot be supported as a revenue measure, we submit herewith a summary of figures obtained as of March 31, 1950, from four large life-insurance companies, i. e., Northwestern Mutual of Milwaukee, Wis.; Union Central of Cincinnati, Ohio; Bankers Life of Des Moines, Iowa; and Continental Assurance of Chicago, Ill. The figures cover existing situations where the insurance companies are paying out life-insurance proceeds in installments following the death of the insureds. The experience of all four companies represented in the study is similar and the individual figures for each have been combined into one summary. Of the 27,551 policy settlements, 65.9 percent involve annual payments of less than $600. The average annual payment for all policies is a little over $600 per policy.

Total annual policy payment (only part of which represents "interest")	Number of policies	Percentage of total	Accumulated percentage
$599 and under	18,152	65 9	65.9
$600 to $899	4,367	15 8	81.7
$900 to $1,199	1,868	6.8	88.5
$1,200 to $1,499	1,481	5 4	93.9
$1,500 to $1,999	709	2 6	96.5
$2,000 to $2,499	403	1.4	97.9
$2,500 to $2,999	167	.6	98.5
$3,000 to $3,999	226	.8	99.3
$4,000 to $4,999	74	.3	99.6
$5,000 to $7,499	72	.3	99 9
$7,500 to $9,999	19	.1	100.0
$10,000 to $14,999	7	0	100 0
$15,000 and over	6	0	100.0
Total	27,551	100.0	100.0

It is difficult to conclude that payments in these amounts will develop a sufficient taxable element to establish any appreciable revenue in view of the fact that out of a payment of $600 it is reasonable to assume that not more than 25 percent, or $150, would represent taxable income under the Treasury proposal.

2. Some might challenge the foregoing conclusions on the ground that an insured often owns several policies and the combined payments might result in substantial totals. On this point a study was made by Judd C. Benson, general manager of the home office agency of the Union Central Life Insurance Co. in Cincinnati. The study covered the number of policies owned by all insureds (300 in number) whose insurance was programed by the agency from September 1945 to April 1950. In 92 percent of the cases the total annual installment payments from all of the policies owned by an insured were less than $2,500 so that if 25 percent should constitute taxable interest, as under section 201, the result would be no tax in the great majority of cases. Here are the figures of the Benson study:

Annual installment payment	Class of beneficiary	Social security	Total possible installment proceeds elections	Percentage of total elections	Accumulated percentage
$10-$599	In 283 cases the insured's wife was designated as the primary beneficiary, in 11 cases the parents, in 2 cases the children, and in 4 cases others.	In 132 cases social-security benefits were indicated in the analysis.	57	19.00	19.00
$600-$899			65	21.67	40.67
$900-$1,199			51	17.00	57.67
$1,200-$1,499			40	13 33	71.00
$1,500-$1,999			37	12 33	83.33
$2,000-$2,499			26	8 67	92 00
$2,500-$2,999			10	3 33	95.33
$3,000-$3,999			12	4 00	99.33
$4,000-$4,999			2	.67	100 00
$5,000-$7,499			0	0	
$7,500-$10,000			0	0	
$10,000-$15,000			0	0	
Over $15,000			0	0	
Total (300 cases)			300	100	

In order to slant the study in favor of the position of the Treasury, all cases where proceeds were left at interest with privilege of changing to installments as well as "suggested" (but not mandatory), settlements were considered as being settled 100 percent on installment basis and providing $25 monthly income for each $5,000 proceeds.

Mr. SEEFURTH. We are very much concerned over the effect of section 201 of the bill before you because of its adverse effect on the sound settlement of life-insurance proceeds. Ever since we have had an income tax the Congress has said that insurance proceeds paid by reason of the death of the insured are not subject to income tax. That is true whether the insurance is paid in a lump sum or in installments over a period of years.

We take particular exception to the proposed change to tax installment payments of insurance proceeds because we believe it would retard what our organization has been striving for during the past two decades. After providing a cash settlement of insurance to take care of last illness and burial expenses and unpaid bills, we believe that insurance in most cases should be paid in monthly installments for the current support of the widow and children. Whether or not a man's widow will ever receive installments large enough to include a taxable income in excess of her personal exemption, we know from experience that the mere change in the law will cause many men to shy away from the soundest method of providing for their dependents on their death. A man listens far more readily to plans to provide a certain sum for life for his wife than to plans for immediate cash to dispose of as her fancy dictates. That is really the nub or the essence of our feeling as an association in opposition to section 201.

Senator MILLIKIN. Does that no go to long experience that in too many cases the cash sum is dissipated?

Mr. SEEFURTH. It does, exactly; and all life insurance men who have been properly trained, the CLU's, and the men working for that designation in the life-insurance business, make that approach to the individual, a certain amount payable in cash at death, a sort of clean-up fund, and the balance as a steady income.

Senator MILLIKIN. A widow with a cash sum is subjected to the operations of all gyp artists who try to take property away from other people.

Mr. SEEFURTH. Yes; and they hear about these things very quickly when there is a little money involved.

Senator MILLIKIN. They watch the death notices.

Mr. SEEFURTH. That is right.

A tax on these installments would have little effect in balancing excise-tax reductions and we believe it would be wrong to depart from the established policy of encouraging sound insurance programing. Even the $5,000,000 of revenue that the House committee reports from this tax is a small item compared with the total tax cut.

Furthermore we believe that the anticipated revenue is overestimated. For example, take the installment settlement that is most generally used, payments during the widow's life and for 20 years certain. Let us assume $30,000 face value of insurance to be paid in this fashion to a widow age 60 when her husband dies. This is considerably more than the average insurance but even this amount when paid in installments during the widow's life, with payments guaranteed for 20 years, will give only $1,570 a year of which $1,430 would be considered a return of insurance proceeds and $140 would be taxable income under section 201. It really is not the revenue, the actual tax rather that is of concern.

Now, $30,000 is quite a substantial amount of life insurance as conditions are, and yet even on the assumption that a man leaves $30,000 life insurance payable for his widow's life and for 20 years certain, the amount of so-called taxable interest out of her payments each year would be just $140, far less than her personal exemption.

Now, then, the question comes up about the large policies. It has been our experience that the men with several hundred thousand of life insurance up to $1,000,000 of life insurance generally do not avail themselves of these installment options. Their need is not to dissipate principal; they want to get cash at death to pay estate taxes, inheritance taxes. A large part of the big policies is insurance payable in lump sums to corporations and partnerships. We do not feel that there is very much revenue in this proposal.

To summarize our position, we feel that it would be a mistake to reverse a long-standing policy of encouraging the payment of insurance in installments for an estimated $5,000,000 of revenue that we do not believe will materialize. We do not want to see any change that would tend to upset the sound programing of a man's personal insurance. Therefore we respectfully request that this committee eliminate section 201 from the bill.

The CHAIRMAN. Thank you, sir, for your appearance.

Mr. SEEFURTH. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Charles Taylor.

STATEMENT OF CHARLES G. TAYLOR, JR., CHAIRMAN, JOINT COMMITTEE OF THE AMERICAN LIFE CONVENTION AND THE LIFE INSURANCE ASSOCIATION OF AMERICA, NEW YORK, N. Y.

Mr. TAYLOR. Mr. Chairman and gentlemen of the committee, I have a statement which I will read. It is not as long as it looks.

My name is Charles G. Taylor, Jr. I am appearing as chairman of a joint committee of the American Life Convention and the Life Insurance Association of America, having to do with questions of Federal taxation involving the rights and interests of beneficiaries under life-insurance policies and payees under annuity contracts. The combined membership of these organizations includes 224 legal-reserve life insurance companies doing business in the United States. In this presentation I shall speak solely in the interest of beneficiaries of life-insurance policies and payees under annuity contracts issued by life-insurance companies.

Section 201 of H. R. 8920 amends section 22 (b) (1) of the code which exempts from income tax "amounts received under a life insurance contract paid by reason of the death of the insured, whether in a single sum or otherwise. * * *" Judicial decisions have construed this language to exempt from tax sums, in the nature of interest, added by the insurer when the proceeds are paid to the beneficiary in installments. Section 201 (a) of the bill would subject such added amounts to income tax notwithstanding the fact that, by congressional enactment, sustained by the courts, such amounts have been for many years exempt from income taxation.

The criticism in the report of the Committee on Ways and Means contrasts the treatment presently accorded beneficiaries of death benefits left on deposit with a life-insurance company is includible in gross income by specific provisions of section 22 (b) (1) of the code and makes a similar contrast with a lump-sum payment invested by the beneficiary in bonds or a savings account. On the other hand, the minority report objects to the proposed change and emphasizes the wise social policy underlying existing law.

We want to assure you that it is not our purpose to favor tax laws which unjustifiably discriminate in favor of any group of individuals nor do we contend that the present law operates with entire consistency. We respectfully suggest, however, that there are other factors and other provisions of law which justify some departure from strict consistency.

The exemption of life-insurance installment payments is entirely consistent with the income-tax treatment accorded survivorship installment benefits under the Social Security Act and the Railroad Retirement Act. Moreover, National Service Life Insurance benefits, when paid in installments, also enjoy complete income-tax exemption. Section 201 of the bill specifically protects the latter exemption. We would not argue against the continuance of these exemptions of death-benefit installments paid under the Federal acts. It would, however, be rank discrimination to exempt these benefits and at the same time to require that similar death-benefit installments under private life-insurance contracts be taxed. We see no justification for any such discrimination.

I might suggest that you might find a man with national service life insurance and regular life insurance and under this law he would be taxed on one and would not be taxed on the other. And nobody could explain any reason why there should be difference between the two.

Mr. Seefurth has expanded on the social advantage of this provision in the existing code and I will not repeat that, but just repeat the question: Is it not far better to encourage the heads of families to make the best possible provision for the future welfare of their families?

Senator MILLIKIN. When they do not do it the Government has to do it and I think we should encourage private efforts to do it.

Mr. TAYLOR. That is our opinion, Senator, and I am glad to hear that is your opinion.

There is a practical side to be considered. For example, a widow with one dependent child is entitled to a personal exemption of $1,200 per annum. If she had no other income, and elected to take the proceeds of a life-insurance policy in installments over a period of 20 years, it would require more than $70,000 of life insurance at 3-percent interest to produce a taxable income in excess of the personal exemption. There will be a relatively small number of widows who are the beneficiaries of $70,000 or more of life insurance and would, therefore, be subject to tax, but many thousands will be put to considerable expense and trouble in making numerous tax returns, the Government will have the expense of processing and auditing returns, to say nothing of the expense that will be imposed upon life-insurance companies in making many thousands of calculations for beneficiaries, and the corresponding information returns.

This discussion of the taxation of the interest element in death-benefit installments leads us to recommend strongly, in the interest of justice to annuitants, that the proposed method for determining the amount of interest element includible in gross income as set forth in section 201 (a) of the bill be applied to regular annuities. Both the report of the Committee on Ways and Means and the views of the minority strongly approve this method. In principle, it follows the recommendation of the Committee on Ways and Means in the revenue revision bill of 1948 for the taxing of regular annuities. The method in the pending bill was commented on favorably in a report prepared by the staff of the Joint Congressional Committee on Internal Revenue Taxation for the Committee on Finance, in connection with H. R. 2948—Seventy-ninth Congress, second session—which bill proposed to exempt from individual income tax annuity payments under the Civil Service Retirement Act to the amount of $1,440 in any calendar year.

The staff of the Joint Congressional Committee on Internal Revenue Taxation concluded that the existing rule for taxation of regular annuities set forth in section 22 (b) (2) (A) of the code was highly inequitable. Under this rule the amount includible in gross income each year is 3 percent of the consideration paid for the annuity. When the amounts excluded from income equal the consideration paid, the subsequent annuity payments must be included in gross income. The 3-percent rate used in computing the amount to be included in gross income, even in 1934 when the rule was adopted, was entirely too high. It was based on the fallacy that since life-insurance companies were earning 4 percent on their investments the

application of that rate to the diminishing principal would average out to 3 percent for each year on the original consideration, that is, the principal invested. Actually a 3-percent rate on the original principal of an annuity would require an interest return of almost 6 percent on the diminishing principal of the annuity. Such a rate is completely unrealistic today when most annuities are based on 2-percent or 2½-percent interest. The result is a tax upon return of capital invested in an annuity.

The 3-percent annuity rule is subject to another serious defect. It taxes the short-lived annuitant on the return of his principal without giving the long-lived annuitant any offsetting tax benefit. The annuitant who dies early is taxed on return of principal and the annuitant who lives long is taxed on the full amount of his annuity after his principal is presumed to have been returned.

The following example demonstrates the unfair consequence of the 3-percent rule. For approximately $20,000 a woman aged 55 may purchase a life annuity providing $1,000 per year. Applying the 3-percent rule, about $600 received each year will be taxable and $400 will be excluded from gross income. She will, in any event, be taxed on a substantial part of her capital investment, since she would have to live 50 more years, to age 105, in order to recover her entire capital free of tax, although her life expectancy is approximately only 25 years.

It does not seem to be sound legislative policy to strike at the beneficiaries of life-insurance death-benefit installments solely on the ground of alleged unfair discrimination, and at the same time create a new form of discrimination against those who directly purchase annuities.

To summarize, with respect to taxation of death benefit installments, we believe that the benefits to be derived in terms of general welfare from the continuation of the present legislative policy outweigh the allegedly relatively slight discrimination described in the report of the Committee on Ways and Means.

Regardless of the committee's decision with respect to the interest element in death benefit installment payments, we strongly urge that the existing rule for taxing regular annuities be replaced by the method set forth in section 201 (a) of the pending bill. The result of the present system is to impose an unjust burden upon a group of individual annuitants who in the main are retired, often depending solely upon their annuity payments, and who, therefore, should not be subjected to such an unfair tax burden. In many instances, a substantial portion of their life savings will be taxed as income. We sincerely hope that you will correct this long existing and obvious injustice to a class of persons who should not be discouraged by Government, but should be encouraged, because they have made the effort and sacrifice during their producing years to provide for their own old age.

Thank you, gentlemen.

The CHAIRMAN. Thank you, Mr. Taylor, for your appearance.

(The complete statement follows:)

STATEMENT OF CHARLES G. TAYLOR, JR., NEW YORK, N. Y., ON BEHALF OF AMERICAN LIFE CONVENTION AND LIFE INSURANCE ASSOCIATION OF AMERICA

My name is Charles G. Taylor, Jr. I am appearing as chairman of a joint committee of the American Life Convention and the Life Insurance Association of America having to do with questions of Federal taxation involving the rights

and interests of beneficiaries under life-insurance policies and payees under annuity contracts. The combined membership of these organizations includes 224 legal reserve life-insurance companies doing business in the United States. In this presentation I shall speak solely in the interest of beneficiaries of life-insurance policies and payees under annuity contracts issued by life-insurance companies.

Section 201 of H. R. 8920 amends section 22 (b) (1) of the code which exempts from income tax "amounts received under a life-insurance contract paid by reason of the death of the insured, whether in a single sum or otherwise * * *" Judicial decisions have construed this language to exempt from tax sums, in the nature of interest, added by the insurer when the proceeds are paid to the beneficiary in installments. Section 201 (a) of the bill would subject such added amounts to income tax notwithstanding the fact that, by congressional enactment, sustained by the courts, such amounts have been for many years exempt from income taxation.

The criticism in the report of the Committee on Ways and Means contrasts the treatment presently accorded beneficiaries of death-benefit installment payments with the requirement that interest paid on death benefits left on deposit with a life-insurance company is includible in gross income by specific provision of section 22 (b) (1) of the code and makes a similar contrast with a lump-sum payment invested by the beneficiary in bonds or a savings account. On the other hand, the minority report objects to the proposed change and emphasizes the wise social policy underlying existing law.

We want to assure you that it is not our purpose to favor tax laws which unjustifiably discriminate in favor of any group of individuals nor do we contend that the present law operates with entire consistency. We respectfully suggest, however, that there are other factors and other provisions of law which justify some departure from strict consistency.

The exemption of life-insurance installment payments is entirely consistent with the income-tax treatment accorded survivorship installment benefits under the Social Security Act and the Railroad Retirement Act. Moreover, National Service Life Insurance benefits, when paid in installments, also enjoy complete income-tax exemption. Section 201 of the bill specifically protects the latter exemption. We would not argue against the continuance of these exemptions of death-benefit installments paid under the Federact acts. It would, however, be rank discrimination to exempt these benefits and at the same time to require that similar death-benefit installments under private life-insurance contracts be taxed. We see no justification for any such discrimination.

In all our national thinking today great emphasis is placed upon economic security. One of the most important life-insurance developments in recent years has been the added security factor to beneficiaries of life-insurance policies that arises from the use of life insurance to provide a stated income instead of paying the entire proceeds in one sum. Programs are set up to provide income payments for specific needs of the family, for food, clothing and shelter as the first and primary obligation of the provider and then education for children and such other features of family life as he is able to protect. Amounts paid to beneficiaries in accordance with such plans usually last longer,. and, therefore, provide greater economic security. Thus it is socially desirable that we should do everything reasonable to encourage planned installment settlements. The question arises as to whether, in order to collect an additional estimated $5,000,000 of revenue per year from beneficiaries, the tax status of these installment settlements should be changed. Is it not far better to encourage the heads of families to make the best possible provision for the future welfare of their families?

There is a practical side to be considered. For example, a widow with one dependent child is entitled to a personal exemption of $1,200 per annum. If she had no other income, and elected to take the proceeds of a life-insurance policy in installments over a period of 20 years, it would require more than $70,000 of life insurance at 3 percent interest to produce a taxable income in excess of the personal exemption. There will be a relatively small number of widows who are the beneficiaries of $70,000 or more of life insurance and would, therefore, be subject to tax, but many thousands will be put to considerable expense and trouble in making numerous tax returns, the Government will have the expense of processing and auditing returns, to say nothing of the expense that will be imposed upon life-insurance companies in making many thousands of calculations for beneficiaries, and the corresponding information returns.

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The staff of the Joint Congressional Committee on Internal Revenue Taxation concluded that the existing rule for taxation of regular annuities set forth in section 22 (b) (2) (A) of the code was highly inequitable. Under this rule the amount includible in gross income each year is 3 percent of the consideration paid for the annuity. When the amounts excluded from income equal the consideration paid, the subsequent annuity payments must be included in gross inocme. The 3-percent rate used in computing the amount to be included in gross income, even in 1934 when the rule was adopted, was entirely too high. It was based on the fallacy that since life insurance companies were earning 4 percent on their investments the application of that rate to the diminishing principal would average out to 3 percent for each year on the original consideration, that is, the principal invested. Actually a 3-percent rate on the original principal of an annuity would require an interest return of almost 6 percent on the diminishing principal of the annuity. Such a rate is completely unrealistic today when most annuities are based on 2 or 2½ percent interest. The result is a tax upon return of capital invested in an annuity.

The 3-percent-annuity rule is subject to another serious defect. It taxes the short-lived annuitant on the return of his principal without giving the long-lived annuitant any offsetting tax benefit. The annuitant who dies early is taxed on return of principal and the annuitant who lives long is taxed on the full amount of his annuity after his principal is presumed to have been returned.

The following example demonstrates the unfair consequences of the 3-percent rule. For approximately $20,000 a woman aged 55 may purchase a life annuity providing $1,000 per year. Applying the 3-percent rule, about $600 received each year will be taxable and $400 will be excluded from gross income. She will, in any event, be taxed on a substantial part of her capital investment, since she would have to live 50 more years, to age 105, in order to recover her entire capital free of tax, although her life expectancy is approximately only 25 years.

It does not seem to be sound legislative policy to strike at the beneficiaries of life insurance death benefit installments solely on the ground of alleged unfair discrimination, and at the same time create a new form of discrimination against those who directly purchase annuities.

To summarize, with respect to taxation of death-benefit installments, we believe that the benefits to be derived in terms of general welfare from the continuation of the present legislative policy outweigh the allegedly relatively slight discrimination described in the report of the Committee on Ways and Means.

Regardless of the committee's decision with respect to the interest element in death-benefit installment payments, we strongly urge that the existing rule for taxing regular annuities be replaced by the method set forth in section 201 (a) of the pending bill. The result of the present system is to impose an unjust burden upon a group of individual annuitants who in the main are retired, often depending solely upon their annuity payments, and who, therefor, should not be subjected to such an unfair tax burden. In many instances, a substantial portion of their life savings will be taxed as income. We sincerely hope that you will correct this long-existing and obvious injustice to a class of persons who should not be discouraged by Government, but should be encouraged, because they have made the effort and sacrifice during their producing years to provide for their own old age.

MEMBER COMPANIES OF AMERICAN LIFE CONVENTION AND LIFE INSURANCE ASSOCIATION OF AMERICA DOING BUSINESS IN THE UNITED STATES

Acacia Mutual Life Insurance Co., 51 Louisiana Avenue NW., Washington, D. C.
Aetna Life Insurance Co., 151 Farmington Avenue, Hartford, Conn.
All States Life Insurance Co., Montgomery, Ala.
American General Life Insurance Co., Post Office Box 1931, Houston, Tex.
American Home Life Insurance Co., Ninth and Harrison Streets, Topeka, Kans.
The American Hospital & Life Insurance Co., Post Office Box 2341, San Antonio, Tex.

American Life Insurance Co., Post Office Box 35, Birmingham, Ala.
American Mutual Life Insurance Co., Liberty Building, Sixth and Grand Avenue, Des Moines, Iowa.
American National Insurance Co., Twenty-first and Mechanic Street, Galveston, Tex.
American Reserve Life Insurance Co., 300 Farm Credit Building, Omaha, Nebr.
American Standard Life Insurance Co., 1616 K Street NW., Washington, D. C.
American United Life Insurance Co., Post Office Box 368, Indianapolis, Ind.
Amicable Life Insurance Co., Amicable Life Building, Waco, Tex.
Atlantic Life Insurance Co., Post Office Box 1455, Richmond, Va.
Atlas Life Insurance Co., Post Office Box 1919, Tulsa 1, Okla.
The Baltimore Life Insurance Co., Charles and Saratoga Streets, Baltimore, Md.
The Bankers Health & Life Insurance Co., Post Office Box 678, Macon, Ga.
Bankers Life Co., 711 High Street, Des Moines, Iowa
Bankers Life Insurance Co. of Nebraska, Fourteenth and N Streets, Lincoln, Nebr.
Bankers National Life Insurance Co., 26 Park Street, Montclair, N. J.
Beneficial Life Insurance Co., 47 West South Temple, Salt Lake City, Utah
Berkshire Life Insurance Co., 7 North Street, Pittsfield, Mass.
Boston Mutual Life Insurance Co., 160 Congress Street, Boston, Mass.
Business Men's Assurance Co. of America, 215 Pershing Road, Kansas City, Mo,
California-Western States Life Insurance Co., Post Office Box 959, Sacramento, Calif.
The Canada Life Assurance Co., 330 University Avenue, Toronto, Ontario, Canada
The Capitol Life Insurance Co., Post Office Box 1200, Denver, Colo.
Carolina Life Insurance Co., Post Office Box 1319, Columbia, S. C.
Central Life Assurance Society, Box 1555, Des Moines, Iowa
The Central Life Insurance Co., Post Office Box 190, Fort Scott, Kans.
Central Life Insurance Co. of Illinois, 211 West Wacker Drive, Chicago, Ill.
Century Life Insurance Co., Century Building, Fort Worth, Tex.
The Colonial Life Insurance Co. of America, 111 Prospect Street, East Orange, N. J.
Columbian Mutual Life Insurance Co., Post Office Box 368, Memphis, Tenn.
Columbian National Life Insurance Co., Box U, Essex Station, Boston, Mass.
The Columbus Mutual Life Insurance Co., Post Office Box 900, Columbus 16, Ohio
Commonwealth Life Insurance Co., 110 South Fifth Street, Louisville, Ky.
Confederation Life Association, 12 Richmond Street, East, Toronto, Ontario, Canada
Connecticut General Life Insurance Co., 55 Elm Street, Hartford, Conn.
The Connecticut Mutual Life Insurance Co., 140 Garden Street, Hartford, Conn.
Constitution Life Insurance Co., 424 South Vermont Avenue, Los Angeles, Calif.
Continental American Life Insurance Co., Post Office Box 750, Wilmington, Del.
Continental Assurance Co., 310 South Michigan Avenue, Chicago, Ill.
Continental Life Insurance Co., Fifteenth and K Streets NW., Washington, D. C.
Country Life Insurance Co., 43 East Ohio Street, Chicago, Ill.
The Crown Life Insurance Co., 59 Yonge Street, Toronto, Ontario, Canada
The Dominion Life Assurance Co., 1 Albert Street, Waterloo, Ontario, Canada
Durham Life Insurance Co., Post Office Box 1801, Raleigh, N. C.
Empire Life & Accident Insurance Co., 215 East New York Street, Indianapolis, Ind.
Empire State Mutual Life Insurance Co., 315 North Main Street, Jamestown, N. Y.
The Equitable Life Assurance Society of the United States, 393 Seventh Avenue, New York, N. Y.
Equitable Life Insurance Co., 816 fourteenth Street NW., Washington, D. C.
Equitable Life Insurance Co. of Iowa, 604 Locust Street, Des Moines, Iowa.
Farm Bureau Life Insurance Co., 246 North High Street, Columbus, Ohio.
The Farmers & Bankers Life Insurance Co., Post Office Box 580, Wichita, Kans.
Farmers and Traders Life Insurance Co., 418 State Tower Building, Syracuse, N. Y.
Farmers Life Insurance Co., 501½ Grand Avenue, Des Moines, Iowa.
Federal Life & Casualty Co., 3107 West Grand Boulevard, Detroit, Mich.
Federal Life Insurance Co., 168 North Michigan Avenue, Chicago, Ill.
The Fidelity Mutual Life Insurance Co., Post Office Box 7317, Philadelphia, Pa.
Fidelity Union Life Insurance Co., 912 Commerce Street, Dallas, Tex.
The Franklin Life Insurance Co., 812 South Sixth Street, Springfield, Ill.

69474—50——41

General American Life Insurance Co., 1501 Locust Street, St. Louis, Mo.
George Washington Life Insurance Co., Post Office Box 913, Charleston, W. Va.
Girard Life Insurance Co., Opposite Independence Hall, Philadelphia, Pa.
The Great American Life Insurance Co., Post Office Box 1073, Hutchinson, Kans.
Great American Reserve Insurance Co., Post Office Box 388, Dallas, Tex.
Great National Life Insurance Co., 803 Great National Life Building, Dallas, Tex.
Great Southern Life Insurance Co., Post Office Box 1972, Houston, Tex.
The Great-West Life Assurance Co., 177 Lombard Avenue, Winnepeg, Manitoba, Canada.
Guarantee Mutual Life Co., 1805 Douglas Street, Omaha, Nebr.
Guaranty Income Life Insurance Co., Box 2231, Baton Rouge, La.
The Guardian Life Insurance Co. of America, 50 Union Square, New York, N. Y.
Gulf Life Insurance Co., Post Office Box 1050, Jacksonville, Fla.
Home Friendly Insurance Co. of Maryland, Centre Street at Park Avenue, Baltimore, Md.
Home Life Insurance Co., 256 Broadway, New York, N. Y.
Home Life Insurance Co. of America, Post Office Box 59, Philadelphia, Pa.
Home Security Life Insurance Co., Box 61, Durham, N. C.
Home State Life Insurance Co., 621 North Robinson Street, Oklahoma City, Okla.
Homesteaders Life Co., 615 Securities Building, 416 Seventh Street, Des Moines, Iowa.
Hoosier Farm Bureau Life Insurance Co., 130 East Washington, Indianapolis, Ind.
Illinois Bankers Life Assurance Co., 125 West First Avenue, Monmouth, Ill.
The Imperial Life Assurance Co. of Canada, 20 Victoria Street, Toronto, Ontario, Canada.
Indianapolis Life Insurance Co., 2960 North Meridian Street, Indianapolis, Ind.
Interstate Life & Accident Co., 540 McCallie Avenue, Chattanooga, Tenn.
Iowa Life Insurance Co., 500 Farm Bureau Building, Des Moines, Iowa.
Jefferson National Life Insurance Co., 241 North Pennsylvania Street, Indianapolis, Ind.
Jefferson Standard Life Insurance Co., Jefferson Square, Greensboro, N. C.
John Hancock Mutual Life Insurance Co., Post Office Box 111, Boston, Mass.
Kansas City Life Insurance Co., Post Office Box 139, Kansas City, Mo.
Kentucky Central Life & Accident Insurance Co., Anchorage, Ky.
Kentucky Home Mutual Life Insurance Co., Fifth and Jefferson, Louisville, Ky.
The Knights Life Insurance Co. of America, 852 Ridge Avenue, North Side, Pittsburgh, Pa.
The LaFayette Life Insurance Co., LaFayette Life Building, Lafayette, Ind.
The Lamar Life Insurance Co., Post Office Box 880, Jackson, Miss.
Liberty Life Insurance Co., Post Office Box 660, Greenville, S. C.
Liberty National Life Insurance Co., Post Office Box 2612, Birmingham, Ala.
Life & Casualty Insurance Co. of Tennessee, Life and Casualty Building, Nashville, Tenn.
Life Insurance Company of Georgia, Post Office Box 4207, Atlanta, Ga.
The Life Insurance Co. of Virginia, Post Office Box 1154, Richmond, Va.
Lincoln Liberty Life Insurance Co., Post Office Box 1193, Lincoln, Nebr.
Lincoln Mutual Life Insurance Co., 939 "O" Street, Lincoln, Nebr.
The Lincoln National Life Insurance Co., 1301 South Harrison Street, Fort Wayne, Ind.
Loyal Protective Life Insurance Co., 19 Deerfield Street, Boston, Mass.
Lutheran Mutual Life Insurance Co. 201–211 First Street SE., Waverly, Iowa.
The Manhattan Life Insurance Co., 120 West Fifty-seventh Street, New York, N. Y.
The Manufacturers Life Insurance Co., 200 Bloor Street, East, Toronto, Ontario.
Massachusetts Mutual Life Insurance Co., 1295 State Street, Springfield, Mass.
Metropolitan Life Insurance Co., 1 Madison Avenue, New York, N. Y.
Michigan Life Insurance Co., Post Office Box 8, North End Station, Detroit, Mich.
Mid-Continent Life Insurance Co., Post Office Box 1516, Oklahoma City, Okla.
The Midland Mutual Life Insurance Co., Post Office Box 1938, Columbus, Ohio.
Midland National Life Insurance Co., West Kemp, Watertown, S. Dak.
The Midwest Life Insurance Co. of Lincoln, 1339 "O" Street, Lincoln, Nebr.
The Minnesota Mutual Life Insurance Co., 156 East Sixth Street, St. Paul, Minn.
Missouri Insurance Co., 705 Chestnut Street, St. Louis, Mo.
Monarch Life Insurance Co., Post Office Box 601, Springfield, Mass.
Monumental Life Insurance Co., Chase and Charles Streets, Baltimore, Md.
The Mutual Benefit Life Insurance Co., Post Office Box 359, Newark, N. J.

The Mutual Life Insurance Co. of New York, Broadway at Fifty-fifth Street, New York, N. Y.
Mutual Savings Life Insurance Co., 812 Olive Street, St. Louis, Mo.
Mutual Trust Life Insurance Co., 135 South LaSalle Street, Chicago, Ill.
National Fidelity Life Insurance Co., 1002 Walnut Street, Kansas City, Mo.
National Guardian Life Insurance Co., Box 1191, Madison, Wis.
The National Life and Accident Co., 301 Seventh Avenue, North, Nashville, Tenn.
National Life Co., Hubbell Building, Des Moines, Iowa.
National Life Insurance Co., Montpelier, Vt.
National Old Line Insurance Co., Post Office Box 2900, Little Rock, Ark.
The National Reserve Life Insurance Co., 1000 Kansas Avenue, Topeka, Kans.
New England Mutual Life Insurance Co., 501 Boylston Street, Boston, Mass.
New World Life Insurance Co., 618 Second Avenue, Seattle, Wash.
New York Life Insurance Co., 51 Madison Avenue, New York, N. Y.
North American Accident Insurance Co., 209 South LaSalle Street, Chicago, Ill.
North American Life Assurance Co., 112 King Street, West, Toronto, Ontario.
North American Life & Casualty Co., 1750 Hennepin Avenue, Minneapolis, Minn.
North American Life Insurance Co. of Chicago, 36 South State Street, Chicago, Ill.
North American Reassurance Co., 110 East Forty-second Street, New York, N. Y.
Northern Life Insurance Co., Northern Life Tower, Seattle, Wash.
Northwestern Life Insurance Co., East Forty-third and Brooklyn, Seattle, Wash.
Northwestern National Life Insurance Co., 430 Oak Grove Street, Minneapolis, Minn.
Occidental Life Insurance Co. of Calif., Box 2101, Terminal Annex, Los Angeles, Calif.
Occidental Life Insurance Co., Post Office Box 2889, Raleigh, N. C.
The Ohio National Life Insurance Co., Post Office Box 237, Cincinnati, Ohio.
The Ohio State Life Insurance Co., 366 East Broad Street, Columbus, Ohio.
The Old Line Life Insurance Co. of America, 707 North Eleventh Street, Milwaukee, Wis.
Olympic National Life Insurance Co., 914 Second Avenue, Seattle, Wash.
Pacific Mutual Life Insurance Co., Box 6050, Metropolitan Station, Los Angeles, Calif.
Pacific National Life Assurance Co., Post Office Box 1440, Salt Lake City, Utah.
Pan-American Life Insurance Co., Post Office Box 219, New Orleans, La.
The Paul Revere Life Insurance Co., 18 Chestnut Street. Worcester, Mass.
Peninsular Life Insurance Co., Post Office Box 1230, Jacksonville, Fla.
The Penn Mutual Life Insurance Co., Post Office Box 178, Philadelphia, Pa.
Pennsylvania Mutual Life Insurance Co., 1619 Arch Street, Philadelphia, Pa.
Peoples Life Insurance Co., Peoples Life Building, Frankfort, Ind.
Peoples Life Insurance Co., 1343 H Street NW., Washington, D. C.
Philadelphia Life Insurance Co., 111 North Broad Street, Philadelphia, Pa.
Phoenix Mutual Life Insurance Co., 79 Elm Street, Hartford, Conn.
Pilot Life Insurance Co., Post Office Box P, Greensboro, N. C.
Pioneer Mutual Life Insurance Co., Post Office Box 1711, Fargo, N. Dak.
Policyholder's National Life Insurance Co., 515 South Main Avenue, Sioux Falls, S. Dak.
Postal Life & Casualty Insurance Co., 4727 Wyandotte Street, Kansas City, Mo.
Presbyterian Minister's Fund, 1805 Walnut Street, Philadelphia, Pa.
Protective Life Insurance Co., Box 2571, Birmingham, Ala.
Provident Life & Accident Insurance Co. of Chattanooga, 725 Broad Street, Chattanooga, Tenn.
Provident Life Insurance Co., Corner Main and Second, Bismarck, N. Dak.
Provident Mutual Life Insurance Co. of Philadelphia, Post Office Box 7378, Philadelphia, Pa.
The Prudential Insurance Co. of America, 763 Broad Street, Newark, N. J.
Puritan Life Insurance Co., Post Office Box 1505, Providence, R. I.
Pyramid Life Insurance Co. (business office—912 Commerce Building, Kansas City, Mo.), Topeka, Kans.
The Reliable Life Insurance Co., 231 West Lockwood Boulevard, St. Louis, Mo.
Reliance Life Insurance Co. of Pittsburgh, 522 Farmers Bank Building, Pittsburgh, Pa.
Republic National Life Insurance Co., Post Office Box 4128A, Dallas, Tex.
Rio Grande National Life Insurance Co., Rio Grande National Building, Dallas, Tex.
Rockford Life Insurance Co., 327 East State Street, Rockford, Ill.

Rural Life Insurance Co., 1108 South Ervay Street, Dallas, Tex.
Scranton Life Insurance Co., 530–546 Spruce Street, Scranton, Pa.
Security Life & Accident Co., Fourteenth and Stout Streets, Denver, Colo.
Security Life & Trust Co., Post Office Box 211, Winston-Salem, N. C.
Security Mutual Life Insurance Co., Post Office Box 351, Binghamton, N. Y.
The Security Mutual Life Insurance Co., 725 Trust Building, Lincoln, Nebr.
The Service Life Insurance Co., Nineteenth and Farnam Streets, Omaha, Nebr.
Shenandoah Life Insurance Co., Inc., Box 2421, Roanoke, Va.
Southern Life & Health Insurance Co., Post Office Box 671, Birmingham, Ala.
Southland Life Insurance Co., Post Office Box 2220, Dallas, Tex.
Southwestern Life Insurance Co., Post Office Box 2699, Dallas, Tex.
Standard Insurance Co., Post Office Box 711, Portland, Oreg.
Standard Life Insurance Co. of America, 345 Fourth Avenue, Pittsburgh, Pa.
Standard Life Insurance Co. of Indiana, 2727 Washington Boulevard, Indianapolis, Ind.
Standard Life Insurance Co. of the South, Post Office Box 1729, Jackson, Miss.
State Capital Life Insurance Co., Post Office Box 3036, Raleigh, N. C.
State Farm Life Insurance Co., 112 East Washington Street, Bloomington, Ill.
The State Life Insurance Co., Post Office Box 406, Indianapolis, Ind.
State Mutual Life Assurance Co., 340 Main Street, Worcester, Mass.
State Reserve Life Insurance Co., Post Office Box 1509, Fort Worth, Tex.
Sun Life Assurance Co. of Canada, Post Office Box 6075, Montreal, Quebec.
Sun Life Insurance Co. of America, 109 East Redwood Street, Baltimore, Md.
Texas Life Insurance Co., Post Office Box 830, Waco, Tex.
Texas Prudential Insurance Co., Post Office Box 149, Galveston, Tex.
The Travelers Insurance Co., 700 Main Street, Hartford, Conn.
The Union Central Life Insurance Co., Post Office Box 179, Cincinnati, Ohio.
The Union Labor Life Insurance Co., 570 Lexington Avenue, New York, N. Y.
Union Life Insurance Co., Union Life Building, Little Rock, Ark.
Union Mutual Life Insurance Co., Post Office Box 548, Portland, Maine.
Union National Life Insurance Co., Box 1271, Lincoln, Nebr.
United American Life Insurance Co., 333 Colorado National Bank Building, Denver, Colo.
United Benefit Life Insurance Co., Farnam at Thirty-third Street, Omaha, Nebr.
United Fidelity Life Insurance Co., Elm and Griffin Streets, Dallas, Tex.
United Life & Accident Insurance Co., 2 White Street, Concord, N. H.
United Services Life Insurance Co., 1600 Twentieth Street NW., Washington, D. C.
The United States Life Insurance Co., 84 William Street, New York, N. Y.
Unity Mutual Life & Accident Insurance Co., 721 South Flower Street, Los Angeles, Calif.
Universal Life & Accident Insurance Co., Post Office Box 779, Dallas, Tex.
Victory Life Insurance Co., Eighth and Van Buren Streets, Topeka, Kans.
The Volunteer State Life Insurance Co., Volunteer Building, Chattanooga, Tenn.
Washington National Insurance Co., 610 Church Street, Evanston, Ill.
West Coast Life Insurance Co., 605 Market Street, San Francisco, Calif.
The Western & Southern Life Insurance Co., 400 Broadway, Cincinnati, Ohio.
Western Life Insurance Co., Post Office Box 1710, Helena, Mont.
Western Reserve Life Insurance Co., Post Office Box 1159, Austin, Tex.
Western States Life Insurance Co., 716 Seventh Street South, Fargo, N. Dak.
The Wisconsin Life Insurance Co., 30 West Mifflin Street, Madison, Wis.
Wisconsin National Life Insurance Co., 77–81 Washington Boulevard, Oshkosh, Wis.
Woodmen Central Life Insurance Co., Post Office Box 873, Lincoln, Nebr.
World Insurance Co., World Insurance Building, Omaha, Nebr.

[Excerpts from hearings before the Committee on Ways and Means of the House of Representatives on proposed revisions of the Internal Revenue Code, 1947–48, appearing in pt. 3 at p. 1678]

Internal-Revenue Taxation of Life-Insurance Policyholders—Proposals for Correction of Existing Inequities and Ambiguities

(Presented by American Life Convention and Life Insurance Association of America)

This statement is submitted on behalf of the American Life Convention and the Life Insurance Association of America, the combined membership of which comprises 219 legal-reserve life-insurance companies of the United States and Canada,

which have outstanding about 95 percent of all such life insurance in force in this country, and on behalf of over 70,000,000 of their policyholders. The combined membership of these two organizations is listed in the appendix.

It will be observed that in making the following suggestions these companies do not seek special privileges or exemptions either for themselves or their policyholders or beneficiaries. The sole purpose of this statement is to recommend correction of manifest injustices in the present law as it affects these individuals who are relying upon life-insurance policies and annuity contracts for protection. No specific statutory language is recommended at this time, but we will be prepared to submit specific recommendations at a later date. * * *

INCOME TAXATION OF ANNUITIES

The present plan for the taxation of annuities, embodied in section 22 (b) (2) (A), was first adopted in 1934 by section 22 (b) (2) of the revenue act of that year. This section provides that 3 percent of the consideration paid for the annuity shall be included in the annuitant's gross income each year and that the balance of the yearly payment shall be excluded from gross income until the amounts excluded equal the consideration paid for the annuity. Thereafter, the entire amount of the annuity payment received during each taxable year is included in the annuitant's gross income.

The 3-percent rule is based on the assumption that every annuity payment is composed of two elements—interest and a return of principal. The legislative history of the 1934 amendment shows that the use of 3 percent was an attempt, on the basis of broad general averages, to apply a 4 percent interest return to the diminishing amount of principal assumed to be held by the company over the duration of the contract. Because of the fact, however, that the average principal held during the life of the contract is much nearer one-half than three-fourths of the consideration, the theory underlying the 3-percent rule actually would require that the interest return on the annuity approximate 6 percent.

The fallacy of the 3-percent rate of the present rule is clear. Life-insurance companies were earning nowhere near 6 percent on their funds in 1934; on the contrary, even the 4-percent assumption was too high since, even then, annuity rates were based on less than 4 percent interest. Today, the formula is even further out of line with the facts. Currently, most annuity rates are based upon 2 percent interest. The result is, of course, that the 3-percent rule operates to tax a return of principal as well as interest.

Quite apart from the fact that the current rule is based on the assumption of an interest return clearly out of line with present-day facts, it is subject to another serious defect. It would tax the short-lived annuitant on the return of his principal as though it were income without giving the long-lived annuitant any offsetting tax benefit. Thus, the annuitant who dies early is taxed on the return of his principal and the annuitant who lives long is taxed on the full amount of his annuity after his principal is presumed to have been returned. Not only does this subject the annuity contract holders as a whole to harsh treatment but it imposes an added tax burden upon the older annuitants at a time when they are presumably least able to carry it.

In view of its inequities and shortcomings, it is believed essential that the present system of taxing annuity payments be abandoned. In its place we suggest the adoption of a system whereby the element of principal in an annuity contract is averaged over the life expectancy of the annuitant as determined by a specified mortality table. This element of principal would be received tax-free each year and the balance of the yearly annuity payment would be considered taxable income. In brief, each annual payment received by the annuitant would be divided into two parts—principal and income. The principal element would be determined by dividing the total cost of the policy by the annuitant's life expectancy and treating the balance, representing an equal yearly amount over the life of annuitant, as taxable income.

It is submitted that such a provision for the income taxation of annuity payments would constitute a logical, sound, and more equitable system. In the aggregate, the tax meets the essential requirements of taxing only interest and not principal. Moreover, since the sum included in gross income represents an equal amount, year by year, there is no abrupt increase in taxable income late in the life of the annuitant. Finally, the suggested system appears to be administratively feasible and probably no more difficult of application that the present 3-percent rule, as evidenced by the successful operation of a similar plan in Canada.

INCOME TAXATION OF ANNUITIES—SECTION 22 (B) (2) (A)—A PROPOSAL FOR CORRECTING INEQUITIES

(Presented by AmericanLife Convention and Life Insurance Association of America)

This memorandum supplements, by discussing in somewhat more detail, the proposal for a new system of taxing annuities discussed in a general way on pages 4 and 5 of the memorandum submitted to the Ways and Means Committee on July 15, 1947, by the American Life Convention and the Life Insurance Association of America. This statement has been printed in part 3 of the recent hearings before the Committee on Ways and Means beginning at page 1678.

PRESENT 3-PERCENT RULE AND ITS INEQUITIES

The present method of taxing annuities is prescribed in section 22 (b) (2) (A) of the Internal Revenue Code. This provides that each year an amount equal to 3 percent of the consideration paid for the annuity must be included in the annuitant's gross income until such time as the amounts excluded equal the consideration he paid for the annuity. Thereafter, the entire amount of the annuity payments received during each taxable year must be included in his gross income. In appendix I hereof is quoted an excerpt from the Congressional Record in which Senator Reed, at the time the 3-percent rule was first enacted (into the 1934 Revenue Act), explains the theory of the 3-percent rule. Briefly, he stated that the Treasury wanted to tax only that part of the annuity payments that represented interest and not that representing a return of principal. He further stated that companies generally used 4 percent as their assumed rate of interest but that since the principal was diminished each year a smaller figure (3-percent) had been arbitrarily fixed in the statute as the portion of the consideration which would be taken as the amount of interest in each payment.

The inequities of the present method of taxing annuities are:

1. The 3-percent itself even in 1934 was too high because it was based on the fallacy that a 4-percent interest rate (which was then somewhat higher than the companies generally were using), when applied to the diminishing principal assumed to be held by the companies over the lifetime of each contract, would average out to 3 percent for each year. However, the average principal that is held by the company during the life of the contract is actually much nearer one-half than the assumed three-fourths of the amount paid by the annuitant. Accordingly the theory underlying the 3-percent rule, if it is to be equitable, would actually require that the interest return on the annuity approximate 6 percent.

The 3-percent rate is certainly unrealistic today when most annuity rates for new contracts are based on 2-percent interest. Therefore, the 3-percent rule operates to tax not only the interest element but to a large extent it also taxes the return of principal to the annuitant. For example for approximately $20,000 a woman aged 55 may purchase a life annuity providing $1,000 per year. About $600 received each year will be taxable and $400 not taxable. It is certain that she will be taxed on a substantial amount of capital return since she would have to live 50 more years to age 105 to recover her entire capital free of tax, although her life expectancy is approximately 25 years.

2. In addition to the excessive 3-percent figure, it must be borne in mind that to meet the expenses of agent's commissions and general overhead the total consideration paid cannot be productive of interest to the annuitant. This circumstance operates to lower the annuitant's return on the whole of the consideration. For example, interest which would amount to 2½ percent on the net consideration would, after deducting the above-mentioned expenses, be equivalent to a return of 2⅓ percent on the entire consideration.

3. Quite apart from the fact that the current rule is based on the assumption of an interest return clearly out of line with the present-day facts, it is subject to another serious defect. It taxes the short-lived annuitant on the return of his principal as though it were income without giving the long-lived annuitant any offsetting tax benefit. Thus, the annuitant who dies early is taxed on the return of his principal and the annuitant who lives long is taxed on the full amount of his annuity after his principal is presumed to have been returned.

This phase of the present law is apparently based on the theory that the continued payments after the consideration has been returned constitute a gain of capital. It is easy to slip into this mistaken concept, but there does not appear to be any support for it in the definitions contained in the income-tax laws themselves. To the extent that a life annuity differs from a contract providing payments for a fixed number of years (annuity certain), it cannot properly be regarded

as an investment. It has rather the nature of a contract of indemnity, in which the chance of survival for a relatively long period during which payments are received is offset by the chance of the loss of the right to receive back any portion of the consideration paid in event the total payments turn out to be less than the consideration.

It should be noted that among a group of annuitants there is no accretion to their aggregate funds outside of interest earnings; so that from the point of view of the national economy, it cannot be said that a capital gain has benefited the fund. Some annuitants will die before they have received as much as they have paid in and others after that point of time. In total there will be a balance. All participants have joined in the project with the expectation and understanding that lifetime security of the individuals in the group necessarily involves the continuance of the remaining funds for the benefit of the survivors. A redistribution of the assets takes place, not a gain in the amount of assets. The present method of making annuity payments fully taxable after exempting amounts aggregating the consideration paid for the contract may appear on its face to be an equitable arrangement, but so long as no adjustment is made involving a tax credit in the case of short-lived annuitants who have not survived their expectancies, no additional taxes should be exacted from the more fortunate individuals who survive past their expectancy. True equity requires that where life contingencies enter into a contract the tax should be fixed at the outset, based on average expectancy, and should not be affected by the actual period of the individual's lifetime.

4. Not only does the present 3-percent system subject the annuity contract holders as a whole to the harsh treatment outlined above, but it moreover operates so as to impose an added tax burden upon the older annuitants at a time when they are presumably least able to carry it. This latter defect of the 3-percent rule is due to "the fact that the bunching of the exclusions during the first few years of the annuity period results in a sharp rise in the amount of tax due the year after the total exclusions equal the taxpayer's consideration. Where the exclusions are large, this increase in tax is severe, and nothing occurs at the time of the increase which adds to the taxpayer's ability to pay. If anything, the latter is tending to decline because of advancing age." (The foregoing quotation is taken from the 1946 Report of the Staff of the Joint Committee on Internal Revenue on H. R. 2948, dealing with the taxation of pensions and annuities, p. 35.)

5. Finally, the extent to which the combination of the 3 percent provision and the feature of the taxation of the entire payments after the consideration has been returned operates to penalize annuitants at the present time may be clearly seen if we consider the total taxes paid by a group of annuitants over the period for which the annuities run. Assume that a group of 1,000 males age 65 purchase $100 annuities at a typical current price of $1,324.85. The total money they must put up is $1,324,850 and the total annuity income they can expect to receive as a group is $1,440,300. Of this amount, $1,324,850 represents a return of principal and the remainder, $115,450, is properly taxable as income. The present law, however, taxes $631,456 of the income of this group, thereby infringing on principal to the extent of $516,006 (see schedule in appendix V). Furthermore, even if the feature taxing the entire payments after the twenty-second year were eliminated from the law, the 3 percent provision would tax $572,454 of this group's income, which is almost five times the excess of aggregate income over principal.

The inequities discussed above emphasize the injustice that is being done today to a class of persons who should be encouraged by the Government, rather than discouraged, in their efforts to provide for their own old age.

PROPOSED SUBSTITUTE PLAN

In view of its inequities and shortcomings, it is believed essential that the present system of taxing annuity payments be abandoned. In its place we respectfully suggest the adoption of a system, the statutory language for which is attached hereto, whereby the element of principal in an annuity contract is averaged over the life expectancy of the annuitant as determined by a specified mortality table. This element of principal would be received tax-free each year during the annuitant's lifetime and the balance of the yearly annuity payment would be considered taxable income. In brief, each annual payment received by the annuitant would be divided into two parts—principal and income. The principal element would be determined by dividing the total cost of the annuity by the annuitant's life expectancy and treating the balance, representing an equal yearly amount over the life of annuitant, as taxable income.

The plan herein proposed is similar to the Canadian system [1] but differs from that system in one important respect, namely, that the figure used in determining the principal element is the cost of the annuity [2] rather than the value of the annuity at the time annuity payments begin. As was pointed out in the 1946 Report of the Staff of the Joint Committee on Internal Revenue on H. R. 2948, dealing with the taxation of annuities, the Canadian statute in this respect would probably be too generous in its treatment of deferred annuities, since their figure (the value of the annuity) includes an accumulation of interest. The system herein suggested is not subject to this criticism because the figure to be used in determining the annual exclusion is the total cost of the annuity. This difference likewise avoids the other disadvantage of the Canadian system, mentioned on page 42 of the above report, which would arise in connection with contributory pension plans. As the report pointed out, under the Canadian system there might be some difficulty in determining just what part of the value of such an annuity resulted from contributions by the employer. Under the plan herein proposed the determination of the cost of the annuity would be a very simple matter.

It will be noted that the plan proposed herein, like the Canadian plan, has the advantage of spreading the exclusion evenly throughout the annuitant's life. The Report of the Staff of the Joint Committee on Internal Revenue on H. R. 2948, on page 43, points out that such a plan "has the advantage of avoiding a sudden increase in the amount of the tax due late in life. It also has a certain logical validity in that the failure to tax the excess receipts received by the long-lived annuitant balances off the absence of a loss allowance to the short-lived annuitant."

It is submitted that such a provision for the income taxation of annuity payments would constitute a logical, sound, and more equitable system. In the aggregate, the tax meets the essential requirement of taxing only income and not principal. Moreover, since the sum included in gross income represents an equal amount, year by year, there is no abrupt increase in taxable income late in the life of the annuitant. It has the further advantage of automatically taking care of any changes in basic interest rates that would otherwise call for periodic revisions of the law. Finally the suggested system appears to be administratively feasible and probably no more difficult of application than the present 3-percent rule, as evidenced by the successful operation of a quite similar plan in Canada.

ADMINISTRATION OF PROPOSED SUBSTITUTE PLAN

Our study of various possible plans for income taxation of annuities led us to the conclusion that the foregoing system, which is quite similar to that now in successful operation in Canada, is the most equitable plan that permits of practical administration.

Statutory language, in the form of a proposed amendment to section 22 (b) (2) (A), to put this plan into effect is set out on the following page and the text of proposed regulations that might be issued thereunder is contained in appendix II.

The proposed regulations cover joint and survivor annuities on two lives where there is no reduction in payment after death of one of the annuitants. For joint and survivor annuities involving such reductions it is thought that computations should be made by the issuer of the annuity in accordance with the revised law and furnished to the annuitants.

If this proposal for taxation of annuity income is adopted, there will be a problem of how to tax annuitants whose annuities have been running for several years and who have been paying taxes under the 3-percent rule. Although it is undesirable to carry over any of the capital-gain philosophy of the present law, it seems impractical to attempt any retroactive adjustment at this time for taxes already paid. Paragraph (g) of the proposed regulations covers single life annuity transition cases. It provides that only the excess of the consideration paid by the annuitant over amounts previously received and not taxed should be spread over the remaining average life of the annuity as tax-exemption. In the case of joint and survivor annuities (see par. (h) of proposed regulations) the expectation of payments to the life or lives in being at the transition date would be used in making this spread.

[1] Income War Tax Act, pt. I, sec. 3 (ch. 97, Rev. Stat. 1927, amended ch. 23, L. 194. See appendix IV for quotation of text).

[2] In the case of an employee benefit plan only the contributions of the employee would be used in determining the nontaxable part of each annuity payment.

TEXT OF SUGGESTED AMENDMENT TO SECTION 22 (B) (2) (A)

Our suggested amendment to the above section 22 (b) (2) (A), which would effect the change suggested above, is set out below. The matter in italics is suggested additions to the existing law and the matter in black brackets is suggested deletions. In the attached appendix VII are proposed regulations thereunder.

(A) In general.—Amounts received (other than amounts paid by reason of the death of the insured and interest payments on such amounts and other than amounts received as annuities) under a life insurance or endowment contract, but if such amounts (when added to amounts received before the taxable year under such contract) exceed the aggregate premiums or consideration paid (whether or not paid during the taxable year) then the excess shall be included in gross income. Amounts received as an annuity under an annuity or endowment contract shall be included in gross income; except that there shall be excluded from gross income *that portion of the total amount received in the taxable year that bears to such total amount the same relation as the aggregate premiums or consideration paid for such annuity bears to the aggregate of all annuity payments to be received, which aggregate shall be in the case of an annuity for life or for more than one life, the total annuity payments expected at the time annuity payments commence, according to the 1937 Standard Annuity mortality table with allowance for any amounts stipulated to be paid under any refund or guaranty provision at or after the death of the annuitant* [the excess of the amount received in the taxable year over an amount equal to 3 per centum of the aggregate premiums or consideration paid for such annuity (whether or not paid during such year), until the aggregate amount excluded from gross income under the chapter or prior income tax laws in respect of such annuity equals the aggregate premiums or consideration paid for such annuity.] In the case of a transfer for a valuable consideration, by assignment or otherwise, of a life insurance, endowment, or annuity contract, or any interest therein, only the actual value of such consideration and the amount of the premiums and other sums subsequently paid by the transferee shall be exempt from taxation under paragraph (1) or *the first sentence of this paragraph, or considered as aggregate premiums or consideration in the computation under the second sentence of* this paragraph. The preceding sentence shall not apply in the case of such a transfer if such contract or interest therein has a basis for determining gain or loss in the hands of a transferee determined in whole or in part by reference to such basis of such contract or interest therein in the hands of the transferor. This subparagraph and paragraph (1) shall not apply with respect to so much of a payment under a life insurance, endowment, or annuity contract, or any interest therein, as, under section 22 (k), is includible in gross income;

(Suggested regulations for promulgation under the above section are in appendix II, with the accompanying tables A and B mentioned therein reproduced in appendix III.)

[Excerpt from Congressional Record, Senate, April 3, 1934 (p. 5910)]

APPENDIX I

Mr. REED. When insurance companies figure the amount that can be paid annually on annuity contracts, they calculate, first, the rental value of the principal during each year. Then, according to the expectancy of life of the individual, they compute how much of the principal can be returned to the annuitant, based on that expectancy. Their calculations involve, first, the interest on the money; second, return of principal during the balance of the probable life of the individual.

In Great Britain the whole amount of such annuities is taxed as income. It did not seem fair to the Treasury—and this suggestion comes from the Treasury—to tax that part of the annuity which represents the return of principal, but it did seem fair, and it seemed to the committee that it would stop a most important loop-hole, to tax that part of the annuity which represents interest on the capital. That factor is generally computed by the insurance companies at 4 percent, but obviously, since the principal is diminishing a little each year, it would be unfair to tax every year 4 percent of the original principal, because that would be more than the remaining principal after the expiration of 2 years.

Consequently the Treasury, in the effort to reach a fair mean, has fixed on the figure of 3 percent. That is less than the interest return on the money in the

early years, and it is probably more than the interest return toward the later years of the annuity. That is the way the arbitrary 3 percent was arrived at.

Mr. President, this is the view the Finance Committee took by a considerable majority. * * *

Appendix II

PROPOSED REGULATIONS—PORTION OF ANNUITY PAYMENT EXEMPT FROM TAX

(*a*) *Annuity for a fixed number of years.*—The aggregate consideration is to be divided by the total number of installments to be paid, and the quotient represents the portion of each installment to be excluded from gross income. The amount of each installment in excess of such excluded portion is to be included in gross income. For example, if an aggregate consideration of $1,000 purchased an annuity of $60.48 payable for 20 years certain, one-twentieth of $1,000, or $50, is excluded from gross income. The balance received, or $10.48, is to be included in gross income.

(*b*) *Annuity payable during the life of the annuitant.*—The aggregate consideration is to be divided by the annuitant's expectation of life according to the 1937 Standard Annuity Mortality Table, at his age on the date of the first annuity payment. The quotient represents the portion of annual payment to be excluded from gross income. In table A,[1] this excludable portion is shown in column O for $1,000 of aggregate consideration. For example, if an aggregate consideration of $1,000 purchased an annuity of $75.48 payable during the lifetime of a male annuitant aged 65, $69.43 is excluded from gross income. The balance received, or $6.05, is to be included in gross income.

(*c*) *Annuity payable for a fixed number of years and for continued life of the annuitant.*—The procedure here is as in paragraph (*b*) of this section, except that the column of table A to be used is that corresponding to the fixed number of years. For example, if an aggregate consideration of $1,000 purchased an annuity of $67.56 payable for 10 years in any event, and thereafter during the continued lifetime of a male annuitant aged 65, $62.41 is excluded from gross income. The balance received, or $5.15, is to be included in gross income.

(*d*) *Annuity payable until payments aggregate consideration and for the continued lifetime of the annuitant.*—The procedure here is as in paragraph (*b*) of this section, except that the column of table A to be used is that corresponding to the ratio (to the nearer integer) of the aggregate consideration to the annual payment. For example, if an aggregate consideration of $1,000 purchased an annuity of $57 payable until the consideration is returned, and thereafter during the continued lifetime of a male annuitant aged 65, the required ratio is 18 and $49.88 is excluded from gross income. The balance received, or $7.12, is to be included in gross income.

(*e*) *Annuity payable during the life of the annuitant with a payment at the death of the annuitant of the excess, if any, of the consideration over the annuity payments made.*—The procedure here is identical with paragraph (*d*). For example, if an aggregate consideration of $1,000 purchased a cash refund annuity of $53.88 payable annually to a male annuitant aged 65, the required ratio is 19 and $48.24 is excluded from gross income. The balance received, or $5.64, is to be included in gross income.

(*f*) *Annuity payable during the joint life of two annuitants and, without reduction, during the remaining life of the surviving annuitant after the first death.*—The aggregate consideration is to be divided by the annuitants' joint and survivor expectation of life according to the 1937 Standard Annuity Mortality Table, at their ages on the date of the first annuity payment. The quotient represents the portion of annual payment to be excluded from gross income. This excludable portion is shown in table B. For example, if an aggregate consideration of $1,000 purchased a joint and survivor annuity of $53.76 payable as long as either or both of a male annuitant aged 65 and a female annuitant aged 65 survives, $46.97 is excluded from gross income. The balance received, or $6.79, is to be included in gross income.

(*g*) *Annuity under which payments commenced prior to the first taxable year which begins after December 31, 1947.*—The aggregate consideration less the entire amount received and excluded from gross income in prior years is to be divided by

[1] See appendix III.

the number of years' annuity payments expected in taxable years which begin after December 31, 1947, which expectation, in the case of annuity payments continuing for life, shall be determined according to the 1937 Standard Annuity Mortality Table, at the age on the date of the first annuity payment in the first taxable year beginning after December 31, 1947. The quotient represents the portion of annual payment to be excluded from gross income. For example, if an aggregate consideration of $1,000 purchased an annuity of $48.96 commencing in 1938 for 20 years certain and the remaining lifetime of a male annuitant aged 45, a total of $189.60 would be excluded from gross income in the years 1938 to 1947, inclusive. In table A, for a man aged 55, under a life annuity with payments certain for 10 years, $45.80 of annuity payment per $1,000 of consideration is exempt. Thus, $45.80×$810.40÷$1,000 or $37.12, of annuity payment is exempt from tax commencing in 1948.

(*h*) *Annuity payable during the joint life of two annuitants and, without reduction, during the remaining lifetime of the surviving annuitant after the first death, under which payments commenced prior to the first taxable year which begins after December 31, 1947.*—The aggregate consideration less the entire amount received and excluded from gross income by either annuitant in prior years is to be divided by the number of years' annuity payments expected in taxable years which begin after December 31, 1947, which expectation, in the case of annuity payments continuing for the life of one or more surviving annuitants, shall be determined according to the 1937 Standard Annuity Mortality Table, at the age or ages on the date of the first annuity payment in the first taxable year beginning after December 31, 1947. For example, if an aggregate consideration of $1,000 purchased a joint and survivor annuity of $53.88 commencing in 1938 for a man aged 60 and a woman aged 55, a total of $238.80 would be excluded from gross income in the years 1938 to 1947, inclusive. From appendix III, table B, for a man aged 70 and a woman aged 65, $50 of annuity payment per $1,000 of consideration is exempt. Thus, $50×$761.20÷$1,000, or $38.06, of annuity payment is exempt from tax commencing in 1948, if both annuitants are then living. On the other hand, if only the female annuitant is then living, from table A, for a woman aged 65, under a life annuity with no payment-certain period, $56.97 of annuity payment per $1,000 of consideration is exempt. Thus, $56.97×$761.20÷$1,000, or $43.37, of annuity payment would be exempt from tax commencing in 1948.

Appendix III

Proposed table A showing annual annuity payment exempt from tax per $1,000 of consideration

Male age nearest birthday [1]	Period for which payments are guaranteed—in years										
	0	5	10	15	20	25	30	35	40	45	50
5	$15.36	$15.36	$15.35	$15.33	$15.31	$15.27	$15.23	$15.16	$15 08	$14 97	$14.81
10	16.54	16.53	16.52	16.50	16.46	16.42	16.36	16.27	16.14	15 96	15.72
15	17.91	17.90	17.89	17.86	17.82	17.75	17 65	17 51	17 32	17.04	16.67
20	19.54	19.53	19.51	19.47	19.40	19.30	19 14	18 92	18 60	18.16	17 60
25	21.49	21.48	21.45	21.39	21.27	21.10	20.84	20 46	19 95	19 28	18.44
30	23.86	23.84	23 79	23.67	23.48	23.18	22 73	22 12	21 31	20.30	19.12
35	26.75	26 72	26 62	26.41	26.06	25.54	24 79	23 80	22.56	21.13	19.59
40	30.31	30 25	30 06	29.68	29.06	28.15	26 92	25.38	23.60	21 71	19.86
45	34 74	34 64	34.28	33.58	32 48	30 93	28.97	26 72	24.34	22 04	19.97
50	40 36	40.16	39.46	38.16	36.22	33.69	30.75	27.68	24.76	22 18	20 00
55	47.57	47.16	45 80	43.41	40.08	36.15	32.06	28.24	24 94	22 22	20.00
60	56.97	56.13	53 46	49.12	43.70	38.04	32.85	28.49	24 99	22.22	20 00
65	69 43	67.65	62.41	54.82	46.63	39.23	33.21	28.56	25.00	22.22	------
70	86 17	82.33	72.23	59.83	48.58	39.79	33 32	28 57	25.00	------	------
75	109.03	100.65	81.97	63.49	49.57	39 97	33 33	28.57	------	------	------
80	140.65	122.41	90.24	65.57	49.93	40.00	33.33	------	------	------	------
85 and over	184.98	146.07	95.90	66.44	50.00	40.00	------	------	------	------	------

[1] On the date of the first annuity payment.

Proposed table B showing annual joint and survivorship annuity payment exempt from tax per $1,000 of consideration

Age of first annuitant [1]		Age of second annuitant [1]												
Male	Female	Male Female	10 15	20 25	30 35	40 45	50 55	55 60	60 65	65 70	70 75	75 80	80 85	85 [2] 90 [2]
10	15		14. 50											
20	25		15. 34	16. 77										
30	35		15. 91	17. 94	19. 98									
40	45		16. 24	18. 73	21. 66	24. 67								
50	55		16. 41	19. 17	22. 78	27. 17	31. 83							
55	60		16. 45	19. 30	23. 14	28. 12	33. 94	36. 90						
60	65		16. 48	19. 39	23. 40	28. 84	35. 77	39. 60	43. 42					
65	70		16. 50	19. 44	23. 56	29 35	37. 24	41. 93	46. 97	52. 00				
70	75		16. 52	19. 48	23. 69	29 72	38. 33	43. 80	50. 00	56. 69	63. 45			
75	80		16. 52	19. 50	23. 75	29. 95	39. 09	45. 17	52. 38	60. 68	69. 78	78. 99		
80	85		16. 53	19. 52	23. 80	30. 09	39. 60	46. 13	54. 11	63. 78	75. 13	87. 57	100. 30	
85 [2]	90 [2]		16. 53	19. 53	23. 83	30. 18	39. 92	46. 73	55. 28	65. 96	79. 11	94. 70	111. 98	129. 53

[1] Age nearest birthday at date annuity payments commence.
[2] Or over.

APPENDIX IV

CANADIAN INCOME TAX ON ANNUITY INCOME

SEC. 3. "INCOME."—SUBSECTION 1. For the purposes of this act, "income" means * * * the annual profit or gain from any other source including

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(*b*) annuities received under a contract (other than payments described in paragraph (*c*) of this section) except a portion of each amount received thereunder that bears the same relation to the whole amount as the amount that the annuitant could, under the contract, have chosen to receive in lieu of the annuity or, if no such choice is provided by the contract, the present value (computed in such manner as the Minister may by regulation prescribe) of the annuity at the time of commencement thereof, bears to the aggregate (computed in the case of an annuity for life on the assumption that the annuitant will live during the period of his normal expectation of life calculated in accordance with mortality tables approved by the Minister) of the annuity for which the contract provides: *Provided*, That this provision shall not be construed to prejudice the operation of subsection 2 of this section.

* * * * * * *

SUBSECTION 2. When portion of principal payments deemed to be interest.—Where under any existing or future contract or arrangement for the payment of money, the Minister is of opinion that (*a*) payments of principal money and interest are blended; or (*b*) payment is made pursuant to a plan which involves an allowance of interest, whether or not there is any provision for payment of interest at a nominal rate or at all, the Minister shall have the power to determine what part of any such payment is interest and the part so determined to be interest shall be deemed to be income for the purposes of this act.

APPENDIX V

Taxable portion of aggregate income received by 1,000 male annuitants age 65, each having a $100 a year annuity (payable monthly) purchased for $1,324.85

Year	Annuitants surviving end of year [1]	Total annuity income received during year	Taxable portion, United States basis	Taxable portion, Canadian basis
	1,000			
1	971	$98,550	$39,169	$7,899
2	941	95,600	37,997	7,663
3	910	92,550	36,784	7,419
4	877	89,350	35,513	7,162
5	843	86,000	34,181	6,893
6	808	82,550	32,810	6,618
7	771	78,950	31,379	6,329
8	734	75,250	29,908	6,032
9	696	71,500	28,418	5,731
10	657	67,650	26,888	5,423
11	617	63,700	25,318	5,106
12	577	59,700	23,728	4,785
13	536	55,650	22,118	4,461
14	496	51,600	20,509	4,136
15	456	47,600	18,919	3,815
16	416	43,600	17,329	3,495
17	377	39,650	15,759	3,178
18	339	35,800	14,229	2,870
19	302	32,050	12,738	2,569
20	267	28,450	11,308	2,280
21	234	25,050	9,956	2,008
22	203	21,850	8,848	1,751
23	173	18,800	18,800	1,507
24	147	16,000	16,000	1,283
25	122	13,450	13,450	1,078
26	101	11,150	11,150	894
27	82	9,150	9,150	733
28	65	7,350	7,350	589
29	51	5,800	5,800	465
30	39	4,500	4,500	361
31	29	3,400	3,400	273
32	22	2,550	2,550	204
33	15	1,850	1,850	148
34	11	1,300	1,300	104
35	7	900	900	72
36	5	600	600	48
37	3	400	400	32
38	2	250	250	20
39	1	150	150	12
40	0	50	50	4
Total		1,440,300	631,456	115,450

Aggregate annuity income	$1,440,300
Less aggregate considerations	1,324,850
Equals properly taxable income	115,450

[1] 1937 Standard Annuity Mortality.

The CHAIRMAN. Mr. Elisha Friedman.

STATEMENT OF ELISHA M. FRIEDMAN, CONSULTING ECONOMIST, NEW YORK, N. Y.

Mr. FRIEDMAN. My name is Elisha M. Friedman, consulting economist, New York City. I have appeared, as a public service, before the Senate Finance Committee or filed briefs with it since 1938 on the capital gains tax, probably the only witness who has done so continuously. I have, also, as a public service, presented analyses to the Senate and House committees on other provisions of revenue bills.

I shall present a 5-minute summary and would ask for the privilege of filing an amplifying statement with supporting statistical data.

The CHAIRMAN. You may do so but you must get your statement to us during the week. Can you get it to us?

Mr. FRIEDMAN. I have it here.

(The statement referred to follows:)

BRIEF OF ELISHA M. FRIEDMAN, OF NEW YORK, CONSULTING ECONOMIST

My name is Elisha M. Friedman, consulting economist, at 20 Broad Street, New York, N. Y. I have appeared, as a public service, before the Senate Finance Committee or filed briefs with it since 1938 on the capital-gains tax, probably the only witness that has done so continuously. I have, as a public service, also presented analyses to the Senate and House committees on other provisions of revenue bills.

My interest in the capital-gains tax was aroused during the trip abroad in 1936. One of the leading banking firms of Amsterdam, Holland, called my attention to a notice from the United States Treasury, stating that the firm's clients were subject to the capital-gains tax and requesting that returns be filed. The bankers abroad stated that the effect of this demand would be to shift their trading in American securities away from New York to European markets, as London, Amsterdam, and Zurich where no capital-gains tax was in effect, thus reducing at the same time the volume of transfer taxes and American brokers' income taxes, both payable to the United States Treasury. This firm suggested that I call the matter to the attention of the American authorities.

On my return to the United States, I thought it would be a constructive public service if I called on Mr. Lovell H. Parker, then chief of staff of the Joint Congressional Committee on Taxation who gave me some of the official documents and statistical data from which I prepared a brief filed with the Senate Finance Committee on March 18, 1938. I had three-column summaries in the New York Times which simultaneously wrote editorials supporting my analyses in 1938 and 1941.

This 1938 brief urged shortening to 6 months the five holding periods, which then ranged from over 10 years to under 1 year. In 1942 I brought to the hearings three European experts. The men from Holland and Belgium explained why their governments never enacted capital-gains tax. The expert from France showed that when the Vichy Government, during the Nazi occupation, introduced the capital-gains tax, the markets remained frozen until the holding period was reduced to 3 months. Liberated France repealed the tax, thus resuming her traditional policy.

I spoke to Mr. George Rhea, then president of the New York Curb Exchange, who responded eagerly and all the preliminary conferences in which I organized the hearing were held in his office. However, he resigned his post and did not participate in the hearings. I sought also to interest Mr. Emil Schram, president of the New York Stock Exchange, but he was reluctant to participate. But I finally succeeded in persuading him and he joined our group in the appearances before the House committee.

The revision by Congress in 1942 which shortened the holding period to 6 months greatly increased Treasury receipts from capital-gains taxes. I now make a plea for the 3 months holding period. This will undoubtedly produce even more revenue, probably more than twice as much. And the Korean expedition of the UN requires more funds of the United States. As for the rate, I believe that a 10 percent rate by increasing the volume of transactions, will increase revenue for the Treasury, which incidentally most of your witnesses are seeking to reduce.

Capital gains is essentially not income. The unique and most significant characteristic of the capital gains tax is that it is contingent. This view was clearly stated by Senator Connally, who said: "It sems to me there is a differentiation between ordinary income and capital gains. In the case of ordinary income the taxpayer has to pay it; he has no choice. But in the case of capital gains he has a choice; he does not have to realize unless he wants to. * * * If the holder does not sell, you do not get any tax." Only the taxpayer decides whether or not to realize the gain.

Unlike capital gains, income is regular and recurrent. It may decline, but it never becomes a minus. However, capital gain in 1 year may be followed by capital losses for several years. For example, the net capital gain in 1917 of $207,000,000 was followed by 6 years of capital loss through the year 1923 totaling about 3.6 billion dollars. Then followed 6 years of capital gains, 1924–29, and 4

years of capital losses, 1930–33; then 4 years of capital gains, 1934–37, and 3 years of capital losses, 1938–40.

For the entire 24 years, 1917–40, the capital gains amounted to about 6.1 billion dollars but if the fantastic boom of 1925–29 is eliminated, then the remaining 19 years show net capital loss of 8.3 billion dollars. The above returns cover periods of prosperity and depression. The average receipts for most years were minus (deductions from the income tax) and the average for the entire period was trifling.

Over a generation, losses and gains so completely offset each other that net capital gains were insignificant, less than 3 percent of the taxable income for the period 1917–31. Certainly, it is very easy to take periods of five or more years within the period 1917–41, which show, on balance, a net loss to the taxpayer and also a net deficit of revenue to the Treasury, as for example, the periods 1918–23 and 1930–35.

The capital gains tax is undependable and unpredictable as a source of revenue. During the years 1917–33 when capital gains and capital losses were treated alike, as additions to income or deductions from income, the great fluctuations in capital-gains tax receipts upset the budget and proved that the capital-gains tax is unproductive, deceptive, and deters investment and expansion when most needed. Even under the unequal treatment of gains and losses relatively little revenue was received until the holding period was shortened to 6 months.

The distinction between long- and short-term gains is arbitrary and meaningless. By waiting 1 day, a taxpayer in the high bracket can cut his capital-gains tax from 80 to 25 percent. That is fiscal nonsense. The capital-gains tax does not reach the rich. Selling securities to take capital gains is discretionary, not mandatory. The taxpayer in the high income brackets takes practically no short-term gains, taxable at high-income rates. He is like a farmer with a bountiful crop rotting away because it is uneconomic to harvest it.

Only taxpayers in low-income brackets can afford to take short-term gains. A low flat tax would create free and stable markets and also produce revenue. A fair capital-gains tax, permitting full deduction of losses from income, is not a revenue producer but an administrative nuisance. It is the most difficult and expensive feature of the tax law to administer, as Government officials concede.

Because a high capital-gains tax deters taking profits by big holders, it tends to exaggerate the market's rise and, therefore, also the subsequent decline. It contributes to the instability of markets for the little fellows rush to buy in group hysteria and sell in mob panic. Therefore, though the market fluctuates violently it produces little or no revenue. Indeed, the market moves more violently than it did before capital gains were taxable.

In fact selling to establish losses during the last 3 months of the year has created the seasonal market pattern of a downward trend in the last quarter. Before 1917 this trend was up. A low rate and brief holding period would encourage profit taking, produce revenue, check a wild rise, encourage buying at low prices thus stabilize stock markets and lay the basis for future capital-gains tax receipts.

The price of shares on the New York Stock Exchange is relatively lower than in the principal European markets, in countries which have no capital-gains tax, as I learned from foreign investment institutions on a recent trip abroad. Taking the yield on government bonds as the yardstick, yields on stocks are much higher (or stock prices are much lower) in New York than in London, Paris, Amsterdam, or Zurich—in these centers the market is free and reflects capital values more truly. Strangely enough in the same company, of which the parent company's dollar shares are listed in New York and sterling shares of a subsidiary listed in London, the yield is lower (or the price is higher) in London even though the product and the management are identical.

Because the capital-gains tax makes investors hold rather than sell, it freezes funds which thus prevents the movement of risk capital from mature situations to new enterprises and new industries and new sources of employment. As Senator Connally stated in the 1942 hearings, "As to capital gains and losses, we should make it more attractive to sell, instead of offering a premium to hold."

A tax on capital gain is a tax on property and on estates. As evidence, the CIO statement to the House Committee on Ways and Means, last February, urges that in figuring the estate tax of a decedent, a tax be levied on the capital gains in addition to the tax on the original value of the property. The capital-gains tax is a form of capital levy or an advance on the death duties. Indeed it is a duplicate inheritance tax. Therefore, investors tend to hold securities until death instead of risking money in new fields.

Again, the country is in the midst of an inflation. All prices have risen because the value of the dollar has declined. As real estate and shares rise in value, the increase represents a paper profit. Profits realized are fictitious. Taxing this fictitious increase at 25 percent as a capital gain is economically unsound and legally unjust. First the Government depreciates the dollar and then when property values rise to reflect that depreciation, the Government proceeds to expropriate part of the unreal increase resulting from currency depreciation, thus drying up sources of investable funds.

The false character of the capital-gains tax is indicated in the Government's own report. "In many instances the capital-gains tax is imposed on the mere increase in monetary value resulting from the depreciation of the dollar instead of on a real increase in value." The present trend toward inflation, with the accompanying rise in the value of all assets, makes it particularly important to reconsider the capital-gains tax.

In countries where the currency fell very greatly, the real evil was exposed. In several countries in Europe, the Government permitted rewriting the income account and the balance sheet in terms of gold instead of depreciated paper currency and based its taxes on real values.

There is no capital-gains tax in Canada or even in Laborite and regimented Britain or most other countries. Therefore, as I found out on a recent trip to Europe, foreign investors in American shares trading in Geneva, Zurich, or elsewhere, can sell their shares without being liable for a capital-gains tax. And they did so in the spring of 1950. Thus the American investor is discriminated against, and holds the bag for foreigners to dump for the capital-gains tax deters him from selling, particularly for the short term.

On the capital-gains tax, the record shows that the lower the rate of tax, the greater are the gains realized and the greater the tax receipts. But the higher the tax rate, the less is the gain realized and the less are the receipts. I proved this conclusively from abundant Treasury data available in 1942. Capital gains were practically nil at high short-term rates and very substantial at low long-term rates. (See my brief in the hearings before the House Ways and Means Committee, 77th Cong., 2d sess., on the revenue revision of 1942.)

The Treasury for the first time segregated short-term gains from long-term gains in the report Statistics of Incomes for 1938. Short-term capital gains are taxed at graduated income-tax rates. But long-term gains are taxed at a flat rate. These two different methods of taxing furnish a good experiment on comparative productivity of rates. In the lowest income group, short-term gains reported in 1938 were 150 percent of long-term gains. But in the highest income group subject to the maximum income tax, short-term gains virtually disappear. They are less than three-tenths of 1 percent of long-term gains.

Following is the Treasury table for 1938 showing the relation of short-term gains taxed at high rates to long-term gains taxed at low rates.

Net income classes—returns with net income	Short-term capital gain	Long-term capital gain	Ratio percent short to long
Under $5,000	$46,000,000	$30,000,000	150.0
$5,000 to $10,000	30,000,000	23,000,000	130.0
$10,000 to $25,000	31,000,000	33,000,000	91.0
$25,000 to $50,000	14,000,000	23,000,000	68.0
$50,000 to $100,000	7,000,000	21,000,000	33.0
$100,000 to $150,000	2,000,000	12,000,000	17.0
$150,000 to $300,000	1,000,000	20,000,000	5.7
$300,000 to $500,000	(1)	16,000,000	1.5
$500,000 to $1,000,000	(1)	22,000,000	1.1
Over $1,000,000	(1)	61,000,000	.3

1 Less than $250,000.

The above table confirms the conclusion that the higher the rate of tax on capital gains, the less the short-term gains realized and the less the Treasury receipts. Can Congress ignore these facts in framing the present tax bill?

Again, incomes under $5,000 reported $30,000,000 in long-term gains but incomes over $1,000,000 reported $60,000,000, or 200 percent as much. However, in short-term gains, subject to the graduated income tax, incomes under $5,000 reported $45,000,000 whereas incomes over $1,000,000 reported, not 200 percent as much or $90,000,000, but only $175,000, or four-tenths of 1 percent as much. Had all taxpayers realized short-term gains as freely as the low-rate group, the

Treasury would have found $250,000,000 more gains subject to tax. The present capital-gains tax is not a revenue-producing measure but a revenue-preventing measure.

Chart II of my 1942 brief compares yields of high taxes during the war period, 1917–21, and the recovery period, 1932–36, with yields of low taxes in the boom period, 1925–29, and the depression period, 1930–31. It shows that under low rates of tax on capital gains, the taxpayer realized heavily on gains and lightly on losses, thus furnishing abundant revenue to the Treasury. But under high rates of tax the results are reversed; heavy losses and light gains were taken thus furnishing little revenue of the Treasury.

The Treasury report for 1934 shows that small taxpayers took short-term gains because their tax rate was low. However, as the rates rose in the higher brackets, there was a sharp decline both in short-term gains realized by taxpayers and in taxes thereon paid into the Treasury. On the other hand, the tax rate was low on capital gains on securities held over 10 years. Therefore, the high-income group realized heavily on such capital gains and provided large tax receipts for the Treasury. Obviously, low rates stimulated realization of gains and tax payments to the Treasury. Exactly the same evidence is shown in chart III–B of my 1942 brief covering the period 1926–29 and the period 1930–33.

Shortening the holding period has resulted in a phenomenal increase of net capital gains. For the 3 years, 1945–47, under the 6 months holding period, total net capital gains reported by individuals averaged $2,578,000,000 as compared with $458,000,000 for the years 1935–37, or 560 percent as much as under the long-holding periods up to 10 years. The increase was undoubtedly due to the shortening of the holding period. This 3-year average of $2,578,000,000 is the highest in the history of capital gains excepting only the fantastic period, 1927–29, when the average was $3,339,000,000. Even the boom years, 1925–27, averaged only $2,354,000,000 under the long-holding periods up to 24 months. Incidentally, the net gains for 1946 of $3,322,000,000 was exceeded only once by the 1928 figure of $4,505,000,000.

Of course, shortening the holding period increased Treasury receipts. Under the long-holding periods the average capital gains receipts for the active years 1935–37 was $94,000,000. But under the 6 months holding period enacted in 1942 the receipts from the tax on capital gains averaged $446,000,000 for the active years 1942–45, or 480 percent as much. Comparing the capital gains tax at the peak of 1936 under the long-holding periods with the peak of 1945 (the latest figures available) under the 6-month period, the receipts increased by over 420 percent, or from $171,000,000 to $721,000,000.

Before the House Ways and Means Committee in 1942 I predicted a rise in receipts to a range of 200 to 600 million dollars from the 30 million dollars average for the decade 1931–40, if the holding period, then 18 months, were entirely eliminated. Mr. Randolph Paul, then Treasury counsel, who opposed my suggestion, thought my estimate "extravagant" because in the year 1940 the Treasury collected apparently only 12 million dollars. But subsequent statistics, even under the 6-month period, greatly exceeded my conservative forecast. What was the cause? The increase by over 400 percent cannot be due to the rise in rate from 15 to 25 percent, or only by 160 percent. Was it not the shortening of the period to 6 months? If so, a further reduction from 6 months to 3 months should increase the yield substantially further.

Ultimately we should try the experiment of reducing the capital gains tax to 10 percent and eliminate the holding period and record the results in revenue. Revenue would undoubtedly rise. There would surely be a great increase in transfer tax receipts, increase in income taxes paid by brokers, an increase in the number of new issues and a reopening of the market for new stocks, therefore, less internal financing through undistributed profits, therefore, a greater percentage of profits distributed as dividends and necessarily more income tax receipts by the Treasury.

What is the next step? Congress has been experimenting since 1917 with the capital gains tax. Since 1938 it has moved persistently in shortening the holding period. The revision of 1938 reduced the five holding periods ranging from under 1 year to over 10 years to three holding periods from under 18 months to over 24 months. In 1942 Congress further shortened the holding period to 6 months. The subsequent great increase in revenue vindicated this congressional policy. Your committee should not recommend shortening the holding period to 3 months. The result should again be a great increase in revenue—an end urgently desired by the committee and made imperative by the aggression in Korea.

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Mr. FRIEDMAN. My interest in the capital gains tax was aroused during a trip abroad in 1936. On my return to the United States I thought it would be a constructive public service if I called on Mr. Lovell H. Parker, then chief of staff of the Joint Congressional Committee on Taxation, who gave me some of the official documents and statistical data from which I prepared a brief filed with the Senate Finance Committee on March 18, 1938. This 1938 brief, and I have copies here if you wish them, urged the shortening to 6 months of the five holding periods which then ranged from over 10 years to under 1 year.

In 1942 I brought to the hearings three European experts who explained why their governments never used the capital gains tax. I sought also to interest Mr. Emil Schram, president of the New York Stock Exchange, but he was reluctant to participate. But I finally succeeded in persuading him and he joined our group in the appearances before the House committee.

The revision by Congress in 1942 which shortened the holding period to 6 months greatly increased Treasury receipts from capital gains taxes. I now make a plea for the 3 months holding period in H. R. 8920. This will undoubtedly produce even more revenue, probably more than twice as much.

Over a generation, losses and gains so completely offset each other that net capital gains were insignificant, less than 3 percent of the taxable income for the period 1917 to 1931.

Because a high capital gains tax deters taking profits by big holders, it tends to exaggerate the market's rise and therefore also the subsequent decline. It contributes to the instability of markets, for the little fellows rush to buy in group hysteria and sell in mob panic. Therefore, though the market fluctuates violently it produces little or no revenue.

The price of shares on the New York Stock Exchange is relatively lower than in the principal European markets in countries which have no capital gains tax. I recently returned from Europe and saw partners in branches of American banking firms in Paris and London and they pointed it out very clearly.

The false character of the capital gains tax is indicated in the Government's own report of 1938. "In many instances the capital gains tax is imposed on the mere increase in monetary value resulting from the depreciation of the dollar instead of on a real increase in value."

The present trend toward inflation, with the accompanying rise in the value of all assets, makes it particularly important to reconsider the capital gains tax.

Shortening the holding period has resulted in a phenomenal increase of net capital gains. For the 3 years 1945 to 1947, under the 6-month holding period, total net capital gains subject to tax reported by individuals averaged $2,578,000,000 as compared with $458,000,000 for the years 1935 to 1937, or 560 percent as much as under the long holding periods from 1 year up to 10 years.

That is a very significant fact. By shortening the holding period from a minimum of 1 year to 6 months you increased the capital gains subject to tax by almost six times.

This increase was undoubtedly due to the shortening of the holding period. This 3-year average of $2,578,000,000 is the highest in the history of capital gains excepting only the fantastic period 1927

to 1929 when the average was $3,339,000,000. Even the boom years 1925 to 1927 averaged only $2,354,000,000 under the longer holding periods up to 24 months. Incidentally, the net capital gains for 1946 of $3,322,000,000 were exceeded only once—by the 1928 figure of $4,505,000,000.

Of course, shortening the holding period not only increased capital gains subject to tax but also increased Treasury receipts.

Senator MILLIKIN. Where you have an economy of the kind we have, generally speaking is it unwholesome to put a deterrent on the taking of profits?

Mr. FRIEDMAN. Undoubtedly. Senator Connally made that point, as cited in my brief.

Senator MILLIKIN. We are running a high velocity economy which would collapse if we ever departed from it. Therefore, should we not encourage the taking of profits all along the line?

Mr. FRIEDMAN. You have hit the nail on the head.

Senator MILLIKIN. I am not discussing this particular problem but generally speaking.

Mr. FRIEDMAN. Senator Connally in 1938 and 1942 pleaded for that.

Senator MILLIKIN. Is it not also true that, with the exception of a possible lag, if you eliminate the capital gains tax entirely, the gain of capital would become the source of income and yield income taxes after perhaps a lag in the loss of revenue?

Mr. FRIEDMAN. You have hit the nail on the head again.

Senator MILLIKIN. I am doing pretty well.

Mr. FRIEDMAN. You are doing very well. I wish to support your remarks. In England they do not tax capital gains and the investment trusts there, unlike ours, are not compelled to pay out capital gains to stockholders. What is the result? The surplus increases, they reinvest the proceeds, and that reinvestment brings stable income from dividends.

But as was pointed out this afternoon, our investment trusts must pay out everything, income from dividends plus capital gains so that the Treasury can tax them. Wait until we get the next market decline and the investment companies that paid out all their capital gains, which in England are regarded as reserves for bad times, will be in a difficult position having impaired their capital stock because they will be having a deficit in capital and they may have to wait for a long time to make it good. When the market declines the value of their portfolio will show capital losses instead of capital gains.

I do not know whether I have made myself clear.

Senator MILLIKIN. You have made yourself clear. We had to grapple with that problem during the period as far as the insurance companies were concerned.

Mr. FRIEDMAN. When the stock market has its next major decline; the investment trusts will be in a difficult situation.

Under the long holding periods from 1 to 10 years the average capital gains receipts by the Treasury for the active years 1935 to 1937 was $94,000,000. But under the 6-month holding period enacted in 1942 the receipts from the tax on capital gains averaged $446,000,000 for the active years 1942 to 1945, or 480 percent as much. Comparing capital gains revenues at the peak of 1936 under the long holding periods with the peak of 1945 (the latest figures available) under the 6-month period, the receipts increased by over 420 percent, or from $171,000,000 to $721,000,000.

Before the House Ways and Means Committee in 1942 I predicted a rise in receipts to a range of $200,000,000 to $600,000,000 from the $30,000,000 average for the decade 1931 to 1940, if the holding period, then 18 months, were entirely eliminated. I did so on the basis of a very careful statistical calculation which was described in my 1942 brief before that committee. But Mr. Randolph Paul, then Treasury counsel, who opposed my suggestion, thought my estimate "extravagant" because in the year 1940 the Treasury collected apparently only $12,000,000. But subsequent revenue, even under the 6-month period, greatly exceeded my conservative forecast.

In other words, if you get a 400-percent increase in capital gains and in Treasury receipts by cutting the minimum holding period from 12 to 6 months, you will get an increase much greater than twofold, if you cut it from 6 to 3 months. That is particularly important now because in the troubled state of the world, who can look 6 months ahead? Therefore who will take the risk of buying? Or who will take the risk of selling when he knows that if he gets out now he will have to wait another 6 months after repurchasing? But if you shorten the holding period to 3 months, you will greatly increase the number of people willing to take the 3-month risk over and above the number of people willing to take the 6-month risk.

What is the next step? Congress has been experimenting since 1917 with the capital-gains tax. I say experimenting because we do not know much about it. We have a vast amount of statistics on this tax but they have not been collated. I think the Joint Committee on Taxation should make a study of all the statistics in capital gains from 1917 to date showing, as I stated in the House hearings, the capital gains, capital losses, and net capital gains, both long and short term, the amount added to or subtracted from taxable income, and to or from tax receipts and correlates these statistics with the length of the holding period and with the income tax brackets. This vast volume of statistics has not been analyzed. But an analysis will point irresistibly to a positive conclusion—abolish the holding period, set a low rate, and segregate the capital gains entirely from the income tax. Then taxpayers in the high brackets will not be compelled, as they are now, to see huge short term profits melt away, like a farmer who has a fine crop and who must let it rot because it is uneconomic to harvest it. And the Treasury would get ample income if taxpayers in the high brackets took their short term capital gains.

As shown in my brief, the Treasury's figures for 1938 proved that in the lowest bracket long-term gains were $30,000,000 and short-term gains were $46,000,000, or 150 percent; but in the highest bracket, long-term gains were $60,000,000 and short-term gains, instead of being $120,000,000, were insignificant, only $175,000. These figures prove clearly from the Treasury's own figures that you can raise the capital gains tax rate high enough, like the income tax rate on short-term gains, to prevent big taxpayers from taking capital gains. In other words, a high rate is not a revenue producer but a revenue preventer.

What is the next step? Congress has been experimenting since 1917 with the capital gains tax. Since 1938 it has moved persistently—and, I believe, correctly and soundly—in shortening the holding period. The revision of 1938 reduced the five holding periods ranging from

under 1 year to over 10 years to three holding periods from under 18 months to over 24 months.

In 1942 Congress further shortened the holding period to 6 months. The subsequent great increase in revenue vindicated this congressional policy. Your committee should now recommend shortening the holding period to 3 months, as embodied in H. R. 8920. The result should again be a great increase in revenue, an end urgently desired by the committee and made imperative by the aggression in Korea. Even if the present tax bill is scrapped, there is one section that should not be scrapped if more money is required, and that section is the capital gains provision, shortening the holding period from 6 months to 3 months.

Thank you, gentlemen, for your patience.

The CHAIRMAN. Thank you, Mr. Friedman.

The CHAIRMAN. Mr. Howard E. Munro.

STATEMENT OF HOWARD E. MUNRO, LEGISLATIVE REPRESENTATIVE, THE CENTRAL LABOR UNION AND METAL TRADES COUNCIL OF THE PANAMA CANAL ZONE

Mr. MUNRO. Mr. Chairman, my name is Howard E. Munro, I am legislative representative of the Canal Zone Central Labor Uuion and the Metal Trades Council.

The organizations which I represent are the central bodies composed of 28 unions affiliated with the American Federation of Labor. The membership of these unions are the United States citizens employed by the Federal Government to operate and maintain the Panama Canal and the Panama Railroad Company on the Canal Zone.

Our members are vitally interested in the results of H. R. 8920 should it become a law in its present form. We are particularly interested in section 216 and should like to call your attention to the following statements made by President Harry S. Truman, in his request for a revision on the tax laws of January 23, 1950:

> In making changes in the tax laws, we should be sure they move toward, and not away from, the major principles of a good tax system. Our tax structure should recognize differences in ability to pay; it should provide incentives to new undertakings and the expansion of existing businesses; it should support the objective of increasing opportunities for all our citizens to obtain a better standard of living; and it should rigidly exclude unfairness or favoritism.

Later on in this message we find:

> Among the steps which should be taken at this time * * * to liberalize the foreign-residence requirement for exemption of income earned abroad.

Section 262 of the Revenue Act of 1921 approved November 23, 1921 (42 Stat. 227, 271) changed to section 251 by the Revenue Act of May 29, 1928, exempt the citizens of the United States from income tax under certain conditions. To cover this section the Deputy Commissioner of Internal Revenue issued the following decision on May 23, 1922:

> A citizen of the United States entitled to the benefits of section 262 will not be required to file returns of income to the United States unless he is in receipt of income from sources within the United States or unless he receives within the United States income from sources without the United States.
>
> Employees of the Panama Canal who receive no other income than the compensation received for services in the Canal Zone and who do not receive any portion of such compensation with the United States will not be liable for returns.

The result of the enactment of section 262 (now 251) and the decision by the Deputy Commissioner has been that practically all employees in the Canal Zone have been exempt from Federal income tax since 1921.

The employee's standard of living has been built around this exemption. During the years of rising prices and internal changes in the Canal Zone organization this exemption has been considered. Wages and charges have been set accordingly. We wish to call your attention to the fact that all items necessary for the employee to live are purchased from the Federal Government. His food, clothes, water, electricity, are purchased from the Federal Government. He also rents his house and in many cases his furniture from the Federal Government. To enact section 216 of H. R. 8920 into law effective as of 6 months ago will seriously affect the standard of living of all United States citizens on the Canal Zone. We believe it to be absolutely necessary to make other financial arrangements before such action is taken.

The Canal Zone is said to have the largest group of white people living in the Tropics. The Tropics not being the natural habitat of the white race it is necessary for these peoples to take recuperative health vacations in a temperate climate. This has been recognized by all Governors of the Panama Canal. In addition to the exemption of income tax a recruitment incentive has been added to the compensation paid Canal Zone employees. This recruitment incentive and the tax exemption just meets the costs of these recuperative health vacations. Should the employee lose this exemption he would find himself without the necessary funds to return to a temperate climate every 2 years. Failure to do this will reflect back on the service he performs until such time as it will be necessary to return him permanently to the temperate climate. When this condition is reached the Canal service will suffer and it will be found to be harder to get employees to go to the Tropics to work.

In place of "rigidly excluding unfairness or favoritism" as mentioned by the President we believe that this section, if enacted, will create a gross unfairness to the United States citizen working for the Federal Government and show a decided favoritism to the Panamanian citizen.

Section 216 applies only to the United States citizen who receives compensation from the Federal Government. The Federal employee on the Canal Zone who is a United States citizen will have to pay income tax while the United States citizen who is employed by the banks, steamship companies, and oil companies in the Canal Zone will retain their exemption.

We also wish to call to your attention the fact that the citizen of Panama who may be working for our Government on the Canal Zone in the same type position as a citizen of the United States will be receiving more take-home pay, as the United States citizen has to pay income tax while the Panamanian citizen is tax-free. This condition will soon cause internal trouble in the Canal Zone organization. It is possible that it will cause the United States citizen to resign and return to the United States leaving his position to the citizen of Panama. It is also possible in cases where the employee has many years of service with the Federal Government that he will take out Panamanian citizenship. It doesn't seem possible that the

United States Congress would pass legislation which would create a condition which would tempt a Federal employee to take out a foreign citizenship to better his living condition.

We wish to call to your attention article X of the treaty with Panama made in 1903. This article prohibits Panama from taxing the United States or its employees on the Canal Zone. It is reasonable to assume that if the United States taxes United States citizens working on the Canal Zone that the Republic of Panama will request a change in the treaty so that she may tax her citizens working on the Canal Zone. The Panama Canal being in Panamanian territory and only being leased by the United States, it will be a reasonable request to allow Panama to tax her own citizens working in Panamanian territory. Should this come about it would necessarily increase the operation cost of the Canal.

Instead of "liberalizing the foreign residence requirement for exemption of income earned abroad" as suggested by the President this section would definitely eliminate exemption for Federal employees.

The Federal employees on the Canal Zone will appreciate it if you will consider these facts and eliminate section 216 from H. R. 8920, as it applies to the Panama Canal Zone.

Gentlemen, I want to thank you for giving me this opportunity to appear before you at this time and I want to assure you that careful consideration of this matter will be appreciated by all United States citizens employed on the Panama Canal Zone.

The CHAIRMAN. Thank you very much.

Mr. Kirby, how much is this section estimated to bring into the Treasury?

Mr. KIRBY. I do not recall, Senator.

Mr. STAM. I think it is about $1,000,000.

The CHAIRMAN. It is not great, is it?

Mr. STAM. No; it is very small.

Mr. KIRBY. Senator, it is $26,000,000. You see, it applies to all the possessions, not merely to the Panama Canal Zone. I think that is the figure.

I would like to say that except with respect to the possessions, all the employees of the United States, no matter where they are employed, in foreign countries or in this country, are subject to our own taxes. There is this provision with respect to possessions, which applies not only to employees of private organizations but also the United States.

Now it was never intended, we feel, that this provision with respect to the possessions should apply to the United States employees. This provision was intended to encourage business and trade with the possessions; in other words, to encourage employees of private organizations to go.

The CHAIRMAN. I know there was some special reason in the case of Panama. It was considered that they lived in a tropical climate where they found it necessary to get out every year or so for a vacation. Now have we citizens in any other tropical areas?

Mr. KIRBY. We have citizens in Guam who are at the present time exempt even though they are employed by the United States Government. This provision is designed to bring them within the structure.

The CHAIRMAN. My point of inquiry is whether we have citizens in other tropical areas. I remember from time to time we have discussed the situation in Panama and there was some special reason Congress thought wise to take into account.

The taking out of this section has universal application, of course.

Mr. KIRBY. Yes. With respect to the United States employees located in foreign countries they are subject to tax.

The CHAIRMAN. Thank you very much for your appearance, Mr. Munro.

Mr. MUNRO. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Walter W. Craigie.

STATEMENT OF WALTER W. CRAIGIE, CHAIRMAN, MUNICIPAL SECURITIES COMMITTEE, INVESTMENT BANKERS ASSOCIATION OF AMERICA, RICHMOND, VA.

Mr. CRAIGIE. My name is Walter W. Craigie. I am chairman of the municipal securities committee of the Investment Bankers Association of America and am also senior partner of the investment banking firm of F. W. Craigie & Co., 616 East Main Street, Richmond, Va.

I should like to bring to the attention of the committee two recommendations in connection with section 202 of the proposed Revenue Act of 1950 as adopted by the House of Representatives. This section I might say was conceived in the executive session of that committee.

This section of the act deals with the treatment of bond premium in the case of dealers in tax-exempt securities. It requires amortization of such premium, without deduction for loss, in the case of all-tax-exempt bonds held more than 30 days which have a maturity call date of less than 5 years, and this section as it now stands is retroactive to January 1, 1950.

Senator KERR. Would you just enlarge on that a little bit? Will you repeat what you have just said in other words?

Mr. CRAIGIE. That means that in the ordinary course of our business and taking into consideration that we are still dealers, we buy and sell municipal bonds much as a department store would choose, on any bonds with a maturity of less than 5 years, which we buy and hold for more than 30 days, we must set up amortization schedules and we would lose any tax right of deduction for the shrinkage of the premium in those bonds during the period in which they were held.

Do I make myself clear, Senator?

Senator KERR. You evidently do but I do not quite get it.

The CHAIRMAN. Maybe the next paragraph will clarify it.

Are you quarreling with the principle here or is it just the retroactive date as of January 1, 1950?

Mr. CRAIGIE. No, sir; I am not opposing the principle. I am opposing the 30-day provision and the retroactive feature of it.

The CHAIRMAN. It seems to me that this provision does have some merit. The Ways and Means Committee suggested it or the Treasury. I think you said it was "born" in Ways and Means.

Mr. CRAIGIE. That is my understanding; yes, sir.

The CHAIRMAN. It has some merit but I do think you have a tremendous scramble here and that it would be tedious and tiresome to make it applicable to the past.

Mr. CRAIGIE. That is the point I am making, sir.

The CHAIRMAN. All right.

Mr. CRAIGIE. Let us consider first the 30-day provision.

In the ordinary course of business, time and time again we find lulls or dead spots in the market caused by changes in economic conditions, disturbing news from abroad, temporary satiation of demand, and other factors. These lulls last anywhere from 2 weeks to 2 months. Just now, due to the Korean situation, the volume of trading in municipals has been at an extremely low ebb for more than 2 weeks. It undoubtedly will continue so until the situation is clarified. Dealers who bought blocks of bonds, figuring on a ready resale, will have to carry these bonds longer than 30 days.

Ip my opinion, the 30-day period is too short to allow for the normal operations of the municipal business. I strongly recommend that the holding period be made 60 days.

Secondly, to make the provisions of this section retroactive would impose a severe and, I am quite sure, unintended hardship upon hundreds of dealers—large and small—throughout the country. In the case of my own firm, we would have to review over 500 transactions which have taken place since January 1, 1950, go back and ascertain the purchase date of each item, compute the amortized book value as of January 1, 1950, recompute it as of the date of sale, then figure the amount of profit or loss involved.

Proper preparation for the requirements of any such proposed amendment to the present law necessitates the setting up of amortization tables, in advance, for each lot of bonds to be affected. To attempt to unscramble these past transactions, figuring backward, would impose, in our own case, about 2 months' work and perhaps the employment of outside accountants. The problem would be magnified many times in the case of larger dealers.

On page 50 of Mr. Doughton's report from the Committee on Ways and Means accompanying H. R. 8920, it is stated that the bill is intended to close any so-called loopholes "* * * without unduly complicating the accounting procedures of dealers." It is apparent, therefore, that it is not the intent of the bill so to burden the dealers. However, the retroactive provision does just that.

I urge as strongly as I know how that the effective date of section 202 be made January 1, 1951, which will allow proper time for the accounting changes necessary to provide for the orderly amortization of the bonds covered by this section.

May I express my appreciation to the members of the committee for the opportunity of appearing before you.

The CHAIRMAN. Thank you, sir, for your appearance.

Mr. CRAIGIE. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Richard B. Barker.

STATEMENT OF RICHARD B. BARKER, ATTORNEY, SOUTHERN BUILDING, WASHINGTON, D. C., ON BEHALF OF THE SAND SPRINGS HOME AND WIDOWS COLONY, OF SAND SPRINGS, OKLA., ACCOMPANIED BY E. J. DOERNER, OF TULSA, OKLA., TRUSTEE, SAND SPRINGS HOME AND WIDOWS COLONY

Mr. BARKER. My name is Richard B. Barker. I am an attorney in the Southern Building, Washington, D. C. I appear here on behalf of the Sand Springs Home and Widows Colony, of Sand Springs, Okla.

Mr. E. J. Doerner, of Tulsa, Okla., a trustee of the Sand Springs Home and Widows Colony, accompanies me.

Senator KERR. Mr. Chairman, I would like to say for the record that Sand Springs Home is operated under the provision of a trust set up by a distinguished Oklahoman who died many, many years ago and has been one of the great charitable and beneficial institutions in Oklahoma. It is now.

Mr. BARKER. Mr. Chairman and members of the committee, the Sand Springs Home was set up in 1908, 1 year after Oklahoma was admitted to statehood and 5 years before any revenue laws were passed in this country. Mr. Charles Page left his entire fortune to the home.

The purpose of the home is to take care of orphans amid home surroundings, take care of them throughout the period of their youth until they are ready to go out on their own, and to take care of widows and children. It is unique. There are other organizations of this type in the country but I am sure that the Sand Springs Home is one of the earliest homes of this type.

The way in which the revenue bill affects Sand Springs Home may be considered rather minor in some respects but it is the principle of the thing that is bothersome. We are speaking of course of title III dealing with charitable organizations. Approximately 75 percent to 80 percent of the Sand Springs Home's income comes from investment income as it is defined in this bill. The balance of it comes from the operation of oil wells which are on their property and there is a rather bothersome question of whether the proceeds from their farm sales might or might not be considered unrelated business income.

That arises in this manner. They grow farm produce for the use of the home but when they have acres of land to cultivate it is more economical to cultivate the full acreage and the surplus produce they sell and use the money to buy tea and coffee, which they cannot grow, or perhaps other things, maybe not tea and coffee, for youngsters.

But it seems to us that the House bill in going into the problem has separated two types of income, the unrelated business income and the investment income. As to the unrelated business income, they propose to tax it. As to the investment income, they propose to prevent unreasonable accumulations of this income.

We sincerely think that the House bill in effect attempts to cut off the patient's arm to cure an infected finger. What difference does it make if you are trying to block this loophole what the source of income is as long as it is expended?

Now let me be specific. Senator Tobey introduced a bill in 1949 which would largely touch this situation and cover it. It was S. 1408 in the last session of the Congress. He provided that if 85 percent

of the income of a charity was spent for charitable purposes, that it should then be treated as exempt and it should be allowed to accumulate 15 percent of its income annually.

Now I do not care whether you take 15 percent or 20 percent or 12½ percent. I merely use the figure of 15 percent to illustrate the point which I am trying to get across to this committee, that it makes little difference in eliminating this loophole what the source of your revenue is as long as you block the accumulation of income.

We are certainly in favor of the major principles of this bill, that you should not allow business enterprises to plow back year after year their business income under the guise of operating a charity and do no charitable work. I am not interested in building up a future endowment for a college 30 years from now out of the current taxpayers' taxes. If you spend your income currently, then you are relieving the Government, State, and Federal, of the burden of those expenditures and you are relieving the citizens currently of that situation.

Now let us illustrate that a moment by applying the loophole provision, the loophole that existed, and how this would work on a specific illustration. Let us assume a business, say a food-manufacturing business, earns $100,000 a year. A fair capitalization of that amount might be 10 percent, or a sales value of $1,000,000. It is sold to a university for $1,000,000 which borrows the entire sum to pay for the food manufacturing plant and then continues to operate it under the present law, using the major portion of the $100,000-a-year income to pay off the purchase price. It may only expend as much as $5,000 a year of the $100,000 a year income for charitable purposes. But if it must spend 85 percent of the current income, or $85,000 a year, for charitable needs at the present time, and thus relieve the Government from the present expenditure of those obligations, no one is going to make that kind of deal because paying off the principal amount of the $1,000,000 purchase at $15,000 a year would take 66⅔ years to pay it off and the seller is not going to make the deal under those circumstances.

I admit that you probably need in this bill a provision similar to the present House provision of 424 (a) (2). It might be liberalized but the principle is valid that you should allow the setting aside of specific trust funds to accumulate for a 5-year period, or whatever is necessary, for specific, direct capital charitable expenses such as a new dormitory. But if you take care of those direct capital charitable expenditures and if you require as to the balance of the income that it be currently spent, your problem does not concern you with where the income comes from, whether it comes from unrelated business income or from investment income. As far as the competition angle is concerned, unrelated business income is competing far less with private business than investment income is competing with private investments.

The problem of competition is not the real problem in this case. Sand Springs Home in selling its milk sells it at the current price, 5 cents a quart, the same as private industry sells it at 5 cents a quart. The restaurant which was talked about earlier in the day would sell its meals at the same price as the private restaurant across the street. The real problem, gentlemen, is spending that money and not accumulating it, building up business empires like Textron, or paying off

for the next 30 years at the expense of the present taxpayers a debt that is presently incurred and not spend the money for charitable purposes.

After all, if you raise $100,000,000 as is estimated by the Treasury through this title III provision, it means that the private charities will just have $100,000,000 less to spend. Because the charities must be carried on, that means that the Government in taking over that $100,000,000 would have the expenses of collection of the taxes and the expenses of spending the money, which would make it a far less economical charity in my opinion than to have the private charities do it.

It seems to me that your problems will become minutiae if you will go at this entire situation from the angle of spending the money currently rather than accumulating it for future distribution and potential future benefit of the charity.

Now I mentioned section 424 (a) (2) reasonable allowances, which is in the Treasury bill for capital improvements. But other than that I think all your problems would be solved.

Senator KERR. What provision would you change or what change would you suggest?

Mr. BARKER. I would take Senator Tobey's bill which is a very short bill.

Senator KERR. With reference to the bill before us.

Mr. BARKER. I would eliminate the whole title III and start anew, Senator Kerr. Take Senator Tobey's bill of a year ago, S. 1408, which is two pages long. I would want some sort of provision 424 (a) (2) in there.

I have no particular objection to the Treasury's draft of it but then I think you could avoid all these problems of changing charters that have been brought up, the problems of lease-backs, changing trusts.

You really have one of the most complicated bills in my opinion that I have ever seen handled before the Congress in some time with the possible exception of section 722. I might say, Senator Kerr, that I am a practicing tax lawyer, have done it for 20 years, and possibly ought to have my head examined, but I will venture the statement that if the present House bill is enacted the tax lawyers will have the most profitable period of litigation for the next decade that we have ever seen.

Senator KERR. You say title III is the most complicated piece of tax legislation you have ever seen?

Mr. BARKER. With the possible exception of section 722 in its administration. I think it would be far more simple if it went at it from the angle of spending the money. Is that not your real problem?

The CHAIRMAN. Is there anything further?

Senator KERR. I believe not.

Mr. BARKER. I might mention one thing, Senator Kerr. With respect to your discussion with Governor Stassen this morning regarding lease-backs, you are going to have in that problem the unscrupulous charity that is going to find loopholes large enough to drive a horse and wagon through in this bill. In other words, let us take the question of leaseholds. If they are unscrupulous, they are going to come as close to the dividing line of what is an exorbitant rental as they possibly can which will make for litigation.

Let us take one illustration, if I may just give it. Let us assume that I now have a business enterprise run by a charity and so I am going to incorporate it so as to get investment income from it. I can either set that up and certainly I would have this privilege as to my capital structure with 80-percent debenture bonds and 20-percent common stock, or I could set it up with 80-percent common stock and 20-percent debenture bonds. Now my bond interest is deductible by the corporation and is not subject to income tax. It comes to me as investment income and therefore it is not subject to tax.

Now you cannot criticize, in setting up a corporate structure, which method of capitalization they use but you are going to find the unscrupulous charity is going to come to just as close that number line as they possibly can in the form of that corporate set-up. You are going to be fraught with litigation for quite a period of time in straightening out the complicated provisions of this bill because the unscrupulous charity will again try to find loopholes in it and you are going to make the innocent suffer with the guilty.

May I ask permission to file this prepared statement?

The CHAIRMAN. Yes; and thank you very much, Mr. Barker.

(The statement referred to follows:)

STATEMENT OF RICHARD B. BARKER, ATTORNEY, ON BEHALF OF SAND SPRINGS HOME AND WIDOWS COLONY, SAND SPRINGS, OKLA.

Mr. Chairman and members of the Senate Finance Committee, my name is Richard B. Barker. I am an attorney with my office in the Southern Building, Washington, D. C. I am appearing here on behalf of the Sand Springs Home and Widows Colony of Sand Springs, Okla. My firm, or its predecessors, has represented the Sand Springs Home in tax matters since approximately 1915 I am appearing to speak with respect to title III dealing with the taxing of income of exempt organizations.

Sand Springs Home was founded by Mr. Charles Page in June 1908, 1 year after Oklahoma was admitted to statehood. It has no capital stock and is run by five trustees who are selected by the grand master of Oklahoma Masonry. Mr. Page turned over his entire fortune for the establishment of this home. Its endowment is perpetual and private and it neither solicits nor accepts outside aid. Its sole purpose is to care for orphan children until they are self-supporting, and the care of widows and their families in cottages which are furnished for these families. The home is nonsectarian, but the children are reared in the faith of their fathers and attend their respective churches regularly. The children are cared for through the public schools, high school, and are assisted in obtaining higher educational or vocational training in the colleges of their own selection. The home maintains the services of two doctors and a dentist and the important factor about this home is that it assimilates home life for its children rather than institutional care; the families are kept together and a widow is encouraged to make herself independent to whatever extent possible while living in the colony.

Attached to my printed statement is a summary sheet, marked "Exhibit A," which outlines in greater detail the activities and purposes of the home.

For our last operating year, our expenditures for charitable purposes were approximately $155,000.

We are interested in this bill because, while approximately 80 percent of our income comes from investment income, 20 percent is derived from so-called unrelated income, namely, the operation of oil wells and possibly from the operations of various farms which we use primarily to produce food for the home, but sell off the excess produce, using the proceeds to help buy food for the home which we cannot raise ourselves.

Unless Congress wants to depart from the age-old principle of encouraging private charities to relieve the governments of many burdens that would otherwise fall upon them, it should not enact legislation which will necessarily reduce the charitable expenditures of eleemosynary institutions.

It is one thing to put a limit on the tax-free accumulation of funds which will actually help the beneficiaries (and thus actually help the public treasuries). Something like this is provided in section 424 of the bill putting a ceiling on tax-

free accumulation of investment income which in many ways might be paralleled to section 102 of the Internal Revenue Code, which imposes a penalty tax on the accumulation by business corporations of funds they should distribute to stockholders.

But there is no sound reason for drawing a distinction between income derived from investment in business and income derived from investment in stocks, bonds, rental properties, and properties yielding royalties. The eleemosynary corporations which invest their endowments in bonds compete in the money market with nonexempt purchasers of bonds just as much as those which invest in businesses compete with nonexemtp businesses.

As a practical matter, the total amount of eleemosynary funds invested in trade or business is infinitesimal compared with the amount of such funds invested in assets yielding what the tax bill defines as investment income. If manufacturers and traders can complain that they have to compete with a few eleemosynary corporations which have the advantage of tax exemption, equally investors in stocks, bonds, and rental and royalty yielding properties can complain to many hundreds of times the same extent.

To the extent that income is actually used in eleemosynary work—education of students, healing of the sick, relief of the poor, prevention of cruelty, etc., the old established policy of encouragement by the Government should continue. This is done in part in section 424 of the bill with respect to investment income, but not in section 422 with respect to business income.

If the principle of section 424 were made applicable to all income, the complicated problems that will necessarily arise under the bill would be avoided—for example, when an orphan asylum operates a farm, one-third of the produce of which is consumed by the inmates and personnel of the institution and the other two-thirds is sold for the purpose of buying other foods for those people (which cannot be raised on that farm).

The fears expressed in the Ways and Means Committee report of all business eventually getting into the hands of eleemosynary institutions would disappear if business income were taxed in the same manner and to the same extent as accumulated investment income under section 424 of title III.

A trust or corporation carrying on an active business, which devotes the entire net income from that business to relief of the poor or assistance of the public schools, serves to just that extent to relieve the taxpayers of the cost of doing the same thing out of public treasuries. It should not be discouraged. If excessive accumulation is taxed, there will be no danger to business generally or to the public.

The instances which have caused the outcry that precipitated the proposals in the tax bill have been exaggerated cases where so-called charitable institutions or trusts have not been disbursing their income to charity but have been reinvesting it in constantly expanding business enterprises or have been using it to pay off indebtedness incurred for the purpose of acquiring the businesses themselves.

If the law taxed excessive accumulated income from business it would certainly prevent the creation or enlargement of these monstrosities in the future.

What the present proposal, in effect, would do would be to force charities which are now operating businesses and using the entire profits for charitable work, to sell out their businesses and go into investments, which would yield them from one-fourth to one-half as much to use for their charitable works.

If an orphan asylum supported by business profits has to pay a tax amounting to 41 percent of its profits, it will have to reduce its support of orphans by 41 percent. This burden will fall back on the local governments.

As far as competition with taxed business is concerned, the complaint is on the part of manufacturers and merchants who say they have to meet prices determined by institutions which do not have to figure taxes in their cost of production. This competition unquestionably benefits the public to the extent that it has any appreciable effect. As a matter of fact, it probably has no appreciable effect because the institutions are just as anxious for profits as are their competitors, and are inclined to charge all the traffic will bear, in the light of the competition by the taxed competitors. If a farmer can get 5 cents a quart for his milk from the dairies, the farm operated by an orphanage is not likely to sell its milk to the same dairies for less.

We have stated that the only real evil or loophole that Congress should plug in connection with section 101 organizations is the prevention of unreasonable accumulation of income and the investment of that income in unrelated business activities. We have suggested that this can be done with respect to unrelated business income in the same manner as it is done under section 424 of the bill with

respect to investment income. Personally, I think that there are much simpler and better methods of handling the situation than is presently proposed by the very complicated provisions of the House bill. Why not simply state that only a certain yearly percentage of either business or investment income can be accumulated other than amounts placed in so-called 5-year trusts, such as are provided for by section 424 (a) (2) of the bill—which provides that income can be accumulated for a charitable capital project. A bill embodying this idea was introduced in the Senate last year by Senator Tobey, and in the House by Mr. Lane (S. 1408, H. R. 3898). Senator Tobey and Mr. Lane suggested a maximum annual accumulation percentage of 15 percent. Furthermore, this suggestion should be applicable to all charitable organizations, i. e., churches, as well as other charities. The present House bill provides a wide-open loophole for the establishment of church-operated business enterprises. Let us see how such a simplified provision would work to prevent the real evil at which the present bill is directed. Assume a private business earning $100,000 a year. Let us assume it can be sold at a capitalization figure of 10 percent or for a million dollars. If some educational institution tries to buy it on borrowed funds and use the earnings to pay off the purchase debt, it would immediately be confronted with the fact that, if it wants to remain tax-exempt, it can only pay $15,000 a year on the $1,000,000 purchase price. At that rate it would take two-thirds of a century to pay the debt and such a foolish deal will never be made.

This august body is faced with the problem that charities must be supported either by the public or by the Government. The House bill is bound to increase the share of the burden that will have to be assumed by the Government. Is it going to be efficient operation for the Government to raise an additional $100,000,000 of taxes from charitable organizations and simultaneously increase governmental charity work by the same amount plus the extra costs of administering this exceedingly complex tax bill. Plug the loophole but don't cut off the patient's arm to cure an infected finger.

Frankly, I am a tax lawyer and make my living out of tax litigation. I can assure you from a purely personal financial viewpoint, I could wish for nothing better than the passage of the present House bill insofar as it relates to the charitable situation. The bill is fraught with litigation possibilities for the next decade.

Founded.—Sand Springs Home was founded by the late Charles Page on June 2, 1908, 1 year after statehood. No capital stock. Charles Page said "the kids are its capital stock."

Incorporated.—It was incorporated on August 9, 1912. (Oklahoma was then struggling with the writing of its own laws and it took 4 years to work out a corporate plan for Sand Springs Home under the laws of the State of Oklahoma. Charles Page, until the day he died, however, was constantly trying to improve the corporate foundation to insure its perpetuity.)

Endowment.—Perpetual and private. Neither solicits nor accepts outside aid.

Purposes.—Care and rearing of orphaned children, to the age of 18, or until they are self-supporting, under a plan that is as nearly like a normal family life as possible. And the care of widows and their families of children (cottages are furnished for these families).

Nonsectarian.—Children are reared "in the faith of their fathers" and attend their respective churches regularly. Presently, we have 44 Baptists, 4 Methodists, 7 Church of Christ, 16 Presbyterians, 3 Jehovah's Witnesses, 7 Christian Church, and 3 with the Salvation Army.

Education.—Public schools and after high school, if they wish higher educational or vocational training, the schools of their own selection. (At present, we have 2 boys in Northeastern State College, Oklahoma, 1 in State Teacher's College, Kansas, and 2 girls, Oklahoma College for Women, 2 who intend to enroll this fall in some college, and 2 girls in nurse's training, St. John's and Hillcrest Memorial Hospitals.)

Medical care.—Two doctors receive monthly salary. Children are sent regularly to dentist. Receive hospital care (one youngster was in the hospital for 1½ years). As proof of the extraordinary care that the children receive, during the 42 years of the home's existence, only three children have died while residents of Sand Springs Home, one of which was an accidental death.

Number cared for home and colony, in 42 years.—The home has reared approximately 535 children during the 42 years. The Widows Colony has cared for approximately 1,400 widows and children. The Widows Colony is a separate department. Mothers are furnished cottages rent-free and what food they need, if they cannot work. If they wish to find employment, a nursery cares for their children.

Family life fostered.—The normal family life, in both the colony and the home is preserved and fostered as nearly as possible. One widow continued her education and graduated with one of her daughters from the local high school.

Aid is offered to those in Oklahoma first and then to outside the State. We now have children from 10 counties in the State of Oklahoma and we have 4 children from Kansas, 2 from Arkansas, and 4 from Texas.

Institutional atmosphere is eliminated wherever possible. Children dress as individuals, grow up as families, have their own family at individual tables in the dining room, and the sisterhood and brotherhood are maintained to an astonishing degree.

Homecoming time finds children from nearly every State in the Union present. There are children abroad, too, since the war. The home welcomes its former children, grandchildren and greatgrandchildren, on these occasions.

Military service.—The home had boys in the First World War, as well as World War II. Approximately 65 boys were in the last war and only 2 were killed, 1 on Normandy and 1 on Bataan. Nearly all were in the foreign fields.

The CHAIRMAN. Mr. Curtis Morris.

STATEMENT OF CURTIS MORRIS, HOUSTON, TEX., IN BEHALF OF THE EAST TEXAS CHAMBER OF COMMERCE, LONGVIEW, TEX.

Mr. MORRIS. Mr. Chairman and gentlemen of the committee, my name is Curtis Morris. My home is Houston, Tex. I appear here as a spokesman for the East Texas Chamber of Commerce and the Council of State Chambers of Commerce with which it is affiliated. I am a member of the Federal taxation committee of the latter.

As the secretary-treasurer of the King Tool Co., Inc., Longview, Tex., whose net worth is approximately $120,000, I might be thought of as representing small business.

As a vice president of Transcontinental Gas Pipe Line Corp., Houston, a $20,000,000 enterprise, I am identified with what would be considered a large business.

Businessmen in Texas would agree that wartime excises in a time of peace should be revised downward. These excises are direct charges on individual people as consumers. They make the business life of many affected enterprises difficult.

Federal taxes other than excises are still very high, too. Personal income taxes continue high, as we all know, ranging from 16.6 to 82.1 percent. Corporate income taxes at a maximum 38-percent rate never before have been held so high after a war.

Let me get down to earth with you gentlemen on this matter of Federal corporate taxes.

Corporations are people, too. The little King Tool Co. is owned by three former neighbors and myself. We four are average consuming, voting citizens finding it difficult to make ends meet.

Transcontinental Gas Pipe Line Corp. is owned by approximately 8,000 different people. Over half of these own not more than 100 shares each. One out of three of Transcontinental's owners are women.

Now the owners of corporate businesses expect income. If such income is earned it is distributed in whole or in part to the owners as dividends.

On each $100 Transcontinental will earn, at present rates, the Federal Government will take $38. Suppose all of the balance of $62 were distributed to the owners. Then the owners as individuals must pay Federal taxes a second time on the identical income at

personal income rates. Where the effective personal tax rate for individual owners is as much as 16¾ percent the Federal Government will have taken more than one-half of the owners' income in Federal income taxes.

Women and children whose income is derived from ownership of corporate businesses are entitled to the same consideration of their National Government as any other citizens. Income in the form of wages, salaries, and interest on bonds is not double taxed.

American consumers would rejoice at relief from excise taxes. It is proposed in H. R. 8920 to afford some relief. But this same bill denies any relief to those taxpaying voting citizens, surely among our most responsible people, whose incomes are derived from ownership in corporate businesses.

As a matter of fact, gentlemen, it is proposed to increase the Federal tax burden on people who own corporate businesses by raising the maximum corporate rate from 38 to 41 percent.

Let's look at an actual case of what the proposed increase in Federal corporate rates will do to people who may own not a single share of a corporate business. Transcontinental, a new business—entirely financed by private funds I may add—begins this winter the sale of natural gas in the Philadelphia-New Jersey-metropolitan New York area.

As an interstate natural gas carrier our company is regulated by the Federal Power Commission under the provisions of the Natural Gas Act of 1938. Our company like all other natural gas carriers is permitted to earn 6 percent on its investment after Federal taxes. If Federal corporate rates are increased from 38 percent to 41 percent, an 8 percent increase by the way, the price at which we sell gas must go up.

Consequently fuel, something that every family must have, must go up in price to rich and poor alike in the Nation's most densely populated area.

This actual case, clearer than most, is only typical of what must result to consumers when an 8 percent increase in Federal taxes occurs. All taxes in the final analysis are a drain on the individual family's savings or an automatic limitation on the family's current consumption. What the families of America pay in Federal taxes, excises, or corporate income, cannot be spent on the families' food, clothing, housing, medical care, and education.

What have the little corporations like my King Tool Co. particurarly to kick about. True, the rate on corporations whose income are under $166,666.66 are not raised under H. R. 8920.

Our tax liabilities for current taxes are not changed. But there is proposed a speed-up on the payment of corporate income taxes. The effect of this for the next 4½ years to the little King Tool Co. is to dig up the cash to pay 11 percent of our current tax liability. Accounts receivable are not taken by the Bureau of Internal Revenue in payment. In my opinion little companies are going to be compelled to increase their net working capital.

I respectfully suggest that you gentlemen in your search for tax relief give the same consideration to the people who own corporate businesses as those whose incomes are derived in some other way.

Thank you all very kindly.

The CHAIRMAN. Thank you very much, Mr. Morris.

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Mr. Alfred Boedtker who was scheduled to appear today in behalf of Volkart Bros. Co. of New York, was unable to make plane connections. In lieu of his personal appearance his statement is herewith submitted for the record.

(The statement referred to above and other material submitted for the record is as follows:)

STATEMENT OF ALFRED BOEDTKER

My name is Alfred Boedtker. I am a citizen of the United States and a partner of Volkart Bros. Co., and president of Volkart Bros., Inc., both of New York City.

I have asked permission to appear before this committee in connection with Senator Gillette's proposed amendment to tax bill H. R. 8920 and I appreciate the fact that the committee has been able to give me a few moment's time.

I understand that Senator Gillette proposes a tax of 30 percent on the capital gains of nonresident alien individuals not engaged in trade or business in the United States. This proposal would tax profits realized by nonresident aliens trading on commodity exchanges located in the United States.

This committee, of course, is familiar with President Truman's expressed desire, commonly referred to as point 4, for the furtherance of foreign investment by nationals of the United States. We are also very much interested in keeping free enterprise in as many countries as possible and discouraging socialistic and communistic ways of doing business. The present serious times are, I believe, demonstrating the correctness of the administration's internationalist point of view, and one of the foundation stones, in my opinion, to a peaceful world is the development of free trade among the nations of the world with due regard to the rights of all nationals. It is easy to understand that nationals of the United States should feel that discrimination exists if those who are nonresidents of the United States and alien nationals pay less taxes upon income from sources in the United States than do United States residents and citizens.

The theory of taxation in the United States has developed, as this committee knows, on the basis of citizenship rather than residence, except for the comparatively recent amendments of the tax statutes which have exempted American citizens from income tax upon income from personal services rendered in foreign lands for an extended period of residence therein. The foreign taxation, on the other hand, has leaned more toward a theory based on residence and it is therefore difficult for foreigners to easily appreciate the fact that if they are not residents of the United States they must pay taxes upon income from sources in the United States.

I personally believe that in the development of the world economy to which I have referred, it would be better if all countries would execute tax treaties such as have already been approved and are in force in six countries, as the committee knows, namely, Canada, Denmark, France, Netherlands, Sweden, and the United Kingdom. I understand that there have been signed, awaiting ratification, tax treaties with six additional countries—Belgium, Greece, New Zealand, Norway, Ireland, and the Union of South Africa; and that negotiations are now under way with the Governments of Brazil, Colombia, Cuba, Mexico, and Switzerland looking to the same end.

I should like to suggest, therefore, that this committee defer the suggestion of Senator Gillette pending the ratification of treaties with the 11 countries that I have last referred to, as I believe that such treaties will be ratified in the not too distant future, probably within a year and perhaps at the utmost, 2 years. One of my reasons for this suggestion is that I believe that if we start taxing profits on commodity exchanges of citizens of the last-named 11 countries through the enactment of a bill passed this year, it is quite probable that the nationals of those countries would immediately discontinue transacting business on commodity exchanges in the United States pending the ratification of the tax treaties when thereafter such nationals could probably resume trading in the United States under the benefits of such tax treaties. The result would be the loss of business to the United States during this period of time without any appreciable revenue for the Internal Revenue Department. Furthermore, the Internal Revenue Department would have to go into a lengthy procedure of asking for tax returns, etc., only to withdraw again as soon as the tax treaties have been concluded.

My other point is that fixing a flat tax of 30 percent on capital gains of all alien exporters and importers trading on United States commodity exchanges is an arbitrary measure of tax not necessarily related to the amount of the actual in-

come of the foreign trader. Such foreign exporters and importers may, in fact, be realizing a loss on their hedging transactions on a United States commodity exchange or making a substantial profit, which, were they citizens and residents of the United States, would render them liable to a tax in a bracket returning much more than 30 percent. In other words, my point in that connection is that if the Congress feels that it is not right to exempt foreign nationals having income from sources in the United States from taxation and that they should pay the same taxes which an American citizen pays, then by use of the tax treaties to which I have referred the Congress should be able to obtain information as to the true income of the foreign national so as to fix his tax on an equitable basis, namely, a large tax if he has a large income, which would put him in the higher brackets which an American citizen might be in, or exempt him or reduce his tax to lower brackets if in fact he has made a loss in hedging transactions or through the final sale of the actual commodity hedged.

In other words, I believe the Congress should not act hastily or adopt a tax of a fixed amount as the perhaps so-called easiest solution of this problem of foreign trade, but should take time and study what should be properly done. I believe that a substantial proportion of commodities traded in on the various exchanges in the United States represent legitimate transactions and it is necessary to have information as to the profit or loss from the closed transaction before deciding whether the individual has made an actual profit.

I realize that under income tax laws prior to 1936 income received from United States sources by nonresident aliens included gains realized from hedging transactions, but at the same time nonresident aliens were then permitted within certain limitations to deduct from such hedge profits actual losses incurred for spot commodity transactions. I believe that the Treasury Department eliminated the taxation of such capital gains, including gains from hedge transactions, because of the difficulty at that time in administering the act. Such difficulty, I believe, will be eliminated when the tax treaties are in effect. If it should now become the policy of the United States to equitably tax nonresident aliens upon their true income from sources in the United States, the Tax Act should be amended only after thorough consideration and study of the possibilities of the future. Otherwise, foreign trade may be seriously disrupted with no appreciable benefit to the United States Treasury.

In taxing domestic firms, hedging operations are not considered capital gains or losses. Taxes are paid on the net profit. If we tax nonresident alien firms on their hedging profit on commodity exchanges in the United States of America without taking into consideration the loss which they made on the actual commodity abroad, I am sure we would force them to discontinue using our commodity exchanges. The danger is that if we make it impossible for nonresident alien firms to continue exporting and importing because we deprive them of the use of commodity exchanges in the United States of America, we encourage foreign governments to set up governmental agencies to take over the export and import business, such as we have them in socialistic and communistic countries.

I believe that in theory and actual practice what the Treasury is attempting to do through these tax treaties is the proper method of procedure, as then the nationals of all countries will pay, I hope, the correct tax on their income from all sources with due regard or credit for the taxes he or she have to pay in each country from which they receive income.

Thank you very much for hearing me.

CARNEGIE CORPORATION OF NEW YORK,
New York 18, N. Y., July 13, 1950.

Re revenue bill of 1950 (H. R. 8920)

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
United States Senate, Washington, D. C.

SIR: The purpose of this letter is to call to the attention of your committee certain inequities which might result in the case of this corporation if section 424 of the above bill, taxing accumulated investment income of certain exempt organizations, should become law.

This corporation was established by Andrew Carnegie in 1911 as the culmination of his philanthropic program. Its purpose is the advancement and diffusion of knowledge and understanding among the people of the United States and the

British Dominions and Colonies. Its basic endowment is $135,000,000. Income only is subject to appropriation by the trustees. In the past the trustees have regularly appropriated all the annual income of the corporation for educational purposes; but, we are advised, certain of such appropriations might not be deductible from gross investment income under section 424 as presently drafted.

A substantial portion of the corporation's appropriations have been made to two other tax-exempt organizations, for the purpose of assisting in the provision of retirement benefits for teachers connected with institutions of higher learning. This we believe to be an important contribution to the cause of education. The facts as to such appropriations, and the problems with respect thereto presented by the pending bill, are summarized below.

CARNEGIE FOUNDATION FOR THE ADVANCEMENT OF TEACHING

The foundation, which was established by Mr. Carnegie in 1908 and to which he gave sums aggregating $15,000,000, is primarily engaged in providing free pensions for teachers who were connected with institutions of higher learning during the first 10 years of the foundation's history.

The foundation's funds proved to be inadequate for the pension load which it undertook, and it turned to this corporation for assistance. The corporation has contributed outright to the foundation sums aggregating $18,900,000. In addition, the corporation has committed itself to advance up to $15,000,000 to the foundation, without interest, over a long period of time, and under this commitment advances of nearly $4,500,000 have already been made. All these gifts and advances have been made, out of the corporation's income, in order that the foundation might meet its commitments to teachers.

The corporation is advised by counsel that there is substantial doubt whether any further advances made to the foundation, after the effective date of the proposed act, would be deductible in computing the accumulated investment income of the corporation under section 424 thereof, notwithstanding the fact that such advances are made to an exempt institution, that they are non-interest-bearing and that repayment is to be deferred until after the foundation is in a position to discharge all its obligations to teachers.

Arguably, such advances would be deductible as "expenditures made during the taxable year which are properly chargeable to capital account," since such expenditures would not be an investment for the production of income. Counsel are by no means satisfied that advances to the foundation would be so considered; and, of course, if the corporation were to be taxed on its income to the extent of the advances which it makes to the foundation, this would impair pro tanto its ability to continue to devote its income to educational purposes.

TEACHERS INSURANCE AND ANNUITY ASSOCIATION

The association is a nonprofit insurance company, which was organized in 1918 and is primarily engaged in writing insurance and annuity contracts for teachers in institutions of higher learning.

In the past this Corporation has contributed over $7,600,000 to the association, by way of capital contributions, contributions for expenses of servicing contracts, and for strengthening the reserves of the association. In addition, in 1948 this corporation appropriated the sum of $5,000,000, payable to the association in annual installments over a 5-year period beginning 1948–49, for the purpose of strengthening the reserves supporting annuity contracts issued by the association prior to 1936.

The corporation is advised by counsel that there is considerable doubt whether its gifts to the association for the purposes of strengthening the association's reserves would be deductible in computing the accumulated income of the corporation in view of the fact that section 424 (d) (7) provides that a gift to another organization which is subject to that section (as the association is) may not be deducted by the donor unless such gift is earmarked "to be expended" by the donee for a specific project.

We think it is arguable that such gifts to the association for the purpose of strengthening its reserves for specific contracts are earmarked "to be expended" by the donee for a specific project; but whether such a construction would be adopted by the Treasury or the courts is at least open to doubt and the risk that a contrary construction would be adopted is, we submit, a risk to which it is not necessary that the corporation be subjected in order to accomplish the purposes of the proposed legislation.

RECOMMENDATIONS

We understand that the Teachers Insurance and Annuity Association is itself asking your committee to amend section 424 (a) (1) (B) so as to add to the exemption for educational organizations a provision exempting any "organization primarily engaged in providing retirement benefits for the employees of such educational organizations." This corporation endorses the amendment proposed by the association. However, such amendment would not solve the corporation's problems with respect to the Carnegie Foundation since its payments to the foundation are made in the form of advances, repayable many years hence, rather than as gifts.

We therefore respectfully suggest that consideration be given to the possibility of amending the bill so as to permit the deduction from gross investment income of amounts advanced to another tax-exempt organization for the purpose of paying, or providing reserves for the payment of, obligations contracted by the donee in the course of its tax-exempt operations prior to the date of such advances.

These suggested changes, we believe, would not in any way prevent the accomplishment of the purposes of the proposed legislation, with which purposes we are in hearty agreement. The Carnegie Corp. has for years followed the policy of distributing all its income for the purposes for which it was founded. Our objection is to those provisions of the bill which might impose a tax upon the corporation despite its adherence to this policy.

Respectfully,

CHARLES DOLLARD, *President.*

HERRICK, SMITH, DONALD, FARLEY & KETCHUM,
Boston 10, July 7, 1950.

Re H. R. 8920.

Hon. WALTER F. GEORGE,
Chairman Senate Finance Committee,
Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: I, as a trustee of the Massachusetts General Hospital, am writing you this letter as my brief of the points about H. R. 8920 about which I talked with you in your office last Thursday.

First: I entirely endorse the suggestion made by President Killian of the Massachusetts Institute of Technology that it would cost little in taxes and save large expenses to eliminate the tax on unrelated business net income of tax-exempt institutions—particularly hospitals—leaving the tax on feeder organizations. I will not here repeat in detail President Killian's argument which has been submitted to you.

Second: As an example of the difficulty of knowing certainly what is unrelated business net income, I ask consideration of the following. Nearly all nonprofit hospitals have some patients of means who pay more than the cost of their hospital care. The aggregate of such excess is in most cases much more than offset by the deficit incurred on account of those patients who pay less than the cost of their hospital care. Could an eager member of the Treasury Department find a proper basis under the wording of the present bill for seeking a tax on the above excess on the ground that the care of well-to-do patients is not part of the charitable work of the hospital and merely furnishes some income to support such charitable work? Under present circumstances when nearly all hospitals are operating at substantial deficits, such a tax would be very serious.

Possibly a clear statement in the record of the position of the committee on this point might tend to obviate this danger. If not so met, there should be a clear statement in the bill, perhaps under sec. 422 (a) (see p. 99 of the bill) stating that amounts received by hospitals for care and treatment of patients shall always be excluded from unrelated business net income. Another method of meeting the point would be to add at the end of sec. 422 (b) (2) (see p. 102, line 24) the following words, "including, without implied limitation, care and treatment by a hospital of patients paying more than the full cost thereof."

Third: I entirely endorse the suggestion made by President Killian of the Massachusetts Institute of Technology that the bill in its present form involves a danger that gains from selling investment securities might be taxed and that the following remedy would be appropriate.

Add to the new section 422 (a) (1) (see p. 99, line 14) after the word "royalties" the following words "and all gains or losses from the sale, exchange or other disposition of securities."

Fourth: The bill in three places exempts certain specified institutions from certain burdensome requirements.

See page 106, line 13 et seq. (accumulated investment income provision).

See page 115, line 19 et seq. (amendment of sec. 101 (c)).

See page 124, line 11 et seq. (new provision re deductibility of gifts).

In the first two cases these exemptions are: (A) religious organizations, (B) certain education institutions, (C) organizations supported in whole or in part by Government or primarily by general public gifts, and (D) organizations controlled, etc., or principally supported by an exempt religious organization other than a trust. In the third case there are those same exemptions plus the exemption of a fraternal organization.

I believe that it is most important that nonprofit hospitals be added as an additional exemption.

In each community throughout the Nation, the nonprofit hospital is likely to be the outstanding charity, or certainly one of the outstanding charities. There is no need of classing it less favorably in the law than the organizations exempt under A, B, C and D. The nonprofit hospitals are not the charities of which the Government is afraid.

Furthermore in this matter the bill—very probably unintentionally—now makes a curious distinction. There are probably about 5,000 nonprofit hospitals in the Nation today. Of these, about 2,000 are owned by the Government and about 1,000 are controlled by religious organizations so that those two classes of hospitals are already exempt under the three provisions above mentioned. Certainly the remaining 2,000 nonprofit hospitals should not be the only nonprofit hospitals which are not exempted from these burdensome requirements.

The remedy for this defect would be to add in each of the above instances after the clause exempting certain educational organizations, another exemption reading as follows:

"A hospital which normally maintains beds for patients and which would fall within sec. 101 (6) as it read just before the amendment made by this Act."

Fifth: If the amendment suggested in fourth above is made, the following point is not important for hospitals. Otherwise it is most important, and it may be important for other charities.

In section 331 is a proposed amendment inserting section 3810 which in clause (b) (1) thereof (see p. 125 line 7) specifies that no gift or bequest to an organization shall be deductible unless the instrument under which the organization is operated provides five different specifications set forth in detail in the bill.

In the case of the Massachusetts General Hospital, it is not clear what this instrument would be. I fear it might be its act of incorporation. This act is a special act of the Massachusetts Legislature passed originally in 1810 to which there have been a few amendments.

The five different specifications could be added to that act only by another act of the legislature and it is not at all clear when or whether such legislative action could be obtained. Failure to obtain it might cost the hospital many substantial gifts.

An amendment of the above clause should be made by inserting after the word "administered", the words "or in its bylaws."

I entirely endorse the suggestion made by President Killian of the Massachusetts Institute of Technology to prevent the proposed withholding of 10 percent on all dividends from having the effect—as it would in its present form—of depriving the exempt hospital of 10 percent of its dividends for a period of more than 6 months. Mr. Killian's suggestion of a new form of refund which would greatly shorten the period during which the exempt hospital would be deprived of this money, seems most appropriate.

The references to page and line in the above letter are to the draft of the bill reported to the Committee of the Whole House on June 23.

Under separate cover I am sending you 80 copies of this letter.

Yours very truly,

PHILLIPS KETCHUM,
Trustee, The Massachusetts General Hospital.

ASSOCIATION OF AMERICAN COLLEGES,
Washington 6, D. C., July 12, 1950.

Senator WALTER F. GEORGE,
Chairman, Committee on Finance,
United States Senate, Washington, D. C.

DEAR SENATOR GEORGE: Through the cooperation of several interested St. Louis banker friends of Secretary of the Treasury John W. Snyder, we had a conference with him in his office this morning on the enclosed proposal for a minor amendment to section 120 of the Internal Revenue Code which refers to deductions for contributions to educational and other charitable institutions. When we left he seemed sympathetic with the minor amendments proposed.

Before committing himself fully he desires further information from his staff to whom he referred us. We conferred with Assistant Secretary of the Treasury John S. Graham, who is a native of Winston-Salem and friendly to Wake Forest College whose friends are deeply concerned with this amendment. Secretary Graham's assistant, L. Laszlo Ecker-Racz, stated that the second amendment proposed was quite in order but was dubious about reducing the period from "ten" to "two" preceding taxable years. We got the impression that if the section were amended to substitute "five" for "ten" he would be more sympathetic.

The consensus now seems to be that with the deteriorating situation in Korea, H. R. 8920 might be shelved, or at least that part which refers to reductions in excise taxes.

Messrs. Graham and Ecker-Racz conceded that amended section 120 could be properly incorporated in H. R. 8920 by the Senate Committee on Finance or it could be introduced in a separate bill. In fact, the proposed amendment without change of time limit was passed by the House in the last Congress.

In our previous discussion of this matter we believe we made it clear that we are not asking for any change in the law but simply a clarification and a slight change in the time limit which would be helpful to the colleges. Mr. Snyder's assistants conceded also that the amount involved would be a mere drop in the bucket as far as the Federal tax revenues are concerned.

From the attitude of the committee members with whom I have talked personally and whom I have heard in discussion in recent open hearings I feel they are fully in sympathy with the importance of/the dual type of higher education that prevails in our country. We need strong State-supported colleges and universities as well as those under independent control. When the latter group pass out of the picture we are obviously headed for a totalitarian type of government.

Faithfully yours,

GUY E. SNAVELY.

PROPOSED AMENDMENT TO SECTION 120 OF THE INTERNAL REVENUE CODE AND MEMORANDUM IN SUPPORT THEREOF

It is proposed that section 120 of the Internal Revenue Code be amended to read as follows:

"SEC. 120. UNLIMITED DEDUCTION FOR CHARITABLE AND OTHER CONTRIBUTIONS.—In the case of an individual if in the taxable year and in each of the [ten] *two* preceding taxable years the amount of the contributions or gifts described in section 23 (o) (or corresponding provisions of prior revenue Acts) plus the amount of income, war-profits, or excess-profits taxes paid during such year in respect *of such year and* of preceding taxable years, exceeds 90 per centum of the taxpayer's net income for each such year, as computed without the benefit of the applicable subsection, then the 15 per centum limit imposed by section 23 (o) shall not be applicable."

The word in brackets indicates an omission from the Statute as it is now contained in the Internal Revenue Code and the words italicized indicate insertions to such statute.

The reasons for the suggested amendment are as follows:

1. *The law in its present form is without meaning.*—Section 120 as it is now contained in the Internal Revenue Code provides that if an individual taxpayer's charitable contributions during the taxable year and in each of the 10 preceding taxable years plus the amount of the income taxes paid by such taxpayer during such year "in respect of preceding taxable years" exceed 90 percent of the taxpayer's net income for each such year (such net income to be computed without the benefit of the charitable deductions) the 15 percent limitation on charitable deductions shall not be applicable.

Prior to the enactment of the Current Tax Payment Act of 1943, section 120 had meaning and was theoretically workable because income taxes paid by an individual during the year were paid in respect of income of a prior year. However, with the enactment of the Current Tax Payment Act of 1943, the section ceased to have any practical meaning (except perhaps to the limited extent of the fourth installment payment on the declaration of estimated tax) because, under that act, income taxes paid by an individual are not paid in respect of a prior year, but are paid in respect of the current year.

Section 120 therefore needs to be amended in order to give the law practical meaning and to conform it to the requirements of the Current Tax Payment Act of 1943. The inserted phrase, "of such year or," contained in the proposed amendment is intended to accomplish that result.

2. *The law in its present state is too stringent to carry out the purpose of Congress to encourage charitable and educational contributions.*—Section 120 was originally adopted to assist charitable, religious, and educational institutions financially; to make it possible for individuals of wealth to give financial assistance to such institutions; and to enable the individual taxpayer with charitable leanings to contribute more than 15 percent of his income to charitable, religious, and educational institutions without incurring an unbearable tax burden. The section has, since 1924, been limited in its application to those individuals who have for 10 consecutive years given practically their entire income to charitable or educational or religious institutions. It is believed that, under present conditions, the 10-year period is much too long and too stringent to be of any actual benefit to either the institutions or the individuals intended to be benefited by the section.

The increased cost of charity and education today, the pressing need of such institutions for more funds, and the impossibility under present economic conditions of any taxpayer giving away his entire income for a period of 10 or 11 years makes it mandatory, if private educational and charitable institutions are to survive that the law be liberalized. To accomplish this purpose it is suggested that the present 10-year period be reduced to 2 years. To liberalize the law in this respect would give effect to the intention of Congress, as it has existed for a period of approximately 25 years, that support of charitable and educational institutions is to be encouraged.

Because of the failure to amend section 120 to conform to the provisions of the Current Tax Payment Act of 1943 at the time of the enactment of that act, it is believed that the amendment suggested is, in effect, but a technical amendment to the law. Accordingly, it is felt that such an amendment should be made a part of any administrative or technical changes act which may be introduced in the second session of the Eighty-first Congress and that such amendment need not await the introduction of a comprehensive revenue bill.

Statement by Teachers Insurance and Annuity Association of America, New York, N. Y.

This statement is made by Teachers Insurance and Annuity Association of America (TIAA), and is addressed solely to the provisions of H. R. 8920 which affect the accumulation of investment income by charitable and educational organizations.

TIAA was organized in 1918 under the laws of the State of New York by the Carnegie Corp. of New York and The Carnegie Foundation for the Advancement of Teaching. It provides a specialized type of retirement plan which assures the mobility of faculty members from one institution to another, and which has the stability of centralized funding which would otherwise be lacking to most institutions. This plan has been remarkably successful in practice, and has become an integral part of the college system. At the present time its facilities are used by 371 colleges and universities and 139 junior colleges and secondary schools, and benefits are provided for over 70,000 staff members. As an adjunct to the college world, TIAA is exempt from taxation under section 101 (6) of the Internal Revenue Code.

The proposed section 424 to be added to the Internal Revenue Code by H. R. 8920 is designed to tax the accumulated investment income of section 101 (6) corporations, with certain exceptions. In the case of TIAA, this section as it now stands would have the result of taxing at the rate of 41 percent all investment income which is added to the reserves from which retirement benefits are ultimately to be provided. Such a tax would drastically reduce the pension expectations of 70,000 participants and cause the dissolution of this organization.

This provision of H. R. 8920 as it now stands discriminates against TIAA retirement plans. The exemption provisions of the proposed section 424 (a) (1) are such that the income of a college used to self-fund its own retirement plan is not affected. Likewise the income of a State teacher's retirement system would not be taxed. We urge that this section be amended to provide a similar exemption for TIAA.

We suggest that the exemption provided for colleges in the proposed section 424 (a) (1) (B) of the Internal Revenue Code (p. 106, lines 14–18 of the bill) be amended by the addition of the language italicized below:

"(B) an educational organization which normally maintains a regular faculty and curriculum and normally has a regularly organized body of pupils or students in attendance at a place where its educational activities are regularly carried on, *or an organization primarily engaged in providing retirement benefits for the employees of such educational organizations;* * * *"

The parallel provisions of paragraph (B) of the proposed addition to section 101 (6) (p. 115, lines 21–25 of the bill) should also be amended to include the same language.

The proposed amendment would also solve a secondary problem. The Carnegie Corp. has donated $1,000,000 per year to TIAA during each of the past 2 years, and is committed to give a further $1,000,000 per year for the next 3 years, for the purpose of strengthening TIAA's pension reserves. As drafted, H. R. 8920 would allow the Carnegie Corp. no deduction from accumulated investment income for such gifts. As a result, any income devoted by the Carnegie Corp. to this purpose would likewise be taxed at the rate of 41 percent. The proposed amendment would remedy this situation by including TIAA in the exempt class.

GEORGE E. JOHNSON,
Vice President and Secretary, Teachers Insurance and Annuity Association of America.

ALLEN-BRADLEY CO.,
Milwaukee, Wis., July 7, 1950.

Mr. CHARLES R. SLIGH, Jr.,
Care of Charles R. Sligh & Co., Holland, Mich.

DEAR MR. SLIGH: In accordance with my telephone conversation with you I am enclosing herewith my objections to the amendments to section 117 (j), Internal Revenue Code, as proposed by H. R. 8920. As you know, the amendments propose to make the losses from the sale of business property capital losses, just as the profits are capital gains, and while this first blush might seem equitable I think that the statement which I have attached hereto shows why it is not and if the Government proposes to change this, why it would be better to have both the gains and profits be treated as ordinary profits and losses instead of as capital gains or losses.

I know that you are very busy and will have to crowd a lot of things into your short presentation, but I think that this is one item that affects most manufacturers and if we once get a bad law it will be difficult to change.

Yours very truly,

A. F. NORTH, *Treasurer.*

OBJECTION TO AMENDMENTS TO SECTION 117 (j) OF THE INTERNAL REVENUE CODE AS CONTAINED IN SECTION 209 (b) AND (d) OF H. R. 8920

Section 117 (j) of the Internal Revenue Code, as now constituted, permits corporations and other business enterprises to have net gains from the sale of business property taxed as capital gains, and to have net losses from the sale of such property allowed as ordinary losses. Theoretically, the procedure whereby the proposed Revenue Act of 1950 puts net losses from the sale of business property in the capital-loss category appears equitable, but practically this is not the case for the following reasons:

(1) The average business enterprise is interested in using its business facilities in business activities, and is not interested in selling them for the purpose of realizing a capital gain. The capital gain benefits of section 117 (j) redound primarily to speculators and short-time business operators.

(2) The average business enterprise when faced with expansion, moving, discontinuance of a certain line of business, or the improvement of its facilities, is forced to sell or abandon its business property with the choice as to action dic-

tated by business necessities. At such time the business enterprise should be entitled to an ordinary loss as to all losses from the sale of assets used in business.

(3) Many business enterprises have of recent years agreed to the procedure of the Bureau of Internal Revenue of applying progressively longer lives to business assets for the reason that the depreciable base of the property would be recovered either over such longer life, or as a loss upon the sale or abandonment of the asset. The procedure whereby a business enterprise would realize a capital loss upon the sale or abandonment of business facilities will create numerous and prolonged controversies as to the ordinary life of business facilities.

(4) The average business enterprise does not have capital gains with which to offset capital losses, and it is apt to be the case that losses sustained upon the sale or abandonment of business facilities will be extremely sizable when they do occur, which by the way is very apt to be during a period of business recession.

(5) It is particularly obnoxious that an abandonment of business properties will result in a capital loss.

EDISON ELECTRIC INSTITUTE,
New York, July 7, 1950.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Washington, D. C.:

The undersigned, vice chairman of the Taxation Accounting Committee, Edison Electric Institute, New York, N. Y., respectfully submits for your consideration the following statement having particular reference to section 209 of the pending tax bill, H. R. 8920. This statement has the unanimous approval of the members of the committee, representing the major electric utilities of the United States.

STATEMENT

Section 209 of H. R. 8920 proposes to treat losses on the sale or abandonment of property used in a trade or business as capital losses subject to deduction only to the extent of capital gains. The stated basis of the statutory proposal is to cure an inconsistency in the present law. The House bill, however, sets up a rule which would result in taxable income in excess of the actual or true income under universally recognized accounting principles.

Public utilities have vast investments in business property. Progress in the art of production and distribution of electrical energy and gas has continuously caused the sale or abandonment of substantial investments in business properties, the costs of which have not been recouped by depreciation allowances at the time of such sale or abandonment. These sales or abandonments are incidental to business operations. To limit by capital-loss provision a deduction on the sale or abandonment of such properties would often result in a denial of any deduction at all for the cost of such property consumed in a business. Generally a utility business does not have any offsetting capital gain against which such losses may be applied. The variations between the adjusted bases of these properties and the amounts received on sale or disposal are incomes or losses incurred in the operation of the business and should be so recognized in the determination of taxable income.

Under present Internal Revenue Code provisions full recognition is accorded this fundamental accounting principle. The investment in depreciable business property is permitted to be recouped over the period of useful life by depreciation allowances, ordinary or accelerated; fire or casualty loss allowances; recognition of losses on sale or exchange; and deduction in full for recouped bases on abandonment or seizure, or transfer under the circumstances described under section 112 (f) of the code. Full recognition has been provided since 1942 for loss on disposal of nondepreciable assets.

As contrasted with the full recognition of the actual loss as an element of cost in the determination of taxable income, gains on the sales or exchanges of property have been given a capital-gain tax-limitation treatment. The House Ways and Means Committee points out that this is inconsistent with the treatment of losses, and section 209 of H. R. 8920 is proposed to eliminate this inconsistency.

Whether or not the gain on disposals of business property should be given a preferred capital-gains treatment,[1] it is submitted that full recoupment of investment in business property is basic to a true computation of taxable income and therefore that losses must be recognized in order that this be accomplished. To do otherwise would impede the progress of the industry, in that obsolete

[1] Report on 1938 act, excerpts attached.

property would tend to be retained in service until its full cost has been recovered through depreciation.

It is further noted that because section 209 of H. R. 8920 will tend to induce the retention in service of obsolete property, the statute will adversely affect the price and quality of service to customers and the integrity of the investment of stockholders.

If complete parity in the treatment of gains and losses is deemed proper, as a matter of policy, it is submitted that full recognition of these elements should be accorded in the Internal Revenue Code provisions and not, as provided in section 209 of H. R. 8920, an arbitrary restriction on the deduction of losses actually sustained in the operation of the business.

In the orderly administration of the Internal Revenue Code provisions, and in order that the revenue may be properly protected, conservative estimates of useful life of business property and conservative estimates of salvage are insisted upon by the Bureau of Internal Revenue. Under the existing Internal Revenue Code provisions this policy has been accepted by industry since the over-all proper determination of income has been insured through the allowance of a deduction for any loss arising out of the ultimate disposal of the property and unrecouped in prior periods through depreciation deductions.

A continuance of this policy is essential to the proper determination of the operating and taxable incomes and therefore it is respectfully urged that the principles herein outlined be considered and that the proposals contained in section 209 of H. R. 8920 be amended accordingly.

Respectfully submitted.

CHARLES WIGAND,
Vice Chairman, Taxation Accounting Committee.

EXCERPTS FROM REPORT ON 1938 ACT

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) DEFINITIONS.—As used in this title—

(1) CAPITAL ASSETS.—The term "capital assets" means property held by the taxpayer * * * but does not include * * * property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (l);

COMMITTEE REPORTS

Report, Ways and Means Subcommittee (75th Cong., 3d sess., H. Rept. Jan. 14, 1938): Substantially as reported by Ways and Means Committee (pp. 34–35). In addition there is the following:

For instance, mortgages, land contracts, etc., are frequently sold at substantial discounts. From a statutory standpoint, the difference between the principal amount and the purchase price is regarded as a capital gain; but from an economic standpoint the discount is merely the means whereby the effective annual yield of the instrument is raised from, say, 6 percent to 12 or 15 percent. A bond purchased at a premium results in a capital loss when redeemed at par, and a bond purchased at a discount, in a capital gain. Yet it is the everyday practice in investment circles to quote both these types of bonds in terms of their effective yields to maturity or call date (p. 30).

Report, Ways and Means Committee (75th Cong., 3d sess., H. Rept. 1860): The change made in the definition of "capital assets" in section 117 (a) (1) of the bill (see discussion under that section), which eliminates from the category of capital assets depreciable assets used in a taxpayer's trade or business, will be of material benefit to corporations as well as individuals. As a result of this change, losses realized on the sale or exchange of such depreciable assets will be deductible in full from ordinary income. Corporations will not, as formerly, be deterred from disposing of partially obsolescent property, such as machinery or equipment, because of the limitations imposed by section 117 upon the deduction of capital losses (p. 6).

First: The definition of capital assets is slightly modified so as to exclude from the definition, property used in the taxpayer's trade or business, which is subject to depreciation allowances. This, in the great majority of cases, should be of benefit to the taxpayer, since it will allow him to take losses against his ordinary income from the sale of such property. Under existing law, if a taxpayer loses on the sale of depreciable property, he cannot charge it off against ordinary income and can only receive a deduction if he has capital gains. Moreover, the loss taken into account is reduced according to the length of time during which he has held such property. Under the proposed change, he will be able to charge off the full

amount of the loss against his ordinary income. It should be noted that this is the only change proposed in the capital gain and loss system which affects both corporations and individuals. All the remaining changes affect only individuals (p. 7).

Section 117 (a) (1) of the present bill makes an important change in the definition of the term "capital assets," as contained in section 117 (b) of the Revenue Act of 1936. This change will operate to exclude from the category of capital assets property used by the taxpayer in his trade or business, of a character which is subject to the allowance for depreciation in section 23 (1). Its effect will be to remove gains or losses from the sale or exchange of such property from the percentage brackets provided in section 117 (b) of the bill, and from the limitation on losses provided by section 117 (d), as well as from the operation of section 117 (c), prescribing an alternative method of taxing capital net gains arising from the sale or exchange of capital assets held for more than 1 year. It will also, in the case of a corporation, permit losses from the sale or exchange of such property to be included in the computation of the net operating loss provided by section 26 (c) of the bill, while at the same time excluding such losses, in the case of individuals, from the computation of the net capital loss carry-overs provided by section 117 (e).

This important change in the law is based upon a recognition of the principle that gains or losses realized upon the sale, exchange, or other disposition of such property are business gains or losses and, as such, directly affect the volume of the business profits which should be subjected to tax in the years in which such transactions occur. Its operation may be illustrated by the following example. Suppose that X, a manufacturer, purchased in 1932 a large machine, at a cost of $50,000. At the time of acquisition and installation in his plant, the machine had an estimated useful life of 10 years. X was therefore allowed an annual deduction from gross income for depreciation on the straight-line method of one-tenth of the cost, or $5,000, with respect to this machine. Assume that in 1938, when the machine has been in use for 6 years, a new and improved type of machine is introduced, the installation of which would materially reduce X's costs of production. X has, however, recovered only 60 percent of the cost of the old machine through the annual deduction for depreciation. Let it be further assumed that X could sell the old machine to Y, another manufacturer, for $7,500, which is only 15 percent of its cost to X, but is materially in excess of its junk or salvage value. If such a sale were consummated, X would sustain an actual loss of $12,500 on this machine. The result of section 117 (a) (1) of the present bill is to allow X to deduct this loss in full from gross income, whereas, but for such provision, section 117 (b) would limit X to a deduction of 40 percent of this amount, or $5,000, of which not more than $2,000 could be applied against income other than long-term capital gains.

The above change is equally applicable to all taxpayers, whether individuals or corporations. It should be noted, however, that it is limited to property used by the taxpayer in his trade or business at the time of the sale or exchange, of a character which is subject to the allowance for depreciation provided in section 23 (1). It therefore has no application to gains or losses arising from the sale of real property used in a trade or business to the extent that such gain or loss is allocable to the land, as distinguished from depreciable improvements upon the land. To such gain or loss the limitations of section 117 (b) and section 117 (d) will apply. It is not believed, however, that in most cases the allocation of basis and of purchase price between the land and the improvements will involve serious difficulties, because for the purposes of the allowance for depreciation under the revenue laws, the cost allocable to the depreciable improvements will already have been determined (pp. 34–35).

Report—Senate Finance Committee (75th Cong., 3d sess., S. Rept. 1567).—The definition of capital assets has been changed, so that depreciable assets are no longer included in the category of capital assets. This change made in the House bill allows a corporation to receive the full benefit of a deduction for losses on the sale of depreciable assets from its ordinary income. The change does not, of course, affect the deduction for obsolescence allowed by section 23 (1) of the bill and corresponding provisions of prior acts (p. 7).

CONGRESSIONAL DISCUSSION

Discussion—House (Congressional Record, vol. 83)—Mr. Fred M. Vinson * * * When you come down to the question of obsolescence, we have had a different rule all through the years, and under existing law the only way you can get obsolescence is to take the thing that you know to be obsolete and sell it to

somebody, and when you do this, then you fall under the capital gain and loss section, and if you have held it for 10 years, until existing law, you are only able to take 30 percent of the obsolete value. This is not all. Unless you have a capital gain against which this capital loss can be applied, you do not get any credit whatever for your obsolete machinery.

We now change this. We say that obsolescence should be treated as operating expense and that one should be permitted to deduct the obsolete value from the gross income which will thereby fully exempt the obsolete value of the piece of machinery from tax.

To illustrate, take a piece of machinery that cost you $100. It has a life of 10 years. You write off 10 percent a year in depreciation, and then you come to the 5-year period, and it has become obsolete. You have 50 percent of that value that is worthless to you. Under existing law you would have to sell it. Say you sold it for $1. You would get 40 percent of $49 or $19.60 loss. You would have to have a capital gain to apply that to before you got any deduction for obsolescence, but under our plan we take the 50-percent of obsolete value and deduct it from gross income. Thereby the person who has this piece of machinery that is used in his trade or business gets a complete and full deduction of the obsolete value. Thus this amount is freed from tax.

I have attempted to illustrate the change. Of course, under existing law, up to $2,000 per year may be deducted as capital loss, even though there was no capital gain (pp. 2785–2786).

AMHERST H. WILDER CHARITY,
St. Paul 2, Minn., July 11, 1950.

Hon. EUGENE J. MCCARTHY,
United States Representative,
House Office Building, Washington, D. C.

DEAR REPRESENTATIVE MCCARTHY: We appreciate the opportunity to present our views on the question of the continued tax-free status of charitable organizations and foundations.

We understand that the proposed legislation is directed toward correcting abuses of the tax-exemption privilege, and that there is no intention to depart from the well-established broad public policy of extending tax-exemption privileges to educational and charitable organizations which are in effect dedicated to public purposes and which do not abuse the tax-exemption privilege. Consequently, this letter will be limited to an expression of our concern as to the possible meaning or interpretations that might be placed on some of the language which we understand has been incorporated into the omnibus tax bill already passed by the House.

The Wilder Charity is a foundation endowed by a St. Paul family at the beginning of this century. Its income is received in the form of interest and dividends on bonds and stocks owned by the charity and in the form of miscellaneous cash receipts from the operating departments. The Wilder Charity does not participate in the management of any of the companies in which it owns stocks or bonds, except to the extent of executing proxies at the request of the management, nor does it own the controlling interest in any corporation or business enterprise. It does not operate or have any interest in a business except through the ownership of stocks and bonds. Miscellaneous cash receipts are largely the result of fees charged to persons benefiting from the services provided by the Wilder Charity. In each instance the fees represent only a small percentage of the cost of providing the service in question.

We believe that the definition of unrelated business income should be such as to make certain that by such income is meant income received from the operation of a business or the rental of property which is owned by the educational institution or charity for the purpose of producing income, and that the formula for determining the taxes to be paid by such a business or from such income property shall be the same as would be applied to a similar activity operated for profit. We believe that unrelated business income should be defined so as to specifically exclude income received from stocks and bonds where the educational institution or charity owns the stocks for investment purposes and does not undertake to operate the business, and the business is independent of the educational institution or charity and is operated subject to the same tax laws as any other business corporation.

We are concerned with the proposal to tax accumulated investment income of charitable trusts and foundations where the funds are not spent on designated purposes within the taxable year or within 2½ months after the close of the year.

We believe that it is sound public policy to require a foundation or charitable trust to spend its income currently but, on the other hand, provision should be made for the allowance of reasonable reserves and a sufficient time period should be allowed within which the accumulated income must be expended in order to avoid forcing the hasty and unwise expenditure of funds. It is suggested that a period of 6 months after the close of a fiscal year would be more reasonable than a period of 2½ months. It would be well if some principle of average annual income could be incorporated in the requirement that a foundation shall spend its income as received, because of the difficulty of accurately estimating annual income.

For example, the board of directors of the Wilder Charity has established a policy of spending the annual income as received. For the last several years the Board of Directors has approved an annual budget which was higher than the income for the previous year and which it was anticipated would result in an operating deficit, but because of an increase in income the Charity has had a balance of unexpended income at the end of the year.

We are also concerned as to the definition of accumulated investment income, and whether the proposal to tax such income would be retroactive in the sense that it would apply to income accumulated prior to, for example, December 31, 1950. Undoubtedly many foundations have accumulated income over the years and in effect added it to their endowment, and it would be disastrous to the program of services developed by such foundations if they were required to pay taxes on such accumulated income.

The whole problem is exceedingly complicated and we regret that there was not more opportunity to express our views in the matter. For example, foundations experienced both profits and losses from the sale of securities. It has been the practice of the Wilder Charity, and we understand that the same practice is followed by most trusts, to consider that the profits from the sale of securities will in the long run offset the losses and consequently we never consider the profit from the sale of securities as income available for current expenditure.

Many thanks for your interest in and attention to our problem and we hope that you will have an opportunity to present this letter to the Senate Finance Committee.

With best wishes.

Sincerely,

F. M. Rarig, Jr.,
Executive Secretary.

Winthrop, Stimson, Putnam & Roberts.
New York 5, N. Y., July 7, 1950.

Hon. Walter F. George,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D. C.

Dear Sir: In connection with your consideration of the tax revision bill known as H. R. 8920, I would like to have the privilege of submitting to your committee a proposed amendment to section 120 of the Internal Revenue Code. The purpose of such amendment would be merely to correct what was an obvious oversight by Congress at the time of the enactment of the Current Tax Payment Act of 1943. The amendment would have a negligible effect on the revenue and is needed to prevent an injustice and hardship resulting from the omission to coordinate the Current Tax Payment Act of 1943 with section 120. Also, I have been informed that the Treasury recognizes the fairness and propriety of such proposed amendment and will not oppose it. Although I have not talked directly with anyone in the Treasury about this, it can readily be checked.

Section 120 of the Internal Revenue Code permits an unlimited deduction for charitable contributions in the case of an individual whose charitable contributions in the current taxable year and in each of the 10 preceding years, plus his income taxes paid during the year with respect to preceding years exceeded 90 percent of his net income.

When the Current Tax Payment Act of 1943 was enacted in June 1943, Congress, with undoubted inadvertence, disregarded the effect upon section 120, which is a section seldom availed of. Since the Current Tax Payment Act provided that payments of income tax made during that year should be deemed to be on account of 1943 income tax, it had the effect of nullifying that part of section 120 which includes taxes paid during the year on account of preceding years as a factor in arriving at the figure which should constitute 90 percent of the net income.

This was recognized as an oversight by Congress, and in H. R. 6712, section 135, passed by the House in 1948, section 120 was amended to remedy what was agreed to be an error.

The Ways and Means Committee report on that bill (Rept. No. 2087) stated on page 23 as follows:

"26. Unlimited deduction for charitable contributions of individuals

"Section 135 of your committee's bill is merely a technical amendment correcting an error made in the Current Tax Payment Act of 1943.

"Existing law waives the 15-percent limitation on allowable charitable deductions of individuals in cases where, for 10 successive years, the contributions of the individual, plus his income taxes paid during the year with respect to preceding years, exceed 90 percent of his net income. However, under the current tax payment systems taxes are paid with respect to the current taxable year rather than the preceding year. The Current Tax Payment Act failed to make an essential amendment of section 120 of the Internal Revenue Code to provide that the 90-percent limitation applies also to taxes paid with respect to the current year.

"Your committee's amendment, therefore, is retroactive to taxable years beginning after December 31, 1942."

The bill, though passed by the House, did not reach the Senate.

In 1949 an identical proposed amendment was included in H. R. 990, but the bill was not passed.

The proposed amendment is not included in the present tax revision bill, No. H. R. 8920, which is now before your committee. However, during this year Mr. Reed of New York introduced a separate bill, No. H. R. 7303, of which I enclose a photostatic copy. It is the same amendment which appeared in the previous bills above mentioned.

The proposed amendment differs from practically all other proposed remedial revisions because H. R. 7303 does not attempt to change some provision of the income tax law which had been intentionally enacted after careful deliberation, but is intended only to correct an unintentional oversight by Congress in not coordinating the Current Tax Payment Act of 1943 with section 120.

The present situation works a great injustice to the very few taxpayers in the country who have fully complied with the requirements of section 120 for 10 successive years prior to 1943, and then found that the tax benefit which had apparently been assured to them was taken away from them through their not being allowed in the eleventh year (1943) to include in the 90-percent limitation any taxes paid in 1943, since all of the taxes which they had paid in 1943 were treated as not payments on account of prior years taxes but of 1943 taxes. This interpretation of the 1943 act means that an individual would have to begin a new 10-year period of 90-percent contributions before being allowed any benefit. A client of ours after 10 years' compliance with section 120 up to December 31, 1942, found herself in this unjust predicament.

Inasmuch as the proposed amendment will have only a most negligible effect on the Nation's revenue, and is only to correct a conceded error, it is earnestly hoped that the provisions of H. R. 7303 will be added to and included in H. R. 8920, and thus remove the hardship which was unintentionally created by the Current Tax Payment Act of 1943.

If it is deemed necessary or desirable I will be glad to appear before your committee for the purpose of submitting the amendment, and I would greatly appreciate the opportunity of doing so.

May I hear from you about this?

Faithfully yours,

PERCY W. CRANE.

MEMORANDUM SUBMITTED BY BRADLEY COLLINS, OF NEW YORK

SECTION 210, H. R. 8920, SHORT SALES OF CAPITAL ASSETS

This section contains a "sleeper." Neither the tax law currently in effect, nor any regulation of the Commissioner of Internal Revenue, nor the statement by Secretary Snyder before the Ways and Means Committee on February 3 suggests that a short seller is, or should be, prohibited from deriving a long-term capital gain. Nor is such suggestion apparent in the Ways and Means Committee report on the 1950 revenue bill unless the reader focuses his attention on example 4 given in the discussion of section 210.

H. R. 8920 preserves the right of a buyer of stock to derive a long-term gain if he bears the risk of ownership for the required holding period (over 3 months).

But under section 210 a short seller is prohibited from having a long-term gain no matter how long he bears the risk of being short.

In order to remove this prohibition from section 210, and yet close completely the loophole to which Secretary Snyder has objected, the following amendment is suggested to subsection m (1):

"(1) SHORT-TERM GAINS AND HOLDING PERIODS.—If substantially identical property has been held by the taxpayer on the date of such short sale for not more than 3 months (determined without regard to the effect, under subparagraph (B) of this paragraph, of such short sale on the holding period), or if substantially identical property is acquired by the taxpayer *within three months* after such short sale * * *

"(A) any gain upon the closing of such short sale shall be considered as a gain upon the sale or exchange of a capital asset held for not more than 3 months (notwithstanding the period of time any *such* property used to close such short sale has been held); * * *." [New matter italicized.]

The report of the Ways and Means Committee suggests that it is estimated that about $2,000,000 a year in additional revenue would be provided by its proposed section 210. It is submitted that all but a very minute portion of this amount would be preserved even with this proposed amendment to section 210 and that it is essential in the interests of an orderly market that the short seller be accorded the same treatment as a buyer on the long side.

STATEMENT OF HARVEY W. PETERS, ATTORNEY

The Edward C. Myers case (6 T. C. 258), established the principle that an exclusive license represented the sale of an invention, or patent, and, assuming the invention was a capital asset, and held the requisite length of time, that the proceeds received through such exclusive license represented installments of the purchase price and long-term capital gains. As attorney in the Edward C. Myers case, I would like to state that I filed the claim for Mr. Myers for the reason that in my opinion, as substantiated by the Tax Court, he had sold a capital asset within the definition laid down in the statute. In brief, there had been a sale through the exclusive license, Mr. Myers was not in the business of selling inventions, and he had held the invention the requisite length of time prior to sale. At that time I did not comprehend, and I do not now comprehend, any reason for denying Mr. Myers the capital-gain provisions simply because he was the creator of the invention in question.

The capital-asset definition as set forth in the Internal Revenue Code (prior to the amendment proposed by sec. 209 (a) of H. R. 8920) has been in effect for a considerable length of time. It extends the capital-gain benefits to all taxpayers regardless of their race, creed, color, occupation, trade, or business. In brief, it excludes from the capital asset category only property held for sale to customers or used in business. The definition applies regardless of the type of business the taxpayer is in or the profession he follows.

Section 209 (a) of H. R. 8920 seeks to deliberately discriminate against inventions, patents and like property by removing them from the capital asset category where the taxpayer seeking the capital gain created the property in question. This discrimination is to be applied despite the fact that it is not unusual in other capital-asset situations for the taxpayer to have created the capital asset, to wit, consider the following examples:

(1) In almost every case of a closed corporation it is a fact that the taxpayer selling the stock of such closed corporation might (be he the original founder, or otherwise managing the corporation) has created, or helped to create the capital asset, no differently than an inventor might create an invention or patent.

(2) Section 117 (j) which extends the capital-asset definition to gains from the sale of property used in business does not differentiate between property that is acquired by purchase, as against property used in the trade or business that was manufactured by the taxpayer.

(3) Another illustration is the breeding cattle situation where the capital gain benefits are not denied under section 117 (j) to farmers who happen to raise the breeding cattle on their own farms.

(4) The capital-gain benefits of section 117 (j) are not denied a taxpayer, such as a builder, who builds a building for rental purposes, and, after renting such property for the requisite length of time, sells the rental property and enjoys a capital gain thereon even though he created the building in question.

(5) The capital-gain benefits are not denied to a home-owner selling his residence at a profit even though his own work and efforts so improved the property and lead to the gain.

It is my opinion that the section complained of attempts to exclude inventions, patents, or like property, simply for the purpose of carrying the Bureau of Internal Revenue's battle. In other words Congress is being asked to aid in a matter that the Bureau itself has found it could not cope with from a litigation standpoint.

It is rather humorous that an inventor may sell a patent, invention, or like property, to another party, and such other party may in turn sell the patent or invention and enjoy capital-gain tax benefits, even though such other party is a rank speculator. In fact, should section 117 be amended as suggested by section 209 (a) of H. R. 8920, it will be the case that capital gains will be restricted to speculators.

At the very least, it is respectfully asserted that a provision such as the one complained of should not be inserted in the Internal Revenue Code without the utmost consideration and full hearings by all concerned.

Respectfully submitted in duplicate.

ASSOCIATED GENERAL CONTRACTORS OF AMERICA, INC.,
Washington, D. C., July 12, 1950.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Washington, D. C.

DEAR SIR: On behalf of the construction industry, the Associated General Contractors of America, Inc., protests the proposal in the pending Revenue Act of 1950, as contained in section 209, amending Internal Revenue Code section 117 (j), to prohibit the treatment of an aggregate net loss from the sale of property used in the trade or business and held for more than 6 months as ordinary loss.

Contractors are required by the nature of their business to invest large sums in depreciable construction equipment. This equipment is subjected to rough, intensive, out-of-door usage, with a resultant high degree of wear and breakage. It is essential to profitable operation in this highly competitive industry that a contractor use the most efficient equipment available for each job. In order to do so, it is imperative that he be permitted to recover his capital outlay for equipment by charging off depreciation at a reasonable rate while such equipment is economical to operate, and that he be allowed to deduct a normal loss for his remaining cost on abandonment or sale thereof when such equipment becomes inefficient. The proposed section 209 would discourage the disposal by a contractor of any equipment until fully depreciated and would impair his capital available for new acquisitions, with results unfavorable not only to the contractor but also to the public.

Under the proposed section 209, a contractor abandoning or selling a machine that no longer is economical to operate, but that has not yet been fully depreciated, could not write off the undepreciated cost against ordinary income. His loss could be used only as an offset against any corresponding capital gain.

The general contracting industry has been complaining for years that existing depreciation regulations of the Treasury are too stringent and that they hamper progress through postponing for too long a period the recovery of capital assets. Section 209 proposes to aggrevate this situation. It would go further than merely postponing the period of full recovery and would often make complete recovery impossible.

The report of the Ways and Means Committee on proposed Revenue Act of 1950, at page 45, concerning section 209, states that the treatment now permitted under section 117 (j) was introduced in 1942 in order to stimulate the sale of business properties so that they would be more apt to go into the hands of persons who could use them efficiently for the war effort. It adds that since business has now had ample opportunity to readjust to peacetime activities it is no longer necessary to give inconsistent treatment to gains and losses from the sales of business property. The Ways and Means Committee report was adopted on June 23, 1950. If there was any doubt at that date of the necessity for the efficient use of machinery and equipment, world developments in the interim have now dispelled such doubt.

The Associated General Contractors of America, Inc., earnestly submits that section 209 should be eliminated from the proposed Revenue Act of 1950.

Sincerely yours,

H. E. FOREMAN, *Managing Director.*

69474—50——44

NILES, BARTON, YOST & DANKMEYER,
Baltimore 1, July 10, 1950.

Hon. MILLARD E. TYDINGS,
Senate Office Building, Washington, D. C.

DEAR MILLARD: I am president of the board of trustees of the Johns Hopkins University. We are disturbed about the possible effect on such institutions of the new tax bill which has passed the House and is now before the Senate Finance Committee.

I fully agree that many of the loopholes in the present income-tax law should be closed so as to prevent so-called nonprofit institutions from realizing tax-free income in an improper manner, but it is of the utmost importance that nothing should be done further to deplete the revenues of such institutions as the Johns Hopkins University.

In my opinion, it is entirely proper to prevent eleemosynary institutions from forming a subsidiary to carry on a business in competition with other tax-paying businesses and to claim that the net income from such subsidiary should be tax-exempt because all of it flows to the eleemosynary institutions and to the owner of all the stock of the subsidiary.

On the other hand, it does not seem proper to attempt to tax the revenue from a research project being carried on by a private institution when the same revenue may not be subject to tax in the case of a like project at the University of Maryland because of the fact that the University of Maryland is a State institution. I know of no instances where there are similar projects, but they might well arise.

Furthermore, every effort should be made to avoid adding to the burdens of the private institutions and possibly destroying them altogether or forcing them to transfer their properties to some Government agency.

There are not many private institutions left in this country, but I do not think that anyone can deny the contribution they make to the general welfare.

Some of the departments of the Johns Hopkins University are operated in black figures and some of its research projects contribute to the general university overhead, but the university itself, and the Johns Hopkins Hospital have had extremely serious deficits in recent years and we are constantly asking for financial contributions to keep things going.

I hope very much that you will bear in mind the importance of seeing to it that there is nothing in this new tax bill which will add to the very serious financial problems of the Hopkins institutions.

Sincerely yours,

CARLYLE BARTON.

STATEMENT OF AMERICAN PATENT LAW ASSOCIATION

The American Patent Law Association is opposed to the enactment of paragraph (C), item (1), section 209 of H. R. 8920, as passed by the House of Representatives.

The paragraph in question excludes from the definition of capital assets:

"(C) a patent or copyright; an invention or design; a literary, musical, or artistic composition; or similar property; held by—

"(i) a taxpayer whose personal efforts created such property, or

"(ii) a taxpayer in whose hands the basis of such property is determined, for the purpose of determining gain from a sale or exchange, in whole or in part by reference to the basis of such property in the hands of the person whose personal efforts created such property; * * *"

This section, if enacted into law, would require the individual inventor or author who is fortunate enough to sell his invention or literary work to report and pay taxes upon the proceeds of the sale as income rather than as the proceeds of the sale of a capital asset.

Such a provision of law, in the view of the American Patent Law Association, would be discriminatory against inventors and would work a hardship tending to retard rather than stimulate inventive ingenuity.

The proposed section would strike hardest at the "little inventor" who in many instances works for many years on the development of an idea which when brought to fruition may be, and often is, the only invention of value which he produces in his lifetime. If he is fortunate enough to sell his invention or the patent which he obtains on it, it would be manifestly unfair to make him pay tax on the entire amount received as income rather than as sale of a capital asset.

It is the incentive of the possibilities of rich reward which spurs on the individual inventor to continue his efforts after repeated failures and if the possibilities

of such reward are reduced by being bled off through high income tax on the amount which may be received, the incentive is largely nullified.

The ways and Means Committee of the House of Representatives estimated that the provision in question would yield approximately $1,000,000. Since this estimate includes yield from sale of all types of literary property as well as patents and inventions, it is obvious that the yield to be obtained from the sale of patents and inventions is small indeed compared to the possible ultimate cost to the country which might result from the discouragement of invention by enactment of the section.

Thus it is submitted that the practical effect of such a provision is repugnant to the philosophy of the Constitution and to the patent laws enacted thereunder, which is to promote the development of science and the useful arts through encouragement of inventors by securing to them the exclusive right to their inventions for limited periods. It is well known that very few small inventors are in a position to capitalize on their inventions through the manufacture and sale on their own behalf, but that most must depend upon the sale of the patent rights to obtain their reward. If that reward, which is attained by so few, is to be diminished as proposed in the present bill through taxation as income, then as heretofore stated, one of the greatest incentives to invention by the individual inventor is largely wiped out. This would be neither good public policy nor in keeping with the constitutional or congressional intent as embodied in the patent laws.

For these reasons it is urged that paragraph (C), item (1) of section 209 be disapproved.

PAUL A. ROSE,
Chairman, Committee on Laws and Rules.

PORTLAND SANITARIUM AND HOSPITAL,
Portland 15, Oreg., July 17, 1950.

The Honorable GUY L. CORDON,
United States Senate, Washington, D. C.

DEAR MR. CORDON: My attention has just been brought to House Resolution 8920, title III. This bill is known as the excise tax repeal bill.

The opinion has been expressed to me, though I have not yet had opportunity to examine the original bill, that some provisions of House Resolution 8920 may seriously jeopardize the status of nonprofit hospitals. For instance, the definition of organizations entitled to receive charitable gifts is so narrow that it may exclude most nonprofit hospitals. I would appreciate it if you would examine the provisions as to the taxation of the income from unrelated activities and see whether it is, possibly, too broad. The question has been raised whether income from gift shops, and the activities of hospital auxiliaries, or even the income from patients who may pay in excess of cost, may be taxable.

It would seem that since this bill was introduced into the House on June 22, and passed on June 29, it must have been passed very hastily and without much study and consideration.

The purpose of this letter is to request your cooperation in carefully examining this bill, and it is our intent in this letter to protest the danger fo such hasty and ill-considered enactment of legislation which might seriously injure our nonprofit hospitals.

I would also appreciate it if you could instruct one of your secretaries to mail me a copy of the above bill so that I could personally examine the proposed legislation in full.

Very truly yours,

R. W. NELSON,
Administrator, Portland Sanitarium and Hospital;
President, Portland Council of Hospitals.

GOOD SAMARITAN HOSPITAL,
Portland 10, Oreg., July 18, 1950.

The Honorable GUY CORDON,
United States Senate, Washington, D. C.

DEAR SENATOR CORDON: We are informed that the provisions of title III of H. R. 8920, the excise tax repeal bill, as it now stands might discourage or prohibit donations to nonprofit hospitals. While the bill is intended to tighten up

the tax exemptions of nonprofit institutions, I am sure that the makers of the bill did not have in mind nonprofit hospitals.

The main danger in the bill seems to be the narrowness of the definition of organizations entitled to receive charitable gifts which would exclude most nonprofit hospitals. In the last fiscal year Good Samaritan Hospital rendered $78,000 worth of free service and during the 7 months to date of this year, it has rendered $64,000 worth of free service. Many other nonprofit hospital records are more impressive than ours. Gifts to Good Samaritan Hospital and other nonprofit hospitals enable us to render this free work. As commendable as the move is to tighten up exemptions, it would seem shortsighted for the people to limit the ability of nonprofit hospitals to render this free work because in the end they, the people, would have to assume the cost of rendering such service. Also, many donations which enable the nonprofit hospitals to provide capital expenditures such as equipment and new buildings, would be discouraged. We are sure that the makers of the bill did not have this effect in mind for nonprofit hospitals.

May we ask that you look into the provisions of this section for us.

Very truly yours,

FRANK J. WALTER.

STATEMENT OF JAMES VORENBERG OF CAMBRIDGE, MASS., ON BEHALF OF THE HARVARD LAW REVIEW ASSOCIATION

My name is James Vorenberg. I am the president of the Harvard Law Review Association, and I am appearing for it in relation to section 424 of H. R. 8920. The Harvard Law Review Association is incorporated under the laws of Massachusetts and is a nonprofit organization the primary function of which is to publish the Harvard Law Review. It has no shareholders and no part of its income inures to the benefit of any private individual. The work of publishing the Law Review is all carried on by the students at the Harvard Law School, without compensation, and the training received from work on the Review has long been regarded by the faculty of the law school as a vital part of the education they receive.

Financially, the Law Review functions independently from the law school, and has always been self-supporting. In a good year, the Review breaks even or may show a small profit from its publishing operations. However, in bad years such as those during the two wars and the depression, a loss may be sustained from the publishing activity and the Review has been able to retain financial independence only because of the cushion provided by the income from its accumulated reserve. This now amounts to about $65,000, and is invested in securities.

Section 424 of the bill would seem to impose a tax on this investment income in any year in which it is not immediately needed for current operations. Such a tax seems to us undesirable and unnecessary. Its unfairness in operation would seem to lie in the fact that while over a long period the Review about breaks even between expenses and total income, in a good year, a tax would be paid under section 424, even though in several subsequent or previous years a loss might have been sustained.

It is, of course, difficult to draft a bill which will deal equitably with the problems of all groups, but it occurred to us that there are many groups in a position similar to ours and that it might be helpful for the committee to know the particular factual situation of one such organization.

It would seem that in drafting a bill which would meet the aims of section 424 and yet not tax such organizations as the Law Review, it might be possible to make a distinction between organizations whose sole or primary activity consists in holding investments for accumulation or payment of the income to others for charitable purposes, on the one hand, and those which are themselves conducting operations, on the other, with investment income being but a relatively small part of the gross receipts.

We hope that some solution will be reached which will not require that organizations like the Harvard Law Review which have long been regarded as performing a legitimate charitable and educational function will lose their tax-exempt status. Such organizations can hardly be regarded as having been used as tax-avoiding or evading devices, and they should not be injured in a move to reach quite a different sort of activity.

LOS ANGELES, CALIF., *July 5, 1950.*

Hon. WILLIAM F. KNOWLAND,
Senate Office Building, Washington, D. C.:

House passed tax bill H. R. 8920 includes amendment of section 209 (d) by providing that abandonment of capital assets or property used in trade or business shall be considered as a sale of exchange. This would permit write-off of abandonments only against capital gains and subject to limitations applicable to capital losses. For the independent oil producers, including ourselves, this means if a lease is bought or an oil well drilled which proves worthless, the loss may only be offset against capital gains instead of charging to expense as has always been done. In the business of leasing lands and prospecting for oil, capital gains are almost nonexistent and under the amendment the independents would often pay taxes when actually losing money over-all as wildcatting and other exploratory operations are inseparable from producing operations. One cannot exist without the other. We respectfully request that you give this your prompt consideration and hope you will contact Finance Committee with view of eliminating the amendment. It is our judgment that if the amendment becomes law, searching for new oil fields by independents who historically make about 75 percent of new oil discoveries will practically cease which would be seriously detrimental not only to the interests of California and the entire oil industry but to the Nation as well.

HOLLY DEVELOPMENT CO.
C. A. JOHNSON, *President.*

The CHAIRMAN. Now the committee will recess until 10 tomorrow morning.

(Whereupon, at 5:05 p. m. the committee recessed to reconvene Wednesday, July 12, 1950, at 10 a. m.)

REVENUE REVISIONS OF 1950

WEDNESDAY, JULY 12, 1950

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D. C.

The committee met, pursuant to recess, at 10 a. m., in room 312 Senate Office Building, Senator Walter F. George, chairman, presiding.

Present: Senators George, Connally, Hoey, Millikin, Butler, and Martin.

Also present: Mrs. Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will please come to order.

I offer for the record at this point in the proceedings a statement of Mr. Guy H. Woodward, attorney, representing the Samuel Roberts Noble Foundation, with reference to H. R. 8920.

(The statement referred to follows:)

STATEMENT OF GUY H. WOODWARD, ATTORNEY, REPRESENTING THE SAMUEL ROBERTS NOBLE FOUNDATION, ARDMORE, OKLA.

Section 331 of H. R. 8920 provides that no gift or bequest for religious, charitable, scientific, literary, or educational purposes shall be deductible for income-, estate-, and gift-tax purposes unless the instrument under which the trust or other organization is administered provides certain express prohibitions against the use of the income or corpus of such trust or other organization. We agree with the Treasury's efforts to prevent abuse of the exempt status of charitable, religious, and educational organizations. However, legitimate charitable trusts should not be penalized.

It is assumed that the purpose of the Congress and the Treasury is to prevent the objectionable transactions described in section 331 and not to penalize legitimate charitable, etc., organizations which are not involved in such transactions. If this assumption is correct then the language of section 331 is unfortunate because it will do serious harm to many legitimate organizations which are not involved in any such transactions.

Under section 331 the test is not whether the organization is actually involved in such transactions but whether the instrument under which it is administered contains provisions prohibiting them. Few, if any, existing charitable trust instruments contain such provisions. If the trust instrument cannot be amended then no deduction will be allowed for income-, estate-, and gift-tax purposes for gifts or bequests to such organization. This source of financial support of such an organization would be vitally impaired.

Section 301 of the House bill (beginning at line 9, p. 116), in providing requirements for continued exemption under section 101 (6), prohibits the same transactions as does section 331, but section 301 does not require that any instrument must contain provisions prohibiting such transactions. Also section 321 of the House bill (beginning at line 20, p. 121) limits the charitable, etc., deductions of trusts allowable under section 162 (a) of the Internal Revenue Code if the trust is involved in any of these same prohibited transactions. Both section 301 and section 321 of the House bill make the actual operation of the trust with respect to such transactions the test as to exemption. The same test should be used in section 331.

The Samuel Roberts Noble Foundation is a trust created and operated exclusively for religious, charitable, scientific, literary, and educational purposes. It has been acclaimed by authorities throughout the Midwest for the work it is

doing in soil conservation. It has never been and is not intended to be involved in any of the proscribed transactions set forth in section 331 of H. R. 8920. It has been and is the potential recipient of substantial gifts and bequests. It is the opinion of several competent lawyers that the trust instrument by which it was created and under which it is being administered probably cannot be amended.

It is not necessary to penalize such an organization in order to prevent the transactions described in section 331 of H. R. 8920. A slight amendment in the language of the House bill will protect such trusts created and administered for legitimate charitable, scientific, religious, and educational purposes which cannot amend the instruments under which they are now being administered and will fully preserve the objectives of the Treasury. Such a proposed amendment is attached. It makes clear that the required provisions may be contained in bylaws or rules passed by the trustees or other governing body of such a trust.

We believe that the provisions of section 331 of the House bill are unfair and unwise and urge that the section be amended as herein proposed.

Proposed Amendment to Section 331 of H. R. 8920

Amend section 331 of H. R. 8920, as follows:

Beginning at line 3, page 125, change to read as follows (proposed changes are in italics):

"(b) Powers and Operation of Trusts or Other Organizations.—No gift or bequest shall be considered a deductible gift or bequest for the purposes of subsection (a) unless—

"(1) [the] *an* instrument *including bylaws or rules passed by the trustees, directors, or other governing body* under which the trust or other organization is administered provides that—"

(Remainder same as in H. R. 8920.)

The Chairman. I also offer for the record a statement by the National Council of Farmer Cooperatives submitted by Mr. John H. Davis, executive secretary.

(The statement referred to follows:)

National Council of Farmer Cooperatives
Washington, D. C., July 10, 1950.

Mrs. Elizabeth Springer,
Senate Finance Committee,
Senate Office Building,
Washington, D. C.

Dear Mrs. Springer: I am enclosing a memorandum entitled "Why the Proposed 10-percent Withholding Tax on Patronage Refunds Paid by Farm Cooperatives Should Not Be Adopted," which Mr. F. V. Heinkel, president, Missouri Farmers Association, Inc., Columbia, Mo., has asked me to place in your hands for inclusion in the record of the current hearings before the Committee on the Revenue Act of 1950. The memorandum prepared by two of the officials of the Missouri Farmers Association, Inc., is presented by Mr. Heinkel as a statement bearing the full endorsement of his organization.

We shall appreciate it very much if you will request Senator George to present this statement for inclusion in the record at the time he presents other similar statements.

Sincerely yours,

John H. Davis,
Executive Secretary.

Why the Proposed 10-Percent Withholding Tax on Patronage Refunds Paid by Farm Cooperatives Should Not Be Adopted

(By A. D. Sappington, chief counsel, Missouri Farmers Association, Inc., and Clyde A. Morwood, CPA)

1. It would be difficult to determine on what amounts the withholding tax should be applied

There is still some question, so far as exempt cooperatives are concerned, as to whether patronage refunds merely credited to a patron constitute taxable income in the hands of the patron. In each case, whether exempt or nonexempt, whether the patronage refund credited and not paid in cash is taxable income to the patron depends upon the marketing agreement, the articles of incorporation,

and the bylaws. That is, the obligation to pay the refund and whether it is merely a reserve fund or whether it constitutes a payment out and a reinvestment by the pátron.

Regardless of the release issued by the Treasury Department, there is still a good deal to be settled with reference to this point. For this reason, the withholding tax would create many administrative problems.

The further question arises as to those cooperatives which operate on a revolving-fund basis. Must they withhold on the amount which they are paying out for a previous year, as well as on the amount credited to the patron's account in the revolving fund?

2. Under the sixteenth constitutional amendment it is contemplated that only fixed or determinable gains or income are to be taxable

A patronage refund is not in any sense a fixed or determinable amount of gain or income. It is simply a portion of the selling price of farm products or a reduction in the cost of farm supplies. In the case of farm supplies, it might be called a repayment of an overcharge. This is recognized by the Commissioner in his instructions to farmers in preparing their tax returns. He advises them that the so-called patronage refund may be stated on the return as a reduction of farm expenses or as an increase in the original advance or selling price of farm products. For example, the farmer markets approximately $1,000 worth of milk. His cooperative will advance him $950. Then, at the close of the year, if the cooperative has been successful, it may make him a second advance of $50, and it is on this $50 that the new bill proposes to withhold the tax. There is no more reason in withholding tax from the $50 second advance than there would be to withhold it on the $950 first advance. Neither the first nor the second advance constitutes a fixed or determinable gain or income to the farmer but is his selling price of an article which has cost value. This $1,000 worth of milk may have cost the farmer $1,100, so that when he receives his $950 and $50 advances he may still be losing $100 on the transaction. It would not seem reasonable to arbitrarily place a withholding tax on such an item.

Take the case of a purchasing cooperative. A farmer needs approximately $1,000 worth of feed. The cooperative charges him $1,000 for the feed and at the end of the year found that they have made a slight savings over their overhead. Therefore, they are able at the end of the year to refund him $20 of what he paid for his feed, making his feed cost him a net of $980. Under what basis of reasoning can the reduction of the farmer's cost of feed be treated as a fixed or determinable gain on which a withholding tax could properly be applied? The feed is fed to his livestock, and his gain or loss arises from the sale of his livestock, and it is difficult to conceive on what basis a withholding tax could be applied to an adjustment in the cost of the farmer's feed. In some cases a part of the farmer's so-called patronage dividends may be on groceries. He is never permitted to deduct the cost of his groceries on his income-tax return. Why should he pay withholding tax on a reduction in the cost of his groceries refunded to him at the end of the year?

Or, the farmer's refund may arise from purchase of machinery. The machinery is a capital cost, not deductible on his income-tax return. However, if he receives a patronage refund at the end of the year, reducing his capital cost, the proposed plan would withhold a tax on this reduction of cost. We should not apply withholding tax to the reduction of the cost of farm machinery.

3. The withholding tax is not to be limited in its application to refunds paid to persons, firms, or corporations which are taxable under the law

In the case of arm cooperatives, refunds are either paid or credited by wholesale cooperatives to local cooperatives who are its patrons. In such cases, the local cooperative to whom the refund is paid or credited may not be a taxpayer, but is exempt under section 101 (12). If the withholding tax were applicable in such cases, every such cooperative would have to file a claim for refund, as it does not owe any income tax. This would create much administration work and effort, which is entirely unnecessary and uncalled for, on the part of both the local associations and the Treasury Department. The refund of the tax withheld would, of course, have to be paid because the cooperative from whom it was withheld is not taxable. But, if no such refund of the tax were provided for, then it would certainly be erroneous, because it would be taxing an association which is exempt from taxation and would also constitute a double withholding on the refund, as the local associations would then withhold on the amount of patronage dividend paid or credited to its patrons.

4. Patronage refunds are small amounts and application of the withholding tax would be costly to both the cooperative and the Government

Unless the proposed withholding tax is limited to sizable patronage refunds paid, the administrative costs to the local cooperative associations will be tremendous. Furthermore, the administrative costs and expense to the Treasury Department, in processing the withholding tax, will be unreasonable and out of all proportion to the revenue derived. Many local cooperative associations have 1,000 to 1,500 patrons to whom refunds are paid. Many of these refunds are as little as a dollar or less; most are less than $10.

In an actual tabulation of 14,918 refunds, the following shows the results as to amounts:

Range in amounts	Number of patronage refunds	Percent of total
1 cent to 99 cents	9,374	63
$1 to $4 99	3,871	26
$5 to $9 99	771	5
$10 and over	902	6
Total	14,918	100

5. The problems encountered as to a withholding tax on patronage refunds are much greater than as to a withholding tax on corporate dividends

The problem with reference to a withholding tax on patronage refunds is much greater than are those with reference to a withholding tax on corporate dividends. In the case of corporate dividends, the stockholders of most corporations are rather limited in number, but even in the smallest cooperative association, in most cases there are hundreds of patrons and in some cases over 1,000. In many cases the actual cost of computing, figuring, and filling out the necessary forms for the withholding tax on patronage refunds would be more than the tax remitted to the Government. Corporations already submit the informational reports on dividend payments to the Government, and it has been proved that it is not unduly burdensome on the corporation. But the same reasoning does not apply in the case of patronage refunds, due to the multitude of patrons of cooperative associations.

Furthermore, many patronage refunds do not constitute taxable income. If the refund is for a consumer item, then the refund does not constitute income to the patron. The refund constitutes taxable income to the patron only if it is an additional payment for the farm products marketed or a refund on farm supplies purchased, which is the category of an expense of operation of the farm or business. In the case of refunds on marketing operations, there seems no more justifiable reason for withholding on the final payment, which the refund constitutes, for the product, than for applying it to the first payment, or the initial advance.

6. A withholding tax on either patronage refunds or corporate dividends is materially different from withholding tax on wages and salaries

The withholding tax on wages and salaries was put in operation for the purpose of getting the income taxes paid on a pay-as-we-go basis. It was not put in operation simply because it was considered that the American people are on the whole tax dodgers or evaders; and, therefore, the tax should be collected in that manner, but it was put in operation so that the tax would be paid as the income is earned rather than having the tax become in arrears and the amount of the tax having to be paid a year after the money had been earned. The withholding tax on wages and salaries takes into consideration the exemptions, dependents, and other items. The withholding tax on refunds or dividends could not take into consideration such factors. It would result that an enormous number of withholdings on patronage refunds or corporate dividends would be made where the recipients would not be liable for any income tax. Consequently, a great number of claims for refund would have to be filed for these small amounts by the recipients, thus placing a great burden of work on the Treasury Department.

We honestly feel that the Treasury will concur with us that such a tax would likely not add enough revenue to pay for added costs of administration. Certainly, the withholding tax on refunds and dividends should not be applied just because

it is thought that many people may not be paying the tax they owe on such income. This is placing the recipient of corporate dividends and patronage refunds as tax dodgers and evaders. There is nothing to indicate that any such action is necessary on the part of Congress to collect the taxes owed the Government. There are ample provisions and penalties now effective to insure the collection of taxes.

Furthermore, the proposed withholding tax on corporate dividends and patronage refunds would not produce one penny of new revenue for the Government as has been insisted upon by the President to replace cuts in excise taxes.

The CHAIRMAN. Mr. Arthur D. Condon.

STATEMENT OF ARTHUR D. CONDON, OF DAVIES, RICHBERG, BEEBE, LANDA & RICHARDSON, 1000 VERMONT AVENUE, WASHINGTON, D. C., IN BEHALF OF AMANA REFRIGERATION, INC., AMANA, IOWA; ACCOMPANIED BY GEORGE FORESTNER, PRESIDENT, AMANA REFRIGERATION, INC; JOHN BESS, DISTRIBUTOR IN THE PHILADELPHIA-NEW YORK-WASHINGTON AREA; AND F. L. SACHA, OF THE DEEPFREEZE DIVISION, MOTOR PRODUCTS CORP.

Mr. CONDON. My name is Arthur D. Condon, attorney, with the firm of Davies, Richberg, Beebe, Landa & Richardson.

Mr. Chairman and gentlemen of the committee, I am appearing her in behalf of the Amana Refrigeration, Inc., of Amana, Iowa, in protest against the proposed 7-percent excise tax on home freezers as is proposed in H. R. 8920, section 155.

Mr. George Forestner, president of Amana Refrigeration, Inc., is here; also Mr. John Bess, distributor in the New York-Philadelphia-Washington area for home freezers; and Mr. F. L. Sacha, of the Deepfreeze Division of Motor Products Corp.

Gentlemen, the House adopted in H. R. 8920 the Ways and Means Committee's proposed 7-percent excise tax on home freezers. Up to the present time no excise tax has been imposed on home freezers, Congress having seen fit to encourage and permit the expansion of this important new industry without the burden of an excise tax.

During the recent hearings before the Ways and Means Committee, there was no testimony on this subject. The electric-refrigeration industry was represented in the testimony, and the committee apparently recognized the pleas of that industry for relief from the existing 10-percent excise tax burden on electric refrigerators to the end that in H. R. 8920 a 7-percent excise tax is proposed on electrical refrigerators in lieu of the present 10-percent tax.

Senator MILLIKIN. Mr. Kirby, is that your understanding that there was no testimony on this at all before the House Ways and Means Committee?

Mr. KIRBY. That may be true, but the recommendation of the Secretary which opened the public hearings was that there be a tax.

Senator MILLIKIN. There was no testimony before the House Ways and Means Committee except the Secretary's recommendation?

Mr. KIRBY. I do not recall any testimony on that other than the Secretary's statement.

Mr. CONDON. We submit that this recognition that the present excise tax is too high for the electric refrigeration industry would a fortiori lead to a realization that no excise tax should be imposed on the home freezer industry, a struggling infant. The Ways and Means

Committee and the House recognized the analogous situation of the young television industry and declined to impose an excise tax despite its proposal by the Secretary of the Treasury.

The rapidly expanding use of home freezers in rural communities indicates that home freezers are being utilized by families and other workingmen desirous of providing better living at a low cost for their families. The experience of the industry and the expressed interest of Department of Agriculture officials establish clearly that home freezers today are a family necessity, not a luxury. Improved family health and economy will be stimulated by the expanding sale of home freezers.

Manufacturers of electric refrigerators reported to the Ways and Means Committee that the present excise tax on this product has been an important factor in preventing many persons in the Nation's lower-income groups from owning electrical refrigerators and thus enjoying the benefits and health safeguards provided (p. 1064, hearings on excise taxes, 81st Cong., 2d sess., vol. 1). It is well known that many bureaus of Federal, State, and municipal governments concerned with health and good questions have advocated mechanical refrigeration, including deepfreezes, as a necessity for the safe and economical preservation of food and prevention of spoilage and waste. The recited experience with electrical refrigerators that the existing excise tax has deterred the sales of these articles, especially to the working people of low incomes, forecasts emphatically that the imposition of the proposed excise tax on home freezers will correspondingly discourage the purchasing of freezers by low-income families.

The CHAIRMAN. Is there any distinction between home freezers and farm freezers? Sometimes reference is made to farm freezers and home freezers.

Mr. CONDON. I understand not. The same type of freezer I believe is used in homes whether it is urban or farm. However, Mr. Forestner, who runs this company, would be in a better position no doubt to answer that question than I am.

The CHAIRMAN. Are they identical?

Mr. FORESTNER. They are identical except that it is generally accepted that those which are used on farms are generally of a larger size than those used in the cities.

The CHAIRMAN. They are not used for general commercial purposes? When you speak of a home freezer you are distinguishing from the commercial freezer, commercial refrigeration?

Mr. FORESTNER. That is right.

Mr. CONDON. Authoritative statements indicate that there are more than 8,000,000 families in this country with electric service who do not possess the method of preserving food by electric refrigeration. A large percentage of these families live in rural communities.

The home-freezer industry was practically nonexistent 10 years ago; in fact, it may be said to date from the end of World War II. The home-freezer industry is still in the "infant industry stage" and the additional tax burden proposed would seriously retard its growth. Most of the home freezers now being sold are manufactured by small manufacturers, like Amana, either for sale direct or on contract with other manufacturers. The industry is highly competitive, the profit margin is small and the industry could not afford to absorb the proposed excise tax. Therefore, the tax, if adopted, would have to be

passed on to the purchaser and will, we feel, prove a deterrent to many prospective purchasers of home freezers, especially in the low-income group.

Senator MILLIKIN. Is the home freezer an assembly job or does the Amana Corp., for example, make the whole thing?

Mr. CONDON. It makes the whole thing, yes, sir. It not only sells it in the formal sense of the word but, as Mr. Forestner will tell you, it has a very extensive educational campaign in conjunction with its sale efforts which instructs people on the farms and in the cities on how to use them efficiently and properly.

The home-freezer industry constitutes an important American industry composed mostly of so-called small manufacturers. The business activity of the industry has a significant effect on employment, wages, salaries, income from investment, and general business conditions. Many other industries are affected by the welfare of the home-freezer industry, such as the suppliers of raw and fabricated materials, the transporters and the distributors composed for the most part of small storekeepers.

Senator MILLIKIN. Can you tell us what is the percentage of increase in the sale of home freezers over a period of time?

Mr. CONDON. Mr. Forestner is prepared to give that answer, Senator, and he can answer now or if I may conclude my statement; he will follow me and answer that question.

Therefore, it is respectfully submitted to this committee that the best interests of the Nation's standards for health, food, and economy would be served by omitting any excise tax on home freezers, such as the tax proposed by the House bill.

Now at this point, Mr. Chairman, and gentlemen, Mr. Forestner will be glad to answer the question that Senator Millikin expounded.

The CHAIRMAN. Mr. Forestner, will you please answer the question?

Senator MILLIKIN. My question was, What is your percentage of increase in sales over some period of time that you may wish to select?

Mr. FORESTNER. The home-freezer industry had a rather peculiar trend insofar as sales are concerned. Shortly after the war the industry boomed and then for the last few years it started declining, and it is again on the way upward.

The reason for that we believe is that not enough educational work had been done with the people who need freezers, such as the farmers and others, and they did not know what could be done with them. In other words, they did not know how to handle food and what could be frozen in freezers and stored and so forth.

Senator MILLIKIN. Can you give us the statistics on it?

Mr. FORESTNER. Last year I think was the low mark since the war on the home-freezer industry but this year I would say that the home-freezer industry is again on the increase.

Senator MILLIKIN. Can you give us the statistics?

Mr. FORESTNER. I believe there were less than 500,000 units sold last year.

Senator MILLIKIN. What was the high point?

Mr. FORESTNER. The high point in the freezer industry I think was probably 1946 or 1947 when a couple hundred thousand more were sold.

Senator MILLIKIN. About 700,000 was the high point?

Mr. FORESTNER. I would say it was the high point.

Senator MILLIKIN. It has gone down to 500,000?

Mr. FORESTNER. Yes.

Senator MILLIKIN. It is now going up again?

Mr. FORESTNER. We believe it is going up again. In our opinion it is strictly because it is a new industry and not enough educational work has been done. We in our company took that into consideration 3 years ago and since that time we have had six or seven highly skilled home economists throughout the United States who hold group meetings in small areas to show the people what can be done with home freezers.

We had a meeting in a small town in Illinois whose population was only one-hundred-and-some-odd and we had, I think, 400 people at this particular meeting.

It might be of interest to you to know that a home freezer will do much to reduce the cost of living to the average person. If they raise food of their own, it is possible for them to store all the food that they raise during the season. Likewise, if they buy food, they can buy in larger quantities and also buy in season when food prices are at their lowest. That is the thing that we advocate.

Senator MILLIKIN. Are these locker installations bothering your business?

Mr. FORESTNER. No. I was one of the originators of the locker industry. I have been in it for 14 years. I think the locker industry and the freezer industry have helped each other tremendously. A lot of the locker facilities are used for processing for the people who store their food.

Senator MILLIKIN. Was there an increase in the locker business during the period that there was a decrease in the home freezer business?

Mr. FORESTNER. Probably a slight increase, but the locker industry is one that has probably been held back more by the high cost of building rather than anything else. At least that is my personal belief.

The CHAIRMAN. Are there any further questions? If not, we thank you.

Is there anyone else in your group who wishes to make a statement?

Mr. CONDON. Mr. Chairman, I have already pointed out that Mr. John Bess, distributor in the New York-Philadelphia-Washington area, is here, and his experience no doubt will be of interest to you gentlemen. He has a particular comment to make about the most recent trend in the industry.

Mr. BESS. Prior to that, Senator, I would like to mention the fact that I am a former manufacturer of freezers and due to the slow acceptance and the competition in terms of home freezers, I, as many other small manufacturers, have had to get out of the business. In other words, the industry has been so slow in developing due to the amount of education required in terms of acquainting the farmer, the suburbanite, even those in the city, of the value of home freezers, as it pertains to food conservation, that it has made it extremely difficult for the small manufacturer to continue in business.

As a matter of fact, facts and figures of the industry indicate that a number of manufacturers that existed in 1946 are no longer in business today because of the fact that the industry has been so slow in developing and the cost of creating the necessary consumer acceptance has been so great.

However, as a distributor in the three major cities in which we are presently operating it is worth while to note that there has been a very, very decided increase in the last 2 or 3 months. As a matter of fact, in the last 30 days, according to our trade papers, I think we noted a hundred percent increase during the month of May. So that there is a decided increase and the industry has finally caught on.

It is our considered opinion that this excise tax will operate very, very definitely to the detriment of this continued public acceptance.

The CHAIRMAN. How many sizes are made in the so-called home freezer?

Mr. BESS. It varies, Senator, with the various manufacturers but I would say the average manufacturer has five different sizes or six, including possibly some of the larger models.

The CHAIRMAN. What are the price ranges for the ordinary home freezers?

Mr. BESS. The price ranges at the present time will vary from the very smaller size of, say, $159.50 up to $700 or $800 for the larger sizes.

Mr. CONDON. Mr. Chairman, Mr. Sacha, who is connected with another company manufacturing home freezers, has a comment to make. He would like to answer Senator Millikin's question about the saturation. It will take only a minute.

The CHAIRMAN. Very well, we will hear him but we are adding a good many names here.

Mr. SACHA. Saturation and marketing statistics are given each year in the Electric and Merchandising magazine and are considered reliable by practically everyone in the industry. The statistics today as listed in the January 1950 issue of the publication indicate that the saturation of home freezers in wired homes is approximately 5 percent, as compared to nearly 80 percent for electric refrigerators, 18 percent for electric ranges, 10 percent for electric water heaters, and about 10 percent for television receivers.

The point which I wish to make here is that it is our understanding in drafting of the proposed revenue bill the decision to eliminate the Federal excise tax on television receivers was somewhat influenced by the fact that television was a young industry, which of course is the same case with the freezer industry.

Senator MILLIKIN. Do you not in part have direct competition with the electric refrigerator? What I mean is that at home we have an electric refrigerator and when that gets crowded I notice that things are piled into the deep freeze. Thus your deep freeze supplements your electric refrigerator whereas your deep freeze always has the function of long-term preservation of food which is not the function of the electric refrigerator.

Is that correct?

Mr. SACHA. That is right, and generally speaking it maintains a lower temperature than the freezing compartment of a refrigerator.

Mr. CONDON. Thank you.

To conclude this particular presentation, I would like to offer for the record at this time, without reading it, a telegram received by Mr. Forestner from the Carrier Corp., another manufacturer of home freezers, stating that Mr. Forestner's point of view as expressed here this morning expresses the point of view of the Carrier Corp. in protest against this excise tax.

The CHAIRMAN. You may offer it for the record.

(The telegram referred to follows:)

SYRACUSE, N. Y., *July 11, 1950.*

GEORGE FORESTNER,
Washington, D. C.:

Understand you are to testify before Senate Finance Committee protesting tax on home freezers proposed in House bill H. R. 8920. We were denied request to be heard by the Committee due to shortage of time but have submitted a statement to Senator George to be put into the records. Will you please advise the Committee that Carrier Corp. joins in your protest that this excise tax would create great hardship to growing young industry and destroy progress in rural communities for conservation of food by use of home freezers.

KRANTZ KELLER,
Treasurer, Carrier Corp.

STATEMENT OF ARTHUR D. CONDON, OF THE FIRM OF DAVIES, RICHBERG, BEEBE, LANDA & RICHARDSON, WASHINGTON, D. C., IN BEHALF OF THE CHAMBERS OF COMMERCE OF PANAMA AND COLON; ACCOMPANIED BY R. M. LOVELADY, PRESIDENT AND LEGISLATIVE REPRESENTATIVE, LODGE 14, AMERICAN FEDERATION OF GOVERNMENT EMPLOYEES, AND CHARLES F. WAHL, WASHINGTON REPRESENTATIVE, INTERNATIONAL BROTHERHOOD OF ELECTRICAL WORKERS, BALBOA, C. Z.

Mr. CONDON. Mr. Chairman, I have another topic. I am on the schedule representing another client.

Mr. KIRBY. Mr. Chairman, I misinformed the committee when Senator Millikin asked whether there had been any testimony as to the deep freeze units. The Secretary did not make a recommendation with respect to deep freeze units in his appearance before the House. He did not mention the subject at all.

Senator MILLIKIN. It was a matter initiated by the committee itself?

Mr. KIRBY. The matter arose in the committee.

The CHAIRMAN. Thank you very much.

All right, Mr. Condon.

Mr. CONDON. I have already identified myself, Mr. Chairman. I am appearing at this point in behalf of the Chamber of Commerce of Panama and the Chamber of Commerce of Colon in protest against the enactment of section 216 of the House bill. There was no testimony before the House Ways and Means Committee on the subject I am now to discuss.

Section 216 of the House bill would impose for the first time income tax upon a group of Americans whose services and devotion to our country plan an important part in our national defense. I refer to the Americans who live in the Panama Canal Zone, both civilian and military personnel. Up to the now Congress has seen fit to recognize one of the inducements which encourage Canal Zone employees to live and raise their families thousands of miles from home in a tropical climate with its enervating effects, by providing that the salaries paid to these American Canal Zone employees are exempt from income tax. No one can question that this tax exemption has been an important factor in the calculations of civilians who determine to accept employment in the Canal Zone with all its attendant problems. For these civilians, employment and service in the Canal Zone are matters of voluntary choice. The same tax exemption applies to military and naval personnel lving in the Canal Zone, presumably

because Congress did not want to discriminate against the military personnel who serve in the Canal Zone as the result of orders unlike the civilians who live there voluntarily.

Now there is the proposal in section 216 which would take from Canal Zone employees this strong inducement which Congress has provided for them. The imposition of income tax is bound to have a detrimental effect upon the morale of the many thousands of loyal Americans serving in the Canal Zone and upon the future employment of other Americans of high ability so necessary in the Canal Zone for the proper operation of that vital defense area.

A careful reading of the Ways and Means Committee report leads to the conclusion that this threatened imposition of the income tax on Americans living in the Canal Zone springs from the desire of the committee to plug the loophole whereby, as recited on page 154 of the report, a well known radio entertainer made arrangements with the Government of Puerto Rico under which he agreed to produce all his radio, television, and films on the Island of Puerto Rico in return for an exemption from the Puerto Rican income tax and with the expectation that he will at the same time qualify for exemption from the United States income tax, even though he may personally be in Puerto Rico for only a short time each year. However, we wish to invite attention to the fact that this alleged loophole pertains to Puerto Rico, not to Panama, which like the Canal Zone, is a possession of the United States. The present income tax exemption I have been referring to which affects Panama Canal Zone employees is applicable also, by its terms to Puerto Rico, and, incidentally, to the Islands of Guam, American Samoa, Wake and Midway—all classified as United States possessions. Puerto Rico and the Canal Zone are both possessions of the United States and would both come within the purview of section 216 as passed by the House. However, when we realize that the purpose of the Canal Zone is to operate the Panama Canal, and all activities in the Canal Zone are under the United States Government for that common purpose, we see at once that no analogous commercial enterprise could be established in the Canal Zone to provide a tax loophole as is reported to have occurred in Puerto Rico. All the Americans in the Canal Zone, except for a few employees of American oil companies, bank branches, and so forth, are employees of the United States Government, and live on Government land in Government quarters. It is an entirely different situation from that in Puerto Rico.

The basis for the protest I am making on the part of the two chambers of commerce in Panama in whose behalf I am speaking, that is, in the Republic of Panama as distinguished from the Canal Zone, is the vastly reduced purchasing power of the Americans in the Canal Zone which will result if this income-tax provision is enacted into law.

By treaty between Panama and the United States, government stores in the Canal Zone, that is the stores operated by the Armed Services and the stores operated by the Panama railroad which is part of the United States Department of the Army, are limited to carrying the necessities of life, generally speaking, for sale to the Americans in the Canal Zone. The American colony, both civilian and military personnel, rely upon the merchants in Panama and Colon to provide them with articles which are not sold in service stores.

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The merchants of Panama, for whom I am speaking through their chambers of commerce, have developed their businesses for a half century specifically to meet the needs and demands of the Canal Zone Americans for merchandise. The living and wage standards in Panama are lower than in the Canal Zone. The fine Panamanian stores could not exist on the trade of Panamanians alone, but have been developed to meet the requirements of the Americans living in the Canal Zone.

As is true of so many places in the world, Panama, since the end of World War II, has found itself in a depressed economic situation. In true democratic fashion, and with commendable logic, the Government is taking steps to meet these pressing needs with promises of cooperation from all branches concerned of the United States Government. The Government of Panama is determined that the standard of living of its people, always distressingly low in contrast to American standards of living, will not drop lower, but will improve despite the difficult economic situation.

Specifically, the Government of Panama is meeting the present situation by imposing higher taxes internally, and lowering indirect taxes, especially the tariffs. This action on the part of Panama will inure to the great benefit of the Americans in the Canal Zone area, who would otherwise along with Panamanian consumers have to pay more for merchandise if higher import tariffs prevailed in Panama.

In face of this move of Panama, which will, of course, stimulate business in Panama and benefit the buying public including Americans at the same time, the proposed income tax upon the Americans would defeat the very purpose of the Panamanian Government to help its own suffering people and would deprive the Americans of the planned benefits, because the purchasing power of the Americans would be vastly reduced. The distressing economic situation in Panama, which the Government is striving vigorously to overcome, would become infinitely worse. Clearly in this situation, it would be unnecessarily harmful to all concerned for the United States to impose the direct income tax contemplated.

To complement the higher direct taxes and the lower indirect taxes, especially tariffs, in the Republic of Panama, the appropriate measures for the United States to adopt would be to impose not a direct income tax upon the Americans, but the extension of United States tariffs to merchandise brought into the Canal Zone by United States Government agencies including stores for sale to American personnel—in other words an indirect tax by way of tariff instead of income tax.

If the United States were to require the payment of tariff duties on imports into the Canal Zone it would not have the disadvantages of the direct tax proposed in this bill by way of income tax. This complementary method of taxation as between the Canal Zone and the Republic of Panama would bring results consistent with the long-standing record of economic cooperation between the two countries. The often-expressed desire of our Government to assist in raising the standard of living in Panama would be implemented. This is a particular problem in Panama because the high standard of living of the Americans in the Canal Zone is so apparent to the Panamanians living literally across the street. The various treaties which have been entered into between the United States and the representatives of Panama dealing with commercial activities, as well as with the es-

tablishment, use, occupation, and control of the Canal Zone, all reflect mutual desire of both governments, and consequently both peoples, that everything possible will be done to improve the living standards in the Republic of Panama.

The imposition of the proposed income tax on the Americans in the Canal Zone will have far more serious effects upon the Panamanian merchants than may first be apparent. It is estimated that the total combined payroll for civilian and military personnel in the Canal Zone exceeds $32,000,000 annually. From Army sources the following figures were obtained:

	Employees	Payroll
Military personnel, 1950 (per annum):		
Army		$13,776,876
Air Force		3,075,359
Navy		2,204,963
Marines		532,992
Total		19,590,190
Civilian personnel (fiscal 1950):		
Army	4,425	9,300,000
Navy	2,800	6,000,000
Air Force	2,950	6,500,000
Total	10,175	21,800,000
60 percent estimated to be paid to United States citizens		13,080,000
Combined annual payroll United States citizen civilian and military Canal Zone personnel		32,670,190

The impact of the proposed income tax, starting at approximately 16⅔ percent, would hit hardest that part of the family budget now available for merchandise in Panama. In fact, the income tax could well eliminate the major part of the American purchasing power now available for spending in Panama stores because Americans in the Zone have to save to pay for their own periodic vacations to the United States, a factor which no doubt Congress has taken into account up to now in exempting these Americans from the Federal income tax, a factor which we respectfully submit that Congress should not ignore in consideration of the hardships which will result to Americans and their neighbors, the Panamanians, alike.

In behalf of the Chambers of Commerce of Panama and Colon it is respectfully urged that section 216 as written in the House bill H. R. 8920 be amended so as not to apply to American citizens in the Panama Canal Zone, thus leaving these Americans with respect to the Federal income tax exactly as they are today, in that their salaries from the United States Government are exempt from Federal income tax.

I understand also that Mr. R. M. Lovelady, who is president and legislative representative of Lodge 14 of the American Federation of Government Employees, has also flown up here in the last few days and has asked this committee for time on the same subject.

The CHAIRMAN. I am not very much impressed with the argument that if this tax is adjusted fairly on the citizens of the United States it is going to have some adverse effects upon the merchants of other countries even though we want to maintain amicable relations with those. I think there was some reason why they were exempted from

the tax in the first instance, you understand. I am not speaking of the merits on that but I am not very much impressed with the other side of the argument that you have presented. I am just speaking for myself.

Senator CONNALLY. You say here in your statement:

> This is a particular problem in Panama because the high standard of living of the Americans in the Canal Zone is so apparent to the Panamanians living literally across the street.

Are not the wages in this particular government employment very high in Panama?

Mr. CONDON. The Panamanians who work in the Canal Zone——

Senator CONNALLY. I am talking about the Americans down there. You are talking about the high standard of living of Americans in the Canal Zone. Do they not get high wages?

Mr. CONDON. They get the same as we do I believe. The same civil service scales prevail there as in Washington, so that the Americans there live on about the same scale as the people in Washington do

Senator CONNALLY. Do they not live on a higher scale? Generally speaking, are not things cheaper in Panama? They can cross the line and go over and buy their stuff in the Panama stores, which as a rule is cheaper than in the American stores in this country.

Mr. CONDON. I do not think they are cheaper, Senator. Our information is that the Panamanian merchants do not sell items particularly cheaper than the American stores. It is the fact that they are there; otherwise, the Americans would have no place to go.

Senator CONNALLY. I think you are wrong about that. I have been down there a time or two and that is where all the women on the boat rush over, to the Panamanians to buy their stuff instead of buying in the Canal Zone. Is that not right?

I see Mr. Wahl smiling. He knows that is so.

Mr. WAHL. You know what you are talking about.

Mr. LOVELADY. The prices in the Republic of Panama run from 25 to 100 percent higher on most staple commodities. Some things such as silks, chests made in India, and Chinese goods, are somewhat cheaper in Panama than they are in this country. However, they do not make up the everyday living costs of the average employee.

The CHAIRMAN. If there are no further questions, we thank you, Mr. Condon, for your appearance here.

Mr. CONDON. Thank you, Mr. Chairman.

(The following material was submitted for the record:)

STATEMENT OF CHARLES F. WAHL, REPRESENTING THE PACIFIC LOCK OPERATORS ASSOCIATION, MASTERS, MATES AND PILOTS, MARINE ENGINEERS, DREDGE OPERATORS, TRUCK DRIVERS, AND MARINE DISPATCHERS OF THE PANAMA CANAL

The largest group of American citizens gathered together in one place in the Tropics in overseas service is on the Panama Canal. Four thousand five hundred of these Americans are employees of the United States Government. They have made a career service of employment on the Panama Canal and the Panama Railroad, and enactment of section 216, subjecting them to income-tax payment, would completely upset their financial foundation.

Surely the elimination of income tax from this group (and this is only a partial exemption) is not too much to ask for loyal service in a tropical zone 1,500 miles from home.

The budget of Panama Canal employees includes a saving for the taking of necessary recuperative leave, which will be further explained in a subsequent paragraph;

it must include a savings for return to the United States after retirement, to reestablish themselves in what by then has become a strange place; it must include an extraordinary budget for the education of their children in the United States, as the Canal Zone gives them only 2 years junior college.

The House committee meant well when they approved section 216, but did not take into consideration that, as applied to the Panama Canal and Panama Railroad, the morale of these employees would be completely disrupted.

For the purpose of comparison, the Comptroller of the Panama Canal has estimated that approximately $1,500,000 per annum in revenue will be gained under this section from Panama Canal employees. This insignificant sum compared to the total is out of all proportion to the unrest and downright panic which prevails on the Canal Zone at the present time.

PHYSICAL ASPECTS

Because of the enervating effects of the tropics on the white man, medical authorities advise recuperative leave once a year, or at the least every 2 years.

The average amount of leave accumulated over a period of 2 years is 4 months.

This amount of recuperative leave is not granted because the United States Government is particularly fond of its employees in the Tropics, but because it is considered a minimum amount of time conducive to good health.

I can say at this time that before I left the Canal Zone for Washington, D. C., That there had been 165 cancellations for transportation on the Panama Railroad ships. Obviously, these cancellations were because of the inclusion of section 216, and particularly because of the retroactive feature of this bill. These employees found it impossible to pay for their recuperative leave if they were to be taxed during this year.

The Economy Act of 1932 extended the tour of duty in the Tropics of the military services from 2 to 3 years. The reuslting illness, insanity, and lowering of morale terminated in a frantic effort in 1934 to restore the 2-year term of duty which had previously been in effect. The then Surgeon General of the Army testified before the subcommittee of the Committee on Military Affairs, United States Senate, on S. 3340 and S. 3397, bills to amend the laws relating to the length of the tours of duty in the Tropics, etc.

This testimony was given on April 30, 1934, and is quoted as follows:

"(P. 5)

"General PATTERSON. * * * I have served in Hawaii and I have been in Panama several times, and Puerto Rico, and my own judgment is, from observation of officers and enlisted men, I will say, it is poor economy on the part of the Government to require them to stay more than 2 years, except for important reasons in the public interest.

"A man rapidly gets back to his normal condition after 2 years, but the longer you keep him over that period—it just takes that much longer for him to get back his normal efficiency after he returns to the home country, and some of them, especially the older men—I think it takes much longer to get back. Now, there are some circumstances which indicate that when you take the admission rates for all cases, except injuries, that is, for disease only, it shows that the rate over, we will say, in 1931, the rate was higher in Panama than anywhere. It was next higher in China; next higher in the Philippines, and Hawaii, and the United States holds the best health record. Over a period of 10 years in the Surgeon General's report, for 1932, on page 26, there is shown a graph which shows the rate over that period of time and you see that the Philippine Islands and Panama stood away above everything else. That is for disease only. The rate has not been shown for China, because we have only been there relatively a short while, but the rate for China is not quite as bad as Panama, but worse than the Philippines."

TURN-OVER

If section 216 is enacted into law, it will increase the turn-over in personnel to an extent which very likely could be of greater cost to the United States Government than the small sum the Treasury Department will receive in income-tax revenues.

Example: The cost of recruiting a new employee averages $1,800. This is the average to bring an employee and his family to the Canal Zone and return him to the United States upon termination of his service. Obviously, the tax measure as provided in section 216 of H. R. 8920 will not offset the cost of recruiting em-

ployees to fill the places of those who must necessarily leave the sthmus because it is impossible to pav their way.

Another factor: Three steamships are provided for the purpose of carrying freight and passengers between the Isthmus and the United States. The schedule for employees' recuperative leave keeps the cabins of these vessels filled all through the spring, summer, and fall seasons. Three steamships are provided for the necessary purpose of maintaining a line of supply between the Canal and the United States. A drastic curtailment of travel to a Temperate Zone by these employees for recuperative leave would result in a serious deficit to the steamship line, and the loss would have to be subsidized by the United States Treasury.

WASHINGTON, D. C., *July 11, 1950.*

Hon. WALTER F. George,
Chairman, Senate Finance Committee,
Senate Office Building:

In behalf of our members of lodges 699 and 811, international association of machinists, and the other United States citizens employed by the Federal Government to operate and maintain the Panama Canal and Panama Railroad Company, we are opposed to section 216 of H. R. 8920 now being considered by the Senate Committee on Finance. The enactment of section 216, which would subject all United States citizens who receive compensation from the Federal Government to Federal income tax, will seriously disrupt the living standards of all United States citizens employed by the United States Government in the Canal Zone. Since 1921, when the exemption was enacted, this has been considered as an integral part of our craftman's employment under the unfavorable working conditions of the Tropics. It has been consistently used as an inducement to recruit the skilled craftsmen necessary to the successful operation and maintenance of the Canal. To enact section 216 would be a direct discrimination against these craftsmen because they would be obliged to pay this tax while other United States citizens employed by private business in the Canal Zone and Panamanian citizens employed by our Government would remain exempt. The morale of the craftsmen needed to operate and maintain the Canal has already been damaged by unreasonable reductions in force and the impact of this discriminatory tax would cause serious damage to the defense of our country and commercial shipping if enacted without safeguards to the employees' living standards. Please make this a part of the record of testimony in your committee's consideration of H. R. 8920.

ELMER E. WALKER,
General Vice President, International Association of Machinists.

The CHAIRMAN. The next witness is Mr. John C. White.

STATEMENT OF JOHN C. WHITE, OF THE FIRM OF FULBRIGHT, CROOKER, FREEMAN & WHITE, WASHINGTON, D. C., AND HOUSTON, TEX., ON BEHALF OF THE NEW YORK COTTON EXCHANGE

Senator CONNALLY. Mr. Chairman, I wish to say that I have known Mr. White for a great many years, since he was a young boy. He is a very able and prominent lawyer from Temple, Tex., who has his office now here in Washington.

Mr. WHITE. I will not attempt to identify myself. I think Senator Connally has done a better job.

Senator CONNALLY. You might identify your firm.

Mr. WHITE. I am with the firm of Fulbright, Crooker, Freeman & White, of Washington, D. C., and Houston, Tex. I am appearing here today on behalf of the New York Cotton Exchange.

First of all, the New York Cotton Exchange would like to commend the House action in reducing the holding period of capital assets from 6 months to 3 months. That is done by section 209 (b) of the bill. Insofar as operations of the futures exchanges are concerned, we believe this change will encourage speculative trading of the type

that is needed and will result in greater revenue. It will also lessen the artificial effects resulting from speculators' holding for tax reasons contracts they would otherwise liquidate. There is an increasing realization that there can be no good market for hedging purposes unless speculators find it attractive.

The exchange was afraid that the original Treasury proposal in connection with short sales might be applied to straddles between months and markets, but are pleased that in section 210 the House has eliminated this possibility through the addition to section 117 of subsections 117 (m) (3) (B) (ii) and 117 (m) (3) (C).

The chief purpose of our appearance is to indicate our concern over the proposed amendment of Senator Gillette to section 212 regarding the taxation of capital gains of aliens and foreign corporations. We are not strongly opposed to the provisions of section 212 of the House bill, which is applicable to temporary residents, but, having worked hard a number of years ago to obtain legislation which would encourage use of our domestic futures markets by aliens and foreign corporations for hedging, straddling, and trading purposes, we oppose action now that undoes or threatens the exemption of such transactions in commodity futures.

The reasons which Congress judged adequate for exemption in 1936 are still sound. The situation was carefully presented by Elwood P. McEnany before the House Ways and Means Committee, at page 369 of the hearings on the Revenue Act of 1936. The specific exemption of commodity futures transactions from tax was approved by this committee in its report upon the 1936 revenue bill (Cumulative Bulleetin 1939-1 (pt. 2), p. 692), and was clarified somewhat and approved again in its report on the 1942 revenue bill. (Cumulative Bulletin 1942-2, p. 460.)

For many reasons the New York Cotton Exchange is too little used by foreigners at present. Liverpool and Bombay are closed and the straddling operations which were once so helpful are impossible until they reopen, as they surely will before too long. This is also true of other foreign markets. War and remnants of war controls of all sorts, including foreign-exchange controls, have made it difficult for many European countries to use our market even for hedging purposes. But we are zealous to preserve the possibility of its use just as soon as international conditions permit.

There are rulings of the Treasury found in General Counsel's Memorandum 18383 (1937-2, Cumulative Bulletin, p. 244, and I. T. 3137, 1937-2 Cumulative Bulletin, 164), that profits from hedging operations by a nonresident alien or foreign corporation are income only to the extent they exceed the losses for which they compensate. It may be that the proposed amendment would not change this situation, but, even if this be true, it is virtually impossible for an alien to establish what the compensating loss for a particular futures transaction profit is, and how a broker required to withhold would determine whether a transaction was a hedge, I do not know. The amendment would certainly tax any profit from the United States end of a straddle regardless of a loss on the other end, and from any speuclative contract. The result could only be elimination of such transactions and consequent loss of the revenue from transfer taxes and taxes upon income of brokers. It will reduce rather than increase revenue.

We recognize that section 213 provides this amendment shall not apply in contravention of any treaty. Treaties which exempt gains from the sales or exchange of capital assets exist with the United Kingdom, Canada, France, the Netherlands, Sweden, Norway, and others. A similar Belgian treaty awaits ratification. A treaty is in preparation with Italy, an important customer for American cotton, which badly needs the use of the exchange facilities, but is not now in effect, and also with Switzerland. The same thing is true of other cotton-producing and -consuming countries.

We are not diplomats, but bound as we are with the exportation of cotton to consuming markets all over the world, it seems to us a rather foolish thing to enact a provision applicable only to a few countries, and contravening an established treaty-rule policy. We can scarcely preserve the present status of our own operations in foreign markets if this amendment is adopted.

We have no intimate knowledge of operations in the coffee market by Brazilians, which inspired this amendment, but we have seen no convincing evidence of abuse that justifies a taxing amendment of this type applicable generally. In addition to the damage it does all over futures markets, it is certain to be interpreted as a direct slap at Brazil. Since the provision would be effective on January 1, 1950, it is retroactive and therefore even more likely to embitter our good neighbors and our own valued customers. While no one likes higher prices for coffee purchases, cotton men know that the better the prices Brazilians get for coffee, the smaller the future crop of Brazilian cotton will be, and the more American goods Brazil will buy. We also know that most of the South likes higher prices for cotton.

We sincerely hope that this committee will not reverse its previous actions and the well-established treaty rule of exempting capital gains from transactions in commodities on futures exchanges.

Senator CONNALLY. On page 3 in referring to the countries with which we have treaties you say:

> Treaties which exempt gains from the sales or exchange of capital assets exist with the United Kingdom, Canada, France, the Netherlands, Sweden, Norway, and others.

Mr. Stam calls my attention to the fact that he thinks you are in error in regard to the Netherlands. Is that true?

Mr. WHITE. I would bow pretty much to Mr. Stam's views on that subject. My check showed that there was such a treaty but if he says there is not, my check must have been inaccurate.

Mr. STAM. There was one country that the committee decided not to exempt with respect to capital gains and I think it was the Netherlands.

Mr. WHITE. I will recheck that and talk to Mr. Stam about it.

I also would like to say that the exchange appreciated the great courtesy and help of the staff itself in working out some of these amendments which the House adopted.

Senator BUTLER. Mr. White, in your statement you do not give any estimate as to the amount of business that would be affected. Is that possible?

Mr. WHITE. I doubt whether it is. We know that concerns now actively hedge on the New York cotton market. They tell us that they will have to quit if this goes in because you cannot pay a 30-

percent tax on one end of a hedging transaction and have a hedge. It just destroys the hedge entirely because the gain will not offset the loss.

Senator BUTLER. Of course, if it is strictly a hedge, why there is no straddling arrangement, to which you refer, because they have the commodity itself on the other end of the trade.

Mr. WHITE. In the simplest form of a hedge, that is correct, but the foreign concerns tell me that in actually working out their taxes with the Bureau they have found it to be almost impossible to say that this particular futures contract was a hedge for this particular cotton or this particular sale, and the result has been that they have been in continual difficulties on such matters, or were before they were exempted. They do not think that the hedging rules of the Department offer them much protection, in other words.

Senator BUTLER. The same rules apply of course to all commodity markets, whether it is cotton, grain, coffee, or some other commodity?

Mr. WHITE. Yes, sir. I think foreign business is much more important to some of the other exchanges.

Senator BUTLER. Of course, the service that a commodity exchange renders is very valuable and if a commodity market, say here in this country, gets unusually low, lower than it should be, why it is a good buy for those who have an opportunity to sell the same commodity in a market elsewhere that is too high.

Mr. WHITE. That is certainly our view, and I think agreed to almost universally.

Senator BUTLER. It would tend to bring the markets internationally to a general level.

Mr. WHITE. Yes, sir.

Senator CONNALLY. What is the difference between a hedge and a straddle?

Mr. WHITE. In the case of a hedge, ordinarily that refers to what might be called a straddle between a spot commodity, the actual cotton, and the futures contract.

In the case of a straddle, that term is used to refer to the ownership of a futures contract in New York and a short contract in Liverpool, for instance. It is a futures against futures.

Senator CONNALLY. Futures against futures?

Mr. WHITE. Yes, and that is designed to equalize the markets, to put them in their proper commercial relationship.

The CHAIRMAN. Thank you very much, Mr. White.

Mr. WHITE. Thank you all.

The CHAIRMAN. Mr. W. P. Hamblin.

STATEMENT OF W. P. HAMBLIN, DIRECTOR AND ATTORNEY FOR THE W. D. HAYDEN CO., ACCOMPANIED BY W. PARKER, PRESIDENT, PARKER BROS.

Senator CONNALLY. Mr. Chairman, I wish to say that Mr. Hamblin is also a constituent of mine, a very distinguished and prominent lawyer of Houston, Tex., and I am glad that he is here.

Mr. HAMBLIN. Thank you, Senator. I do not know whether I deserve all that encomium or not, but I hope it is true.

Senator CONNALLY. Do not debate it.

Mr. HAMBLIN. My name is W. P. Hamblin, of Houston, Tex. I am one of the directors and attorney for the W. D. Hayden Co., one of the largest producers of oyster shell.

I have with me Capt. W. Parker, who is president of Parker Bros., who is a producer of oyster shells in the Texas area.

There has been a great deal of confusion about what we mean when we speak of the oyster shell industry. Most people think that we use the shucked shell, or that we are gathering shells from the sea which are continually being replaced. That is not true.

The Government has said that it is a mining operation. It is a fossil shell that has been deposited hundreds of millions of years ago—we do not know how many. We reach that with a dredging process, going down underneath the bottom of the bays 2 to 4 feet, moving that much silt, and then reaching this fossil shell.

Senator CONNALLY. In other words, the shell is covered up with silt?

Mr. HAMBLIN. The shell is covered up with silt, anywhere from 2 to 4 feet.

Senator CONNALLY. You have to dredge that off?

Mr. HAMBLIN. We have to dredge that off and then get the shell, take it up to the top of our dredges and wash it and screen it; and the fines, the smaller shells, go into one barge and the heavier shells go into another, because the cement plants and the chicken-feed plant and the fertilizer plants want the finer shell. The other shell can be used for other purposes. The Dow Chemical Co., for instance, uses a vast quantity of our shell and does not require the fine. I think their monthly requirement is 54,000 yards of shell. Each one of the cement plants in Houston requires approximately a thousand yards a day. The chicken-feed plant will probably require a thousand yards three times a week and so on.

The shell is used in vast quantities by the chemical industry down there. As a matter of fact, Captain Parker has had a request from du Pont: "If you can give us a guaranty that we will have shell there for the next 15 or 20 years, we will put a $10,000,000 or $50,000,000 plant there."

We cannot give them any guaranty because we do not know how much is there, but we are depleting it very rapidly because it is found only at the bottom of the bays, Galveston Bay and Matagorda Bay in Texas. It is also found in Alabama, Florida, and Louisiana. I am really appearing on behalf of all the shell producers, but the vast quantity of it is produced in and around Houston and the lower Gulf coast, Matagorda, and Corpus Christi.

The chemical industry requires a great deal of that. They turn it into lime and use it as a catalyst, and a great deal of it is used in the metal industry. In other words, Dow Chemical uses shell or lime made from shell to produce magnesium.

Inasmuch as our supply is being exhausted rapidly, we think probably in Galveston Bay we have only a 10 years' supply.

The Hayden Co. recently completed a new dredge because during the wartime period we produced vast quantities of shell. As a matter of fact, Parker Bros. and Hayden Co. went into a joint contract at the request of the Government to furnish Dow magnesium with 3,000 yards a day. We wore out our equipment. Now we are replacing it. That new dredge cost us something over $400,000. Captain Parker is building a dredge now that is nearly completed that is costing him better than $500,000.

The CHAIRMAN. Does this tax bill affect you?

Mr. HAMBLIN. We are trying to get a depletion allowance. We are allowed 5 percent under the bill. Very frankly, it is a very small allowance if we have to keep building dredges every 10 years.

Senator CONNALLY. Do you contend that the supply of shell is exhaustible?

Mr. HAMBLIN. There is no doubt about its being exhaustible, sir, and it cannot be replaced except maybe after eons have passed. It will not be within the memory of any human being either living or contemplated today. It is something like the oil supply.

Senator CONNALLY. Under your definition, I do not expect to see that.

Mr. HAMBLIN. Nor I.

Senator CONNALLY. This shell that you are speaking of is calcareous?

Mr. HAMBLIN. It is almost pure calcium carbonate, about 99 percent pure calcium carbonate. Almost everything has been leeched out of it years ago.

Senator CONNALLY. It is the product of the sea?

Mr. HAMBLIN. It is undoubtedly the remains of mollusks, oysters, and clams and other shell fish. But of course, as I say, it is not replaceable; it is not being replaced.

Senator BUTLER. How much of a bed is there under this 3 or 4 feet of sediment?

Mr. HAMBLIN. Sometimes it will run anywhere from 3 to 10 feet. I filed with each member of the committee a brief, and we have tried to illustrate as nearly as we could in a crude way the way the shell appears at the bottom. There will be a layer of silt from 2 to 4 feet, and there will be a layer of shell from 2 to maybe 6 feet, and underneath that there is blue mud, what we call blue mud. When we get to blue mud we have to quit. Some of that shell goes down nearly to 20 feet. We are prepared to dredge down to 26 feet. If we find shell at a lower depth than that, we are going to be required through some process of putting our pumps at the bottom to force that shell up. We cannot pump it up any more. As it is now, we pump it up into the dredge and force it to the top of the dredge and screen and wash it as it comes down.

Senator CONNALLY. What is the difference between this shell and ordinary oyster shell?

Mr. HAMBLIN. The ordinary oyster shell is what is shucked from the live oyster. This is fossil. Some of them look like old-fashioned oyster shell, of course. They are leeched out until they are almost crumbly.

The CHAIRMAN. What is the size of the industry engaged in this business?

Mr. HAMBLIN. Senator, to engage in it in the way that Hayden Co., Parker Bros., and Matagorda Shell does, takes anywhere from $2,000,000 to $4,000,000. Some of them require less. They have small dredges, small towboats, and small barges. The Hayden Co. has 32 barges hauling from 800 to 1,000 yards apiece—8 towboats.

The CHAIRMAN. But it is an industry that requires relatively heavy capitalization?

Mr. HAMBLIN. Yes, sir; with a very small return per dollar of investment.

Senator BUTLER. How long as the industry been in existence?

Mr. HAMBLIN. It started about 40 years ago. Capt. W. D. Hayden was the first man, with an old-fashioned dipper dredge cutting off reefs; but it has only beeen running in a big way for the last 15 years.

Senator CONNALLY. That conserves a valuable asset; does it not?

Mr. HAMBLIN. It not only does that, but during the war 90 percent of our production went to the defense program.

Senator CONNALLY. If you did not get this commodity out of these shells, you would have to get it somewhere else at a higher cost?

Mr. HAMBLIN. As I say, it is pure calcium carbonate. It is the cheapest form of calcium carbonate. You can get the same thing out of limestone, but it costs more to get it and to produce it, and there is a few hundred miles of freight transportation required.

The CHAIRMAN. Is there anything you wish to say, Mr. Parker?

Mr. PARKER. No, sir; that just about sums it up.

Senator CONNALLY. You represent one big company?

Mr. HAMBLIN. I represent the W. D. Hayden Co.

Senator CONNALLY. He represents another big company?

Mr. HAMBLIN. The Parker Bros. Co.

Senator CONNALLY. You want to corroborate what he says; is that right?

Mr. PARKER. Yes, sir.

The CHAIRMAN. Thank you very much, Mr. Hamblin, for your appearance.

Mr. HAMBLIN. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. A. Bryan Clark, Jr.

STATEMENT OF A. BRYAN CLARK, PRESIDENT, ASSOCIATED SEED GROWERS, INC., NEW HAVEN, CONN.

Mr. CLARK. My name is A. Bryan Clark. I am connected with the Associated Seed Growers, Inc., which name is misleading. It is a private company engaged in the production principally of vegetable seeds. Our operations include breeding stations in different parts of the country, some eight of them, in California, Montana, Idaho, Texas, Florida, Indiana, and so forth. The seeds which are developed and maintained at these breeding stations are then put out to individual farmers and grown into seed crops. It is those crops which we sell primarily to canners and to freezers, producers, and so forth.

What I wish to talk about particularly is the unequal exemption of cooperative organizations from the income tax, and also I would like to make a few remarks in favor of the adoption of a progressive tax rate on corporations.

These developments in Korea, I presume, may place a different light on the tax bill than might have been the case several weeks ago, but this question of the equity involved in the competitive picture will be the same whenever it becomes appropriate to pass a new tax law, whether that tax law be one with an increased tax rate or a decreased one.

Today the taxing responsibility is much greater than it has ever been before. There are many responsibilities in this Government of very sobering character, but the power to determine what part of the population shall carry the tax load and in what proportions is more significant today than ever before. It is estimated that the total

Government take is something like 25 percent of our national income and the way in which that is placed on some parts of the competitive national economy with exemptions given to other parts has a very significant bearing, in fact a determining bearing probably in the outcome of that competitive struggle.

It has been said the power to tax is the power to destroy. It seems to me that now the power to exempt from taxation is virtually the power to create.

It used to be that an income-tax law was for the purpose of raising revenue. Now the collateral effects of the tax law can kill certain parts of the economy and practically cause an increase of life in other parts of the economy.

There is I think a fairly clear analogy to that in the agricultural field today in the use of hormones. The time was when the favoring or fostering of the crop itself and the desire to kill the weeds was handled by such things as fertilizer under regular cultivation. Today we are to some extent using hormones, which when used in proper proportions and very skillfully, can encourage the life of certain plants; when used otherwise it can kill the weeds. But the powers of the hormones are so strong that frequently when used for one purpose quite a different purpose results. So I consider the incidence of the income tax burden as of paramount importance.

Now this bill H. R. 8920 makes a new departure with respect to various charitable, religious, educational organizations in continuing to exempt their regular activities but placing a tax upon the business income of various general commercial business activities. I think that is a very salutary new development because in those business activities they are part of the competitive economy.

It seems to me that the same principle should apply in the case of cooperative corporations and mutual banks and insurance companies. The company with which I am associated, despite its name, is not a cooperative. We do, however, have some cooperatives among our competitors. We have some among our customers.

I am not opposed to the cooperatives, I am not opposed to their principles. In fact, I am a member of a consumers' cooperative in New Haven. I was a member of its first board of directors. I am in favor of them in principle. I think they are a healthy influence in the total competitive picture but the competition ought to be a fair and equal competition. I am satisfied it is not that now. I think there are some people in the cooperative movement who feel that they should apologize for their especially privileged tax status.

I would like to say just a few words about the question of progressive rates. It seems that the competitive condition of the country is improved by the greater number of competing units that we have. This new bill which reduces the tax on corporations earning up to approximately $150,000 and increasing it on corporations earning above $500,000 I think is moving in the right direction. I would like to see it move somewhat more in that direction. I do not believe that the tax on corporations should ever go perhaps above 50 percent because the tax is getting to the point where it tends to prevent money being invested in business activities. But the tax on many small corporations, especially when taken together with the inheritance tax, tends to restrict their operation.

We have among our customers and competitors many instances where a small organization for tax reasons has sold out to a larger corporation.

I suppose our company in this total picture would probably come somewhere between a small and a large company but in our particular industry we are one of the larger units. Therefore, the adoption of this principle would save our smaller competitors and would in general be against our interest. But on the whole I am satisfied that it would be a move in the right direction.

I am not opposed to these large industrial corporations. Modern technology has developed to such a point that we have to have them. There is no point in denying ourselves the benefits that come from mass production and the use of this technology, but to quite an extent the development of this large concentration of industrial power has led to the increase of many of our governmental activities. It has caused a kind of distortion in our competitive economy. Therefore it seems to me only fair that the major corporations benefiting the most from mass production and modern technology should carry a somewhat larger share of the tax load. In other words, it is a question of taxing somewhat less the more freely competitive part of the economy and taxing somewhat more heavily the less freely competitive part of it.

That, sir, is all I have to say. I feel that the rules of taxation should be as fair and equitable as possible. The significance and importance of the tax in the competitive structure of the economy is more vital than ever before, almost the most vital part of it today.

The American businessman many times has sought tariff protection and other favors. I hope perhaps the day of seeking special favors is passing away. At least we want a reasonable and a just tax measure in view of the economic and security needs of the nation at this time.

Thank you.

The CHAIRMAN. Thank you very much.

(The formal statement follows:)

MEMORANDUM FROM A. BRYAN CLARK, PRESIDENT, ASSOCIATED SEED GROWERS, INC., NEW HAVEN, CONN.

I appreciate the opportunity to appear before this committee to express certain convictions I have about the taxation of corporations with special reference to this bill, H. R. 8920. Current developments in Korea overshadow this as well as all other matters, but whether taxes are eventually increased or decreased they should be equitable.

Let me begin by saying that I speak under no other auspices than my own and those of the private company with which I am connected. This company, Associated Seed Growers, Inc., is engaged in the business of breeding, growing, and distributing seeds. Our eight breeding stations in different parts of the country develop and maintain our pedigreed Asgrow planting stocks. At 18 growing and processing branches these pedigreed stocks are grown for seed by independent farmers under contract with us. Our customers are canners, freezers, fresh produce growers, etc. Therefore, I look at this tax business as a private businessman dealing directly with farmers and intensely interested in their problems.

The responsibility of this Senate committee together with its counterpart committee in the House has grown in recent decades into a charge of staggering proportions. There are many sobering responsibilities resting on various parts of our Government these days, but in many ways the most fundamental and far-reaching is that of determing what groups in the nation shall bear the cost of Government and in what proportions. Now that the Government "take" is something like 25 percent of the total economic output of the Nation, the determination of the sources from which that take shall come has unprecedented consequences in molding the structure of our economic system.

The power to tax has long been recognized as the power to destroy, but now the power to exempt from taxation has become the power to create.

An income-tax law used to be simply an act for the raising of revenue. Today the magnitude of the tax makes such a measure not only a revenue bill but also an instrument, including the power of life and death over different segments of the Nation's economy. It may not be sudden death or an immediate springing to life, but by placing this insuperable burden on some and withholding it from others the taxing authorities so greatly influence the competitive struggle as to determine its outcome.

Now, a proper function of democratic government is to foster various healthy developments within the national community and to restrain other unhealthy ones. No fault is found with the exercise of this essential function. The concern here expressed is that in formulating a tax measure for the raising of necessary revenue the severity of these collateral effects may not be fully comprehended. An analogy is found in the use of hormones in the cultivation of vegetable crops. The "fostering" of crops and the "restraining" of weeds traditionally has been done by the use of common fertilizers and ordinary cultivation. Now to some extent hormones are used both to foster plant growth and in other instances to kill it. They have thus the power to increase life and to destroy it. Moreover their potency is so great and their action so violent that not infrequently when employed for one purpose they produce quite another.

Thus I consider it of transcendent importance that the blighting as well as the therapeutic reactions of these tax hormones—as they spread throughout the Nation's economic and political system—be watched and controlled by taxing authorities having a keen sense of their tremendous power and responsibility.

There are two aspects of H. R. 8920 on which I should like to comment in particular. They are (1) its exemptions for cooperative corporations and for mutual banks and insurance companies, and (2) the principle of progressive corporate tax rates.

The granting of exemptions from taxes to charitable, religious and educational organizations has always been acknowledged as sound public policy and has seldom if ever been called in question. The motives behind these exemptions are as sound today as ever before, but the commercial or business activities which these organizations sometimes carry on are in competition with other commercial and business organizations. Since tax exemption under today's tax rates is one of the most potent of all competitive advantages, the public policy aspect of this situation is no longer entirely what it once was. Accordingly, the provisions of H. R. 8920 in continuing the basic exemptions of these organizations but then proceeding to tax their competitive, commercial business activities seem to me to be an altogether wise and salutary departure from past practice.

I feel strongly that for the very same reasons cooperative and mutual corporations should also be taxed on their business earnings. As in the case of the charitable organizations, the motive of fostering cooperative and mutual enterprises, especially in their early stages, was good public policy. It can hardly be appropriate at this stage of the game, however, to give them the competitive business advantage which their present tax-exempt status gives them. In fact I am sure there are some in the cooperative movement who feel apologetic for their specially privileged tax status.

Our company Associated Seed Growers, despite its misleading name, is not a cooperative. It is an ordinary tax-paying concern. We are in competition with some cooperatives. And we have other cooperatives among our customers. Personnally, I am not opposed to them or their principles. I am a member of the Cooperative Consumers of New Haven, Inc., and was a member of its first board of directors. I believe the cooperative plan has a real place and function in our economy as an antidote to, or check on, some of the tendencies which are inherent in the conduct of private business. But the competition between cooperatives and private business should be fair and equal competition. It is not that now. It has not been that since income taxes have become such a major hindrance to the accumulation of business reserves.

I believe that cooperatives and mutuals—as mature, self-respecting members of the business community—should stand their fair share of the total tax load.

Coming now to the principle of progressive corporate tax rates, I don't hold this to be as vital a matter as the equal taxation of cooperatives and mutuals, but it is still significant. It appears to me that those tax hormones mentioned above would be more beneficial to the system as a whole if there were some graduation in the rates. For this reason, I think H. R. 8920 moves in the right direction in diminishing the rate on corporate earnings up to $150,000 or thereabouts and in

slightly increasing them above $500,000. I should like to see this principle carried a little further. I believe the maximum rate on even the largest earnings should not exceed 50 percent, but I would favor a more consistent progression in rate from the low earnings to the high ones.

The health of our competitive economic system is improved in general by a large number of competing units. For this reason it seems to me appropriate for the smaller companies generally, to be given a tax advantage of this type. Parenthetically, Asgrow is probably somewhere in between "small" and "large" in the over-all national picture. In the seed business, however, we are one of the larger companies. Thus most of our competition is from smaller concerns which means that this proposal would be against our interest.

The main justification for moderating the rates on small companies is the fact that present rates, especially when coupled with inheritance taxes, are placing too great a burden on the small and the new competitor. The growth of new enterprise needs the type of fostering which will enable it to prosper and to accumulate reserves. Cheap and loose government credit is not nearly so potent a stimulant as this.

One other point: Modern technology (in steel and autos, for example) makes large-scale operation essential in some industries. In some of these industries, or parts of them, small concerns cannot begin to compete with the large ones, and no tax advantage will materially alter the situation. Moreover, national progress will not be served by any effort to thwart the reaping of those benefits which come from mass production and large-scale industrial technology. The fact remains, nevertheless, that the growth of this vast technology and of these industrial giants has presented us with many of the problems which now plague our competitive economy, which in turn have caused much of the growth in our governmental organization.

Therefore, since the over-all and long-range health of our competitive economy is not improved but rather complicated by the existence and power of these great industrial organizations, and since much of the weight of our governmental burden has been occasioned by their distortion of our social and economic fabric, it is both wholesome and equitable for them to bear an increased share of the tax load. In other words, decrease the tax load on the more freely competitive part of the national economy, and increase the load on the less freely competitive part of it.

In conclusion, I plead that the rules of the game be made fair and equitable for all competitors—co-ops and mutuals as well as private companies. We in American business expect no great panaceas from Government. Neither do we want hand-outs. We look to our tax-creating authorities to keep the burden of taxation reasonable and just in the light of the economic and security needs of the Nation.

The CHAIRMAN. Mr. Lester? You may identify yourself, sir, for the record.

STATEMENT OF GARNER M. LESTER, JACKSON, MISS., APPEARING AS PRESIDENT, NATIONAL TAX EQUALITY ASSOCIATION, CHICAGO 4, ILL.

Mr. LESTER. I am Garner M. Lester, of Jackson, Miss. I am an independent farmer and businessman, engaged in buying and selling cotton, cottonseed, feed, and fertilizer and in operating cotton gins and warehouses. I am also president of the National Tax Equality Association and I am appearing here today in that capacity, to speak directly for our 8,000 members and also indirectly for the members of some 1,600 trade associations and chambers of commerce that share our views and work with our association in the fight for competitive tax justice.

The House Committee on Ways and Means has on two recent occasions been given statistical and legal information that clearly demonstrates the existence of a serious inequality in business taxation and reveals important sources of needed revenue that are not now being tapped. I am making available to you copies of recent reports pub-

lished by NTEA entitled "Facts and Figures" and "The Law," which corroborate facts of which I am sure you are well aware, namely:

1. That there is a tax escape on the part of cooperatives and other tax-exempts in our business community that is unfair to their tax-paying competitors, and furthermore,
2. That this escape is depriving the Federal Treasury of something more than $1,000,000,000 of revenue each year that it is permitted to continue.

Since these facts are well established, the only thing to be considered at this time is what to do about the situation.

The bill now before you, H. R. 8920, makes a start in the right direction.

It imposes income tax on the unrelated business earnings of educational and charitable institutions and labor unions. And it sets up a withholding tax on the patronage dividends of cooperatives.

But it does not go so far as it should in closing loopholes in our tax structure. It does not even conform fully to the principles laid down by the Ways and Means Committee in taxing the tax-exempts. In the report accompanying the bill the committee said:

> The problem at which the tax on unrelated business income is directed here is primarily that of unfair competition. The tax-free status of these section 101 organizations enables them to use their profits tax-free to expand operations, while their competitors can expand only with the profits remaining after taxes.

That statement applies to all tax-exempts—not merely those that are in business to make money for educational or charitable purposes, but also those that are in business to make money for members and investors—in other words, the cooperatives and the mutuals.

Further, as Secretary of the Treasury Snyder said when he appeared before you a week ago:

> Favored groups must not be provided with unwarranted opportunity to escape taxes intended to apply generally.

Those statements express fundamental principles to which all advocates of equality and justice will subscribe. The impressive significance of the Secretary's words was enhanced at the very moment of their utterance by the rattle of guns, the drone of planes and the marching feet of American soldiers on the Korean battlefield. This unexpected development in world affairs means heavier taxes, and emphasizes the need for immediate tax equality.

The proposed withholding tax on patronage dividends will perform a useful administrative service, but it must not be looked upon as satisfying the demand of taxpaying businessmen for competitive tax equality. It will levy no tax on the corporate income of cooperative corporations. It will produce no income that is not already owed to the Treasury under present laws. It will, however, point the way to the collection of an estimated 20 to 30 million dollars of revenue which has heretofore escaped for the very simple reason, as your tax experts have now discovered, that the recipients of patronage dividends frequently forget to report them in spite of the Treasury's recent efforts to jog their memory, and in refutation of the claim of co-op leaders that their patrons always pay what they choose to call this "partnership" tax.

The cooperative press has attacked this withholding tax on the ground that it would cause much new record keeping and would

69474—50——46

involve administrative difficulties. It must be apparent to this committee, however, that if a cooperative is now keeping the proper sort of books it will have no difficulty in complying with this law.

Mr. Chairman, for the benefit of the committee, a cooperative is supposed to keep a complete record of all transactions of its members and is supposed to keep it right before them, and to withhold a certain percentage of that would certainly be a very easy task.

As for the Treasury, it has been trying for several years to find a way to collect the unreported tax on dividends and this method has its approval, as Secretary Snyder stated to you, because it promises to do the job.

This withholding provision will bring in some much needed revenue, but a far greater amount would result from the previous studies ordered by Congress.

We would urge one addition to this withholding tax provision—namely, that city consumer co-ops also be subject to the withholding tax on their patronage dividends.

In the matter of the proposed corporate rate readjustment, the bill offers to smaller companies the sop of a slight tax reduction, but ignores their plea for relief from an untenable competitive situation by leaving the cooperatives still legally tax-exempt. It appears to us that the little decrease for small corporations would more properly have been balanced by the imposition of exactly the same taxes on the co-ops. The new graduated rate would cause no special hardship to the co-ops; certainly it would not destroy them, any more than it would destroy ordinary fully taxed business corporations. On the contrary, it would remedy a competitive situation that becomes more grievous each year.

The question now before you is how shall this wholesale tax escape be remedied—and when?

In presenting the issue of tax equality to the Ways and Means Committee we asked for full tax equality, without compromise or reservation. We ask your committee for the same. We urge that the cooperative corporation be treated taxwise exactly the same as any other corporation; that its total earnings be taxed before distribution of any dividends, patronage or otherwise; that it be allowed only such deductions as are permitted to other corporations; that so long as double taxation is the law of the land the recipients of patronage dividends be taxed individually along with other dividend recipients.

We believe that such treatment is fair, honest, and competitively equal.

This committee has before it an amendment to H. R. 8920 proposed by Senator Williams, of Delaware. That amendment proposes to tax the earnings of cooperatives under certain specified conditions. It is a thoughtful, well worked out proposal, obviously developed after long and careful consideration by a man who has made almost a lifetime study of the cooperatives. Frankly, it does not go as far as we would like, for it still leaves the door open for certain classes of cooperatives to escape all or nearly all of their corporate income taxes. It would be a beginning, however, and we commend it to you as such.

I have only one more thought to leave with you, gentlemen of the committee. Since this bill was written in the House, we have embarked upon a great new expenditure of men and money. Already

a draft call for 20,000 men has been issued. It is now estimated that even a little war will cost an additional 3 to 5 billion dollars. Congress is being asked to appropriate huge sums for bombs and planes and ships and equipment. We are warned that if a full-scale war develops, business will be regimented, individual income taxes will average three times higher than in World War II, and war taxes will take practically every penny that business can earn.

I can assure you that independent, taxpaying business will gladly do its part, as usual. But this time we shall expected every business to do its part. We shall expect the Congress to clamp down fast and hard on all tax-exempts that are doing business in the market place.

The cooperatives got their first tax exemption before we entered World War I. They went to town in a big way when they kept all their profits as contrasted with taxes, up to 80 percent of earnings, paid by other businesses in World War II.

No business should be allowed to get away with such an advantage again either in peace or in war.

H. R. 8920 is the first tax bill to be considered by the Congress since the outbreak of fighting in Korea. It may be the only opportunity for this Congress to make sure that all groups are called upon to pay their share of the costs of this conflict.

It must not happen again that one segment of the economy pays the costs of war while directly competing businesses reap great competitive advantage and keep all their profits through the avenue of legal tax escape. Failure to adopt tax equality at this time can only result in the accelerated expansion of the tax-exempt part of our economy and the corresponding contraction of the income tax base at a time when an increase in Government revenues is imperative for the preservation of our nation.

This time the co-ops and mutuals must pay their share. There can be no better time to establish a fair tax system than now—in this very tax bill.

And, Mr. Chairman, I would like to have passed to the committee copies, which we have already turned over to the clerk, of a letter from the Consumers Cooperative Association of Eau Claire, Wis. In the last paragraph of that letter, on the first page, it says this:

> Our annual volume, ending June 30, 1947, was $204,000, 1948 was $321,000, 1949 was $937,000—

450 percent increase in 2 years—

> and ending June 30 of this year we are aiming at (with a million dollars sales already in the bag) and should get $1,250,000 sales or 33 percent over 1949.

So in 3 years they jumped their business from $200,000 to a million and a quarter; and that is the reason that I say, here, that it is going to result in an accelerated expansion of co-op business. And where did they get that business? They took it away from somebody else, who is having to pay income taxes.

And so, gentlemen, I submit this to you for your serious consideration, because it is a very serious thing for us businessmen.

I thank you very much.

The CHAIRMAN. Thank you, sir, for your appearance.

(The letter referred to above follows:)

CONSUMERS COOPERATIVE ASSOCIATION,
Eau Claire, Wis., May 15, 1950.

DEAR SUPPLIER OF OURS: This letter comes to you explaining a little bit about our organization, its history, its problems, its expansion pains, its character, and last, but by far not the least this letter is being sent to you in appreciation of your splendid cooperation as our supplier, in supplying our cooperative merchandise during the past period. This is a form letter and you'll pardon us for using it but it's the only way I can write 187 letters in a short time.

Our cooperative organization began with a few members joining together to cooperatively purchase coal and petroleum products in 1935. In 1940 we built a new superservice station and went along nicely until after the war. Our biggest dollar volume year's sales until 1946 was $67,670. We then, after careful consideration and planning for many years began our 15-year plan to develop our co-op stores in a location with expansion possibilities on the east side of Eau Claire. Our city now has a population of approximately 45,000 people. You suppliers of ours from Eau Claire already know this but I touch on it to give this information to those of you outside of Eau Claire.

Along with the long-range plan, we purchased our own coal yard in 1946 and paid for it in 90 days by sale of stock to members. Also in 1946 we purchased a bulk petroleum business and paid for that in 6 months. In 1947 we completed the purchase of 8½ acres of land (two city blocks) on United States Highway 53 in Eau Claire. This cost us $25,000. We then laid plans to develop the land—having studied the shopping center idea development very thoroughly for years.

Until we went into these expansion pains we never lost a discount and we refer you to Dun & Badstreet on this. Our shopping center has 10 departments; we opened on November 18, 1948. The departments we have are as follows: Supermarket consisting of groceries, meats, and produce; hardware department, housewares, plumbing, home heating, farm supplies, appliances and kitchen cabinets, shoes, dry goods (very complete), lunch counter and a service station, We still operate our downtown service station outlet, our coal yard, and bulk petroleum.

Our annual volume ending June 30, 1947, was $204,000, 1948 was $321,000, 1949 was $937,000, and ending June 30 of this year we are aiming at (with a million dollars sales already in the bag) and should get, $1,250,000 sales or 33 percent over 1949.

We are coming better now and our short-term obligations are about out of the way. We did have some difficulty in 1949 meeting our bills by discount time and it was you who have been patient with us who we are writing this letter of appreciation. Having you, whether you are our big supplier or a small one, with us is teamwork and we sincerely appreciate your accommodations.

I'll say a word about our manager, Ray J. Theisen. I came to work for this co-op in 1938 and was gone from 1942 till November 1945 in the Armed Forces. I returned to manager at that time and have been here since.

Recently we sent a letter telling our history to Dun and Bradstreet in St. Paul and we would like to have you contact them in regards to our rating.

If you have been a supplier of ours on open account and desire to continue to sell us on open account I'd appreciate a reply; however, if you feel you cannot carry us 30 days or whatever terms we have been going along on with you, then I'll also like a reply to this letter.

As I said, it's teamwork, this dealer-supplier proposition. We are part of that team. I like frankness between business partners and that's why I am writing you.

Things are going good and in a few months we'll be right up there on top with all of you.

Cooperatively yours,

RAY J. THEISEN, *General Manager.*

P. S.—If you would like a copy of our annual statements in June, let me know. I'll be happy to send one to you.

Senator CONNALLY. Is your association national in its spread?

Mr. LESTER. Yes, sir. We have members scattered from the Atlantic to the Pacific, all over the Nation.

Senator BUTLER. You may have made the statement in your opening, and I may have missed it. You are from Jackson?

Mr. LESTER. That is my home; yes, sir. I am a farmer and small-business man. We buy and sell cotton, operate cotton gins and warehouses, and sell feed and fertilizer.

Senator BUTLER. Do you operate as a partnership, or as an individual?

Mr. LESTER. I operate three ways. I am in business for myself alone. We have four gins that I own individually. I am interested in two partnerships, and I am also interested in a corporation.

Senator BUTLER. What you said about taxing the cooperatives would apply just the same to taxing your partnership profits, would it not?

Mr. LESTER. Senator, if you will just let me have a moment, I will explain that. I am interested in two partnerships. Suppose, under a partnership, we make $10,000. That means that each partner pays income tax on $5,000, if they are equal partners. Even though we keep that money in the business, or what not, we still have to pay taxes on it. But under a cooperative, they can keep the money and not pay any income taxes on it, in this way:

In other words, suppose for instance they declared all of the $10,000 as a dividend. All they would have to do is turn it right back into the business as capital stock, and there is no tax on it. They keep reserves, which we can't do. No corporation can keep reserves without being taxed.

The CHAIRMAN. All right. Thank you, sir.

Mr. LESTER. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Kerr, a member of this committee, desired to have entered in the record a telegram from Mr. E. K. Dean, manager of the Oklahoma Farmers Union Cooperative.

That will be offered at this time for the record.

(The telegram referred to follows:)

OKLAHOMA CITY, OKLA., *July 5, 1950.*

Hon. Senator ROBERT S. KERR,
Senate Office Building, Washington, D. C.:

We are unalterably opposed to 10 percent withholding provision on cooperatives in the new revenue bill now before the Senate Finance Committee. This bill would tax both the proceeds and expenses of farmers through their cooperatives without regard to the farmers' income-tax status. Under this proposal farmers would be required to pay income tax on a portion of their gross income even though they actually had an operating loss. We understand representatives of the National Farmers Union and of the Missouri Farmers Association will be appearing before the Senate Finance Committee, of which you are a member, in regard to this proposal. We urge you to support their position on this proposal when the committee takes action on it. Your favorable consideration on this matter will be greatly appreciated.

E. K. DEAN,
Manager, Oklahoma Farmers Union Cooperative.

Senator HOEY. Mr. Chairman, I wish to have submitted for the record a statement from Harry B. Caldwell, master of the North Carolina State Grange, dealing with one or two questions that supplement his testimony before the House Ways and Means Committee. Owing to the crowded condition of our calendar, he requested that permission to file this for the record be granted so that he would not have to ask for a personal appearance.

The CHAIRMAN. Thank you, Senator Hoey. It will go into the record.

(The statement referred to follows:)

STATEMENT BY HARRY B. CALDWELL, MASTER, NORTH CAROLINA STATE GRANGE

Mr. Chairman and members of the committee, my name is Harry B. Caldwell. I am master of the North Carolina State Grange, secretary of the Farmers Cooperative Council of North Carolina, and a farmer. While I am appearing as master of the North Carolina State Grange, this statement reflects the expressed views of organizations with a combined membership of more than 100,000 North Carolina farm families.

I want to take a moment to pay my respects to our own Clyde R. Hoey, distinguished member of this committee, who has served the people of North Carolina in many capacities with credit to himself and honor to the Nation. It is always a pleasure to work with and to be associated with him.

We recognize the tremendous problems confronting this committee, some of which have created uncertainties as to our total needs. We hope that the time may come when the tax structure as it affects business and individuals, and the relationship between government at local, State, and national levels may be studied so that pyramiding of tax levies on the same property or income by various branches of government can be eliminated and adequate support for each branch maintained.

We understand that this committee desires to confine discussions to those items of the bill that were not thoroughly covered in testimony presented to the Ways and Means Committee. With this idea in mind, we will limit our comments to: (1) Excise tax on home freezers, (2) the request made to this committee for a graduated tax on cigarettes, and (3) to the collection of income tax at source on dividends, including patronage refunds.

EXCISE TAX ON HOME FREEZERS

North Carolina farmers question the desirability of adding a new excise tax on home freezers and the continuation of excise taxes on home refrigerators at a time when excise taxes on such items as jewelry, furs, etc., are being reduced by 50 percent and the tax on inexpensive watches, toilet preparations used by barber shops and beauty parlors for use in their establishments, etc., are being completely eliminated.

Home freezers are becoming increasingly important to both rural and urban families in handling their food supply. We cannot see any justification for adding an excise tax on items so important to family living at a time when the general level of excise taxes are being drastically reduced.

We hope that your committee will delete the proposed new excise tax on home freezers and repeal the present excise tax on home refrigerators.

TAXATION OF TOBACCO

A group of cigarette manufacturers requested the Ways and Means Committee to provide a graduated tax so that the tax rate on economy brands would be less than on standard brands. The Ways and Means Committee held public hearings on this proposal.

We note that the manufacturers of economy brands appeared before your committee and renewed their request for adoption of a graduated tax. Press reports indicate that they claimed again that the adoption of the graduated tax will produce more revenue for the Treasury and better markets for farmers.

Members of the North Carolina State Grange studied their proposal and then unanimously adopted a resolution opposing the graduated tax on cigarettes.

We fail to see how their proposal will help the United States Treasury. To the extent that the lower tax shifted smokers from standard to economy brands, the amount of the tax collected would be reduced. Their real purpose is to encourage that shift according to a statement made to our organization when the advocates of the proposal said, "With a greater spread between the retail price of the economy brand and the standard brand, there would be a stronger appeal to the price-conscious cigarette smoker." It thus appears that Congress is being asked to amend the cigarette tax at the consumer level for the special purpose of helping a segment of the industry capture a larger share of the market for themselves.

Tobacco growers want competition. There is a place for economy brands, standard brands, and premium-brand cigarettes. We oppose any change in the consumer excise tax on cigarettes designed to promote the use of some particular brand.

It is our belief that the adoption of the graduated tax will reduce the farm price on tobacco. Studies made by OPA show that the amount paid for leaf tobacco

used in manufacturing economy-brand cigarettes was considerably less than the payments for leaf used in standard brands.

We sincerely hope that this committee will reject the request for a graduated tax on cigarettes.

COLLECTION OF INCOME TAX AT SOURCE ON DIVIDENDS

We assume that this provision was added to the revenue bill on the assumption that taxpayers are not including their dividends in their tax returns. While this may be true to some degree, it is our belief that the adoption of this proposal as it is now included in the bill will create so much needless expense and work for the Treasury that other ways of handling the problem should be explored.

This feature of the bill was not considered when the hearings were in progress before the Ways and Means Committee.

Our organization made a survey of three farmer cooperative corporations in North Carolina to get information as to the number of stockholders and size of the interest or dividend payments. I am summarizing the information from their reports:

1. The Farmers Mutual, of Durham, N. C. They reported 17,868 stockholders, of which 12,252 received checks of less than $1 each and 5,343 who received $1 or more.

2. The F. C. X., of Raleigh, N. C., reported 104,587 stockholders. A sample of 5,988 accounts revealed that 78 percent of the interest or dividend checks were for amounts less than $1; 17 percent for amounts from $1 to $10; and 5 percent for amounts in excess of $10.

3. The Farmers Federation, of Asheville, N. C., reported 15,415 stockholders, of which 3,492 received interest or dividend payments for amounts less than $1; 8,287 for amounts from $1 to $10; and 3,636 for amounts in excess of $10.

It is our opinion that other business corporations likewise have many small stockholders.

Our study of this question leads us to the conclusion that most of the farmers who are small stockholders in these cooperative corporations do not have taxable income so that they will either be confronted with the expense of securing a refund of the tax withheld, which incidentally will be expensive to the Treasury, or they will have paid a tax when no tax liability exists. Undoubtedly this same situation will exist with regard to many nonfarm small investors.

It occurs to us that the Treasury would be benefited most and the corporations and the investors who do not have taxable income spared considerable expense by providing for:

1. Corporations to report the name of all individuals who receive dividends amounting to $50 or more. No new legislation will be required since authority for fixing this lower limit already exists.

2. Taxpayers to list the corporations and amount of dividends received from each one as a part of their tax return. This is now required in our own State.

It is our opinion that the adoption of these two provisions will get the maximum amount of tax from dividends based on the tax liability of the taxpayer without creating the expense and confusion which seems apparent under provisions of the pending bill.

If the committee should decide to retain the section, then we would suggest:

1. That the tax be applied and withheld only in those instances where the amount of the dividend to be paid amounts to some basic minimum such as $50 or $100.

Subsection (c) of section 601 relates to patronage refunds. Our study of this provision leads us to the conclusion that its purpose is to assure inclusion of these items in the returns filed by individual tax payers. It is our opinion that a more satisfactory way can be provided for handling this problem.

We made a study of four farmer cooperative corporations in North Carolina on this point. I am summarizing the informattion from their reports:

1. Davidson Farmers Mutual Exchange, of Lexington, N. C., reported the payment of 3,349 patronage refunds, of which 1,405 were for amounts of less than $1; 1,572 were for amounts ranging from $1 to $10 and 372 exceeded $10.

2. The F. C. X., of Raleigh, reported the payment of 104,743 patronage refunds. They sampled 11,425 accounts and found 61 percent were for amounts less than $1; 35 percent for amounts ranging from $1 to $10; and 4 percent for amounts in excess of $10.

3. The Farmers Federation, of Asheville, N. C., reported 9,194 patronage refunds; 92 percent were less than $10 and of this amount 47½ percent were less than $1.

4. The Farmers Mutual, of Durham, N. C., reported 16,113 patronage refunds, of which about 5,000 were for amounts less than $1; about 3,000 were for amounts from $1 to $2; and 7,900 for amounts in excess of $2.

I am sure you recognize that the small farmers, who incidentally would make up the large percentage of individuals receiving small refunds, do not have sufficient income to have tax liability. The application of the withholding tax to patronage refunds will therefore create needless expense for the Treasury and confusion for the farmer.

The committee should also recognize the basic difference between patronage refunds and dividends. The patronage refund represents final settlement in a business transaction. The exact nature of the refund or payment depends upon the contract between the association and its patrons. In some instances they are final payments for products marketed, while in others they represent the difference between an advance price paid and the actual cost as determined at the close of the year or when the transaction has been completed.

We cannot see any justification subjecting patronage refunds to the withholding tax unless trade discounts and similar payments made by all corporations are to be subjected to the same tax. Under the terms of this bill, if a farmer purchases his supplies through his own cooperative association and gets a refund, it will be subject to the withholding tax, whereas if he purchased from a noncooperative agency or corporation and later received a refund or rebate, it would not be subject to the withholding tax. Why this discrimination in subjecting refunds to the withholding-tax principle?

Our cooperative dairies and the flue-cured Tobacco Stabilization Cooperative make an advance payment to the producer. They market the product, deduct costs, and then complete settlement with the producer. Is this final payment to be subject to the withholding tax? If so, then why not extend the principle to include similar transactions by all corporations?

Since this subsection (c) relates only to associations "operated on a cooperative basis" we hope that it will be deleted from the bill.

The committee can assure the inclusion of refunds, rebates, etc., in the return of taxpayers by:

1. Requiring all corporations, including cooperatives, to report the names of persons receiving refunds, rebates, etc., of $50 or more. This provision is now a part of our North Carolina law.
2. Providing the tax be required for refunds, rebates, and similar payments made by all corporations.
3. Providing that the tax be withheld only by the association that makes the refund to the individual. Otherwise the tax will become cumulative in those instances where cooperatives are federated or do business with one another in handling the program for their members.

The CHAIRMAN. Mr. Elton Kile? Mr. Kile, will you please identify yourself for the record?

STATEMENT OF ELTON KILE, KILEVILLE, OHIO, APPEARING AS DIRECTOR AND MEMBER OF THE TAX COMMITTEE, GRAIN AND FEED DEALERS NATIONAL ASSOCIATION, WASHINGTON, D. C.

Mr. KILE. My name is Elton Kile. I am a farmer and country grain elevator operator, of Kileville, Ohio. I have been a member of the Ohio General Assembly for the past 2 years. I am appearing before this committee as a director and member of the tax committee of the Grain and Feed Dealers National Association and most of its affiliated associations, representing a membership of 12,000 dealers of whom 90 percent are classified as small business.

I also want to state at this time that I am a member of the Madison County Farm Bureau in Madison County, Ohio, and a member of our local grange.

On two previous occasions, when I have been a witness before the House Ways and Means Committee, to advocate legislation to tax the earnings of cooperatives, I have later been taken to task by the distinguished attorney for the cooperatives for daring to say that

my business, which was then a partnership, was being hurt by the tax-free competition of cooperative corporations.

It was stated that the partnerships that make up, I suppose, some percentage of the membership of the Grain and Feed Dealers' National, as well as hardware store partnerships and farm implement dealer partnerships and others, have no legitimate reason to kick because the cooperatives are untaxed, since, it is said, these cooperative corporations pay their income taxes in the same way that partnerships pay

Of course, that has never been true except in theory—like a great many other statements that are made by the cooperatives in attempted explanation of their income tax escape. In the first place, there is a very great difference between the amount of tax paid by two or three partners on the earnings of a business, and the amount of tax paid by 50 or 100 or 500 members of a cooperative on the distribution of profits that comes to each individual member in the form of patronage dividends.

In the second place, the technique of calling a cooperative corporation a partnership for tax purposes does not make it a partnership any more than calling a cow a pig will make her a pig. Some 90 percent of all cooperatives have become corporations because it is very greatly to their advantage to be corporations—in all matters save the computation and payment of income tax. And I submit to you, gentlemen of the committee, that any corporation should always be taxed as a corporation and not permitted to call itself something else when the tax collector comes around.

Third, I offer for your consideration the findings of your own tax experts of the congressional joint committee. In their recent report to the House Ways and Means Committee, these experts said flatly:

> Cooperatives now have a tax advantage over both corporations and partnerships. Moreover, this advantage is not merely due to the fact that corporate earnings paid out as dividends are subject to double tax. A tax must be paid by a corporation on earnings retained for expansion, and even though there is no double tax involved in these particular earnings so long as they are retained, the tax that is paid decreases the funds available for expansion. Even in the case of the partnership, funds available for expansion are likely to be depleted by the amount of the tax which the partners must pay on these earnings. In the case of the cooperative, however, this is not the case.

To that most excellent and conclusive statement I have only one thought of my own to add: At the suggestion, I understand, of the Treasury Department, the Ways and Means Committee and the House of Representatives have included in H. R. 8920 a requirement that cooperative corporations pay a withholding tax of 10 percent on all patronage dividends, however paid. The purpose of this withholding tax is to inform the Bureau of Internal Revenue as to who has received patronage dividends so that the individual income tax may be collected, and it is estimated that some 20 to 30 million dollars of new revenue will result from this expedient.

May I point out to the committee that never, so far as I am aware, has it been necessary for the Government to adopt a scheme of this sort to keep track of the taxes due from partners owning competing businesses. And that is another reason for maintaining a full distinction between the partnerships of the Grain and Feed Dealers National, the Retail Hardware Association and others on the one hand and the self-styled partners of the cooperative corporations on the other hand

In Madison County, Ohio, where I do business, the wheat crop is just coming in. My company and our chief competitor, the Farm Bureau Cooperative, are both advertising to the farmers in practically the same words: "We are ready to handle your wheat crop, whether you want to sell, store privately, or store for Government loan."

Both of us have increased facilities this year. Our company—now a corporation—borrowed $45,000 to build new elevators. The co-op bought out an established company 3 miles away from us. As in past years, we shall probably divide the business between us.

But right there the similarity ends.

My corporation pays Federal income taxes on every dime of income that we have.

The cooperative corporation pays little or no income tax on its earnings.

My company sets up reserves after we pay our taxes to pay for our new facilities.

The Farm Bureau co-op sets up tax-free reserves to pay for the elevators that it has taken off the tax rolls.

We paid taxes in World War I and World War II to support the United States in time of need. We are paying taxes now to help support the national effort in Korea.

What reason is there—what sense is there—in permitting the cooperative that does exactly the same sort of business as we do, and makes the same kind of profits, to escape its share of taxes when we are buying guns and tanks and planes again, when we are sending an army of our drafted sons into the Far East?

Heretofore, we have asked Congress to tax these cooperative corporations because they have an utterly unfair competitive advantage over the rest of us. That reason still holds true, but there is now another reason which is beyond self-interest.

Nobody knows as yet how much this new adventure in Korea is going to cost us. Nobody knows whether the war will be confined to the Korean peninsula or whether it will spread again into a world-wide conflagration.

Actually, it shouldn't make much difference now. We are beginning to mobilize the resources of the Nation. Taxing the cooperatives will provide a minimum of $350,000,000 a year. Gentlemen, now, in this tax bill that you are writing, is the time to include the taxation of the business income of all the tax exempts, including the co-ops.

Perhaps you are worried by the political implications of this issue, as members of the Ways and Means Committee were a few short weeks ago. Gentlemen, it is no time to play politics when the lifeblood of our Nation may shortly be at stake. The Government needs the money—and besides, what is the political wisdom of voting to tax the business interests of colleges, charities, labor unions and the like, while you fail to tax the greater and more profitable commercial operations of the cooperative corporations?

In truth, from a political viewpoint this is not an unpopular issue. We have only to look at a recent election in the strongly co-op, predominantly agricultural State of North Carolina. The giant, tax-exempt Farmers Cooperative Exchange, Inc., endorsed their friend the incumbent for the United States Senate. An obvious majority of the farmer members of the co-op joined with businessmen, contrary to the recommendations of the co-op leaders, and retired him to private life.

This committee, in my opinion, could do nothing more sound, both from the standpoint of statesmanship and politics, than to amend H. R. 8920 to provide that the business income of all of the tax-exempts be taxed at once.

Thank you, gentlemen.

The CHAIRMAN. Are there any questions?

Senator BUTLER. Mr. Chairman?

The CHAIRMAN. Senator BUTLER.

Senator BUTLER. I wonder if Mr. Kile would care to add a few words just to tell us if he does business at Kileville in the same way as his competitor that he says is a cooperative.

Mr. KILE. We do business in exactly the same way. And for the committee's information, I have some advertising in our local papers, issued in the same paper, in which our cooperative calls the attention of the farmers to the fact that "We are in a position to handle wheat for you, cash, private storage, Government loan. Important! When delivering your wheat be sure to notify truck drivers whether to store or sell grain." And in the same column is the list of their prices, their cash prices that they are paying.

Senator MILLIKIN. I did not quite get the significance of that "important" business.

Mr. KILE. Well, there is some idea that they do not pay a price but just handle the farmer's grain as sort of an agent and then refund to him the money. However, they buy grain at cash, the same as we do.

Senator MILLIKIN. What was the context of the "important?" I did not get the words.

Mr. KILE. "Important! When delivering your wheat be sure to notify truck drivers whether to store or sell." And we do the same. You will find our ad in this paper saying the same thing. "We are ready to handle your wheat whether you want to sell, store privately, or store for Government loan." And you will find in the same paper the same ads. There are two local papers, and you will find the same ads in each, in which practically the same words are used, as to our methods of operation. And let me tell the committee that we operate in a friendly manner. We are friendly with each other. We go to the Farm Bureau office.

As I said in the beginning, I am a member of the Farm Bureau and believe in farm organizations. I am a member of the Grange. There are a great many of the Farm Bureau members that deal with me, and they are not averse, as farmers, to the cooperative paying income tax on their business.

Senator BUTLER. How about the prices that the two of you pay?

Mr. KILE. Of necessity, we pay the same price, because we are close together competitively and we have to pay the same price. We will call each other on the telephone, probably, to find out what the other fellow is doing, or we find out through the trade, and of necessity we pay the same price generally.

Senator MILLIKIN. Are your charges for other services the same?

Mr. KILE. Practically the same.

The CHAIRMAN. Thank you very much, Mr. Kile, for your appearance.

Mr. KILE. Thank you, Senator.

The CHAIRMAN. Mr. Jerry Voorhis?

STATEMENT OF JERRY VOORHIS, EXECUTIVE SECRETARY, COOPERATIVE LEAGUE OF THE UNITED STATES

Mr. VOORHIS. Mr. Chairman and gentlemen of the committee, I would like to ask consent that my statement may be printed in the record, because I am going to try to abbreviate it in order to save the committee's time.

Mr. Chairman, my name is Jerry Voorhis. I am a former Member of the House of Representatives, where I served for 5 terms. I am now executive secretary of the Cooperative League of the United States, a national service, information, and educational organization, with a membership of about a million and a half persons, whose cooperative business organizations support the league's work by dues payments of 10 cents per member per year. About 75 percent of our membership are farmers and rural people.

Now, Mr. Chairman, it was my understanding that only new material was to be covered before this committee and that the ground covered before the Ways and Means Committee was not to be gone over again. The two previous witnesses have gone over a good deal of that ground, and there are one or two points that I would like to correct.

The CHAIRMAN. You may do so, but we would rather that you would not duplicate your testimony. Did you testify before the House Ways and Means Committee?

Mr. VOORHIS. I did, Mr. Chairman, and I only want to cover one or two points which have been made.

The CHAIRMAN. All right.

Mr. VOORHIS. The first is that it has been said that in the case of a partnership, where the income was divided between two partners, where the income was $10,000 and each partner paid on $5,000, that was a different matter from what it would be if that $10,000 had been divided among a very large number of people. I cannot see any difference. I can only see that it seems to me that it is good practice in America if more and more people can share in ownership, and to argue that you want a closely held business structure in order to increase Government revenue is unsound; that on the other hand we would rather have, it seems to me, a wider participation in business ownership by more people. And furthermore, it simply isn't true that the members of that cooperative are not taxed upon the income to them as individuals, which is represented by any patronage refunds to them that affect their business income. They would pay those taxes just the same as a partner would.

Senator BUTLER. I have the impression that what the witness tried to get over at the time he made that remark about the partnership was that there was not one cent of earnings kept in the reserve in partnership; while he did say that that is not true with reference to cooperatives.

Now, I do not know whether that is true or not. You are perhaps in a position to say whether, as to one of your cooperatives, if it does not distribute $8,000 of the $10,000, and distributes only $2,000, taxes would be paid only on the $2,000 but the $8,000 would still be exempt and held in reserve. Is that correct?

Mr. VOORHIS. Senator, the great majority of cooperatives in this country have no tax exemption whatsoever. Section 101 (12) was

passed long ago by a conservative Congress, and the whole theory was that it was better to encourage farmers to solve their problems by cooperative action than to have them either dependent on Government programs or at the mercy of market conditions. And the definition in 101 (12) states that necessary reserves may be set aside; certainly not reserves to buy an elevator. But what the definition of "necessary reserves" should be is a question for the Bureau of Internal Revenue.

The whole theory of 101 (12) is that this should be a nonprofit organization, and if it is not, then the exemption should be lost. As to all other cooperatives, it certainly can be said flatly that they cannot accumulate any reserves other than what other companies can accumulate, without paying taxes thereon.

Senator BUTLER. I would like to say, Mr. Chairman, that like one or two of the witnesses that have testified here I believe in cooperative organizations. I am a member of several myself. So I am not prejudiced as to any questions I may ask. But I do agree with the remark that you have just made that perhaps nearly all of this controversy would be settled if the Internal Revenue Department would properly interpret the laws that are on the books now.

Mr. VOORHIS. Certainly we want them interpreted in the most careful and fair and strict manner.

Senator MILLIKIN. May I ask Mr. Kirby a question, Mr. Chairman?

How do you handle the question of earnings which are retained for expansion?

Mr. KIRBY. Well, under 101 (12), as I recall, the farm cooperatives that are operating under that exemption section are permitted to retain reasonable reserves for their operation of their business. The Bureau of Internal Revenue is required to examine their reserves and see whether they are reasonable within the meaning of that exemption.

Senator MILLIKIN. What has been the history of acceptance or rejection of the claim for nontaxability of retained reserves?

Mr. KIRBY. I don't know the number of rejections, but we do know that there are a number of cooperatives that have a business that would permit them to be exempt under 101 (12), who do not claim the exemption.

Senator MILLIKIN. Is it your contention, Mr. Voorhis, that a very small proportion of the cooperatives keep their reserves without paying taxes on them?

Mr. VOORHIS. It is my contention that a very small amount of reserves that could conceivably be taxable are retained by cooperatives without payment of tax. The only ones that could possibly do it would be the 101 (12) exempt cooperatives. That involves about half of the farmer cooperatives. The other half don't ask for the exemption, as has just been said by Mr. Kirby. The reason they don't ask for it, in part at least, is because the restrictions under 101 (12) are so severe as to their business operations.

Senator MILLIKIN. Do you mean half in terms of volume of business, or half in terms of numbers?

Mr. VOORHIS. In numbers. In volume of business there would be more that qualified under 101 (12) than not, of the farmer cooperatives.

But the point that I want mainly to leave with you is that either they are regulated under 101 (12), and if they don't abide by those regulations they lose the exemption, or else cooperatives are taxable

under the same laws as anybody else. The only issue here, as a matter of fact, gentlemen, is this: Is it sound policy to say that a group of people may organize a business on a nonprofit basis to benefit the members and patrons, instead of the business, or is it not? If that is sound policy, then the whole issue becomes this: That a cooperative, if it deliberately binds itself to forego the making of profit, in order to benefit its patrons, should no more be subject to income tax on income that it doesn't receive than a profit business should be subject to tax on profits it fails to make.

In other words, there ought to be scope for groups of people in this country, it seems to me, particularly farm people, where they are up against economic problems as small producers which will leave them in a very vulnerable position in the economy, to put their strength together without in effect saying, "You must run it on a basis where the business profits." You can, it seems to me, run it as a business where the farmer profits. That is what the farmer cooperative is after. The whole burden of my testimony to the Ways and Means Committee was to the effect that the alleged tax advantages which co-ops are supposed to enjoy today vanish into thin air on the basis of any fair examination of the facts. And the truth of the matter is that as of today any business in America that wants to pay patronage refunds instead of retaining its earnings can be in exactly the same tax position as a cooperative is when it pays patronage refunds. The further fact is that those patronage refunds are taxable against the member of the cooperative if they add to his business income.

Now, as a basic proposition, Mr. Chairman, I just want to say this: That we recognize the national problem, and from the people that I represent there will be no objection if taxes are raised. We believe that the soundest tax is the individual income tax rather than business taxes, frankly, and we think that is where the main burden ought to go.

If we thought we had tax privileges, I would not be here, Mr Chairman, because I do not believe in them. It is all a question of equity, and I contend that some of the points that have been raised recently would not be tax equality. You cannot fairly tax one business on money that does not belong to it, but the ownership of which it gives over legally and as a binding matter to somebody else. And if you were to apply the process of reasoning that has been given, you would have to apply it also to many other businesses. It is not only cooperatives that give discounts or pay patronage refunds. It is many other businesses as well. All we want is fairness and equity.

The cooperative, it is true, has many owners, but we believe that participation by the people in every phase of the life of a democracy is the genius of that democracy, and it is to promote such participation that cooperatives basically exist. We are in business for one primary reason, to spread primary ownership, and with it responsibility among the people, more broadly than can be done in any other way, and thus to shift back to the people responsibility for their own welfare. We think that is good. And in the balance of my testimony you will see, in the figures I am going to submit, how true that is.

The main reason I asked for this time, Senator George, was to talk about the withholding tax and its impacts. I will do it just as quickly as I can.

The CHAIRMAN. We will have to ask you to be as brief as you can, if you covered this same point before the Ways and Means Committee.

Mr. VOORHIS. No, sir; I did not, because this same point had not even been raised when we were before the House, you see.

My contention about those provisions is that unless the bill is changed in certain respects it will have the following results: First, that hundreds of thousands of small income recipients will have tiny amounts withheld at source, and, because they won't trouble to ask for refunds, will pay taxes that the Government hasn't a legal right to collect under the law; and, second, that an almost insupportable burden of bookkeeping and accounting and correspondence will be imposed upon thousands of little businesses and upon the Bureau of Internal Revenue as well, as a result of which Government revenue might actually be reduced instead of increased.

Now, as to the 10 percent withholding tax as applied to dividends paid to stockholders, which is an entirely different matter from a patronage refund, the cooperatives of the country would neither ask nor expect any different treatment to their stockholders than that accorded the stockholders of other businesses. There is no different treatment now, and none should be provided in the bill.

The interest paid on cooperative stock is taxable to the person who receives it, and should be, and taxable against the cooperative too, except in the case of 101 (12) cooperatives, incidentally. As to all corporations, however, cooperatives and otherwise, it seems evident to me that there is little sense in requiring withholding on very small dividend payments. There are a lot of people who have just one share of stock in the amount of $100. If a dividend is 5 percent, the withholding would only be 50 percent, and the question is: Is that worth it? I doubt whether it is.

My proposal to the committee, therefore, is that dividend payments made by any corporation in amounts less than a certain number of dollars be exempted from the withholding tax.

Let me emphasize once more that I am recommending this not for cooperatives but for all corporations. Just what that minimum ought to be, I hesitate to say, but it would seem to me almost foolish to require withholding in a case where the amount withheld would be less than $5. And that would mean putting a figure of $50 in the bill and saying that below that withholding would not be required.

Here are a few statistics which again illustrate the point I made about cooperatives as businesses belonging to lots of people, in which lots of people share responsibility. In one cooperative in 1948, 65 percent of its dividends to stockholders were for less than $1. In another group of 28 cooperatives, the average dividend to stockholders in that same year was $2.17. Withholding on that would be 22 cents, on the average.

Now, as to a wholesale cooperative, which is a larger business, here is one with 2,702 individual stockholders, four-fifths of whom own less than a thousand dollars of stock and receive annual dividends thereon of $40 or less. There are 462 individual stockholders who receive dividends of only $4. It is obvious that the additional bookkeeping and labor involved in complying with a withholding tax provision affecting dividends paid to stockholders would constitute a substantial percentage of the value of the dividend actually paid.

In this connection, Mr. Chairman, I would like just to point out that cooperatives, as you know, pay a limited return on capital stock. It isn't like a common-stock holding in a corporation. It is a limited

interest rate, really. So that is another reason why the payments are small.

I have here the complete records of all dividend payments which were made by a typical cooperative in a midwestern rural community, and I will be glad to leave these with the committee if they are interested. The whole works is here, Senator, on dividends and patronage refunds both.

The CHAIRMAN. Yes. You may leave that.

Mr. VOORHIS. This cooperative had 1,645 stockholders. Here is a medium-sized business in a rural community with 1,645 active owners. Now, of course, it is true that their payment of individual income taxes on whatever that cooperative may save as a result of its operation is going to be less than if only five people owned it as partners. But which is the best? To have 5 people own it or 1,645? I think there is room for both, and I think maybe it is a good thing if some of our business is owned by 1,645 stockholders in a small community.

Anyway the dividend payments from this cooperative were as follows. They paid a total of $12,881. Of that, 1,135 payments were for less than $5, or 69 percent of the total; 171 were for between $5 and $10; 329 were for more than $10 but less than $50; 10 were for over $50; the largest payment to any one individual was $80.

I believe these figures speak for themselves as to the obvious wisdom of confining the withholding-tax requirement to some substantial amount and thus avoiding a clearly ridiculous burden of accounting, record keeping, and correspondence upon this business and a like burden of utterly unjustifiable checking by the Bureau of Internal Revenue, if indeed they ever paid any attention to enforcement of the provision at all so far as the smaller amounts are concerned.

Senator MILLIKIN. Mr. Voorhis, I am opposed to this withholding in entirety. But we have to consider more than a single dividend that one stockholder gets, no matter what the size. You have to think of the aggregate of dividends that a man might get by having a lot of small holdings in a lot of companies, thus putting himself in position, perhaps, to avoid the tax.

Mr. VOORHIS. I suppose that is true, Senator. It won't be true as to many of these co-op members.

Senator MILLIKIN. I was just playing devil's advocate and wondering how far you could carry this principle of not paying any attention to really small dividends, and it occurs to me that a man might be a stockholder in many corporations and have small dividends from each one of them, but the aggregate might be a sizable amount.

Mr. VOORHIS. Ultimately I think you have to get at that with respect to the man individually, and it seems to me it would be extremely unproductive for the Bureau of Internal Revenue to check $5 amounts in all kinds of companies. That is the only thing I am trying to say. I just think that it would be conceivable that people might deliberately try to defraud the Government that way, of course.

Senator MILLIKIN. I am opposed to withholding for co-ops or any other form of business.

Mr. VOORHIS. Mr. Chairman, I come now to the question of withholding on patronage refunds, which is a somewhat different question from the question of withholding on dividends. May I say that certainly we want every cooperative member who receives a patronage dividend that represents taxable income to pay the tax thereon, and

we are in favor of the reporting provisions that will require a reporting on the part of cooperatives as to what these are. But in its present form it seems to me that this withholding provision is ill-considered and will lead to very great difficulties.

A patronage refund, as you know, represents a delayed payment on the part of the sales price of a farm crop, or else a refund of an overpayment made on goods purchased. These practices are by no means limited to cooperatives. But the bill's requirements are limited to cooperatives, and in practical effect to certain farmer cooperatives only. We believe this is not right and that if a withholding tax were to be required on cooperatives' patronage refunds, it should be required on any refund granted in whatever manner by any business to the extent that that represented taxable income to the recipient. But the present language of the bill says that it covers only a certain type of cooperative, the major part of which consists of marketing crops for members or getting supplies for members and distributing them to members. That would mean, therefore, that while a part of those patronage refunds would be taxable against the member, because they would represent a purchase of fertilizer or farm machinery or what not, and those taxes are now paid by the farmer members, nonetheless, if the farmer's wife bought a flat iron from that cooperative and if a patronage refund were paid at the end of the year on that, which is a consumable commodity, it would be no different than if she had got a 3-percent reduction in price from another store; and therefore there would be inequality, certainly, from the point of view of requiring withholding on a patronage refund that could not conceivably represent income, thus laying yourself open either to having no claim for refund made or to having a great many claims for very small amounts.

Now, then, as to figures on patronage refunds, the first cooperative example I would like to give is one which had paid out 1,071 patronage refund payments, of which 805, or 75 percent, were for less than $5. In the second example, 63 percent of the patronage refunds were in amounts of less than $2.50, where withholding would be 25 cents. In the third one, 37 percent of the patronage refunds were for less than $1, and withholding would be only 10 cents for those. Then here is a cooperative whose figures I have, here, and I am skipping a lot of these examples, but in this case they paid $23,000 of patronage refunds to 2,451 individuals in 1949, divided as follows:

There were 1,566 patronage refunds of less than $5; 334 between $5 and $10; 448 between $10 and $50; and 103 in amounts of $50 or more.

In other words, two-thirds of these patronage refunds would result in a withholding of less than 50 cents.

This cooperative now follows the practice of informing its members fully as to their tax liabilities, as most of them do. It has invited officials of the Bureau of Internal Revenue to come and speak at its meetings, to be perfectly sure that all taxes were paid in full both by the cooperative and its members. It could qualify under 101 (12), but doesn't attempt to do so. In 1948 it paid $4,250 of Federal corporation income taxes in addition to all other taxes.

Surely it ought not to be required to go through all the expensive motions of withholding over 2,000 items against over 2,000 patrons. three-quarters of which would be in amounts less than $1. And

I doubt that it would do the United States Treasury any good even if this were done.

At present this cooperative has an office force of 4½ workers. The manager tells me if this provision were put into effect he would probably have to hire two additional people. The effect of that on the possibility of the payment of the patronage refunds would be something of importance, and it might well be that the revenue to the Treasury would be even less.

Senator MILLIKIN. Do you think, Mr. Voorhis, that if all corporations and cooperatives furnished the Treasury, the Bureau of Internal Revenue, with a record of dividends and patronage refunds, in whatever form they might take, the Bureau of Internal Revenue would be in position under present methods to turn up tax evaders?

Mr. VOORHIS. I believe so, Senator. And certainly I want to say that we have a vested interest in seeing that every penny of tax owed by a cooperative or one of its members is paid.

I want to say one thing further, too, and that is that no cooperative in this country so far as I am aware can or does own a business that is run for profit, without that business paying a full tax as a profit business. And I agree with what Mr. Clark had to say, that no one who is in a nonprofit position not to be able to own or run a profit business without full taxes being paid. I don't know of any such example in a cooperative, and certainly there ought not to be one.

Mr. Chairman, we on principle have certainly no objection to the principle of withholding, so far as the amount is substantial; but we do believe that the bill in its present form would work undue hardship and would not yield the results that are hoped for. And I agree with Senator Millikin's last point quite heartily.

We also want the Senators to understand that if they can show us, or if anyone can show us, where cooperatives have any actual tax advantage than other businesses could not have just the same, by treating their patrons as co-ops do, and by spreading the benefits broadly and the ownership broadly, we want to know it, and we would be the first to come in and suggest a change in the law.

The CHAIRMAN. Thank you, Mr. Voorhis.

Mr. VOORHIS. Thank you, Mr. Chairman.

(The prepared statement of Mr. Voorhis follows:)

TESTIMONY OF JERRY VOORHIS, EXECUTIVE SECRETARY OF THE COOPERATIVE LEAGUE OF THE UNITED STATES

Mr. Chairman and Senators of the committee, I ask your consent to have my whole statement included in the record of your hearings, but I shall consume only the allotted time in making my oral presentation.

My name is Jerry Voorhis. I am a former Member of the House of Representatives where I served for 5 terms. I am now executive secretary of the Cooperative League of the United States, a national service, information, and educational organization with a membership of some 1,500,000 persons, whose cooperative business organizations support the league's work by dues payments. About 75 percent of our membership is farmers and rural people.

Every decent American stands ready to pay his just share of the taxes our country needs today, or any other day. If in view of the international situation Congress deems it wise to raise taxes there will be no complaint from the people I represent here today.

The burden of my testimony some months ago before the House committee on this bill was that the alleged tax advantages which co-ops are supposed to enjoy today vanish into thin air upon any fair examination of the facts. The truth is that, with one exception adopted long ago by a conservative Congress as an aid

to agriculture, co-ops today are subject to tax under the same laws and the same regulations as any other business. The further truth is that even the bitterest opponents of cooperatives have declared that the one exception, namely section 101 (12) makes no real difference and that its repeal would add hardly a drop of revenue to the Treasury.

Cooperatives in America can no more make for themselves taxable income without paying full tax on it than can any other business. If cooperative members receive any funds as a result of dealings with their cooperative which would constitute taxable income to anyone dealing with any type of business then the co-op member is subject to tax thereon right now. We would not have it otherwise.

All the fuss and furor about cooperatives and taxes results from a basic misinterpretation of the facts. The central position of the cooperative is this. If one business, a cooperative, deliberately binds itself to forego the making of profit in order to benefit its patrons it should no more be subject to income tax on income it doesn't receive than a profit business is subject to tax on profits it fails to make.

With our contention that cooperatives have today no tax advantage a long series of Congresses and an unbroken succession of court decisions have agreed. The House committee in preparing the bill before you and the House in passing it has confirmed once again this basic truth.

If any institutions in our country are typically American, cooperatives are so. True cooperatives cannot exist in a totalitarian country at all. Their very chance for existence depends on the maintenance of free institutions, political and economic. The essence of cooperation is free voluntary association of free people.

On the other hand the very essence of a true democracy is participation by the people—by all the people—in every phase of its life. This means not only political participation but social and religious and economic and every other kind of participation. The very basis and essence of economic participation is a share in ownership. For a share in ownership carries with it a share of responsibility for what we own. And with that kind of responsibility and probably only so there develops a readiness to take the still more basic responsibility for meeting one's own problems and those of one's neighbors by one's own efforts. If America means anything it means a country that encourages that sort of thing—that wide participation by the people in ownership and responsibility.

Well that is precisely why we have cooperatives. It's what they exist to do. The whole net effect of the organization and operation of a cooperative is to spread ownership and with it responsibility for their own economic welfare widely among millions of people, who would otherwise not be participants in free enterprise to any significant extent at al . I therefore simply ask the question as to whether cooperatives should be confronted with an organized, highly financed campaign of misrepresentation against them or whether they do not deserve the full moral support of every thoughtful person who sincerely cares about the future of democracy in America.

We come before this great committee in no spirit of supplication or appeal for a single special consideration. We come here with our heads high and our hearts thankful to point out that participation by the people in every phase of its life is the very genius of a vital democracy and to point out further that it is to promote such participation that cooperatives basically and primarily exist. We are in business for one primary reason—to spread private ownership and with it responsibility among the people more broadly than can be done in any other way and thus to shift back to the people again responsibility for their own welfare. Since we know this is what you too desire in our country we confidently solicit your continued interest in and moral support of cooperatives in the United States.

My testimony has to do with the question as to whether certain provisions of this bill are or are not practical and workable. I refer to the 10 percent withholding tax proposed to be required of all corporations including cooperatives on dividends paid to stockholders and to the 10 percent withholding tax, applicable against certain types of cooperatives only, on patronage refunds paid by them. My contention is that unless the bill is changed in certain respects it will have the following results: (1) hundreds of thousands of small-income recipients will save tiny amounts withheld at source and because they will not trouble to ask for refunds on such small amounts will pay taxes that the Government has no legal right to collect under the law; (2) an almost insupportable burden of bookkeeping and accounting and correspondence will be imposed upon thousands of little businesses and upon the Bureau of Internal Revenue as a result of which the Government revenue will amost certainly be actually reduced instead of increased.

First let me discuss the 10 percent withholding tax as applied to dividends paid to stockholders. (This is an entirely different type of payment from the patronage refund, as the law and an unbroken line of court decisions have made clear.) The cooperatives of the country would neither ask you nor expect any different treatment of their stockholders from that accorded the stockholders of other businesses. There is no different treatment now and none should be provided in this bill. However, as to all corporations, cooperatives and otherwise, it seems evident to me that there is little sense in requiring withholding on very small dividend payments. For example, let us consider the number of people who hold one share only of stock valued at $100. If the dividend on such stock were 5 percent, the amount of the dividend would be $5 and the amount withheld would be just 50 cents. Is that worth it? Is it worth it when it is considered that in many cases the recipient of that small dividend will wind up owing no income tax and will be entitled to a refund from the Treasury? Either he will ask for the refund or he won't. If he does the cost of making it will be far more than a dozen such withholdings could make up for in revenue. If he doesn't apply for a refund he will be paying a tax he doesn't owe—a situation I cannot believe the Congress desires to create.

My proposal to the committee therefore is that dividend payments made by any corporation in amounts less than a certain number of dollars be exempted from the withholding tax. Let me emphasize once more that I am recommending this not for cooperatives but for all corporations of whatever sort. Just what the minimum figure ought to be I hesitate somewhat to say, but it would seem to me almost foolish to require withholding in any case where the amount withheld would be less than $5 and I should think $25 would be more nearly an amount worth bothering with. This would mean that language would be inserted exempting dividends of less than $50 or $250 from the withholding tax, depending on the judgment of the committee.

Let me illustrate the force of my point with a few statistical facts. Cooperatives as you know follow the universal practice of paying a limited but fair return on capital. Their dividends to stockholders are much more comparable to interest payments to corporation bondholders than to dividends paid to common stockholders of corporations. We do not propose to press this point nor to ask any different treatment for cooperative dividend payments but it is important for the committee to understand these facts.

Here is one cooperative where 53 percent of the dividend payments made in 1947 were in amounts of less than $1. In 1948, 65 percent of the dividend checks were for $1 or less. Withholding would amount to 10 cents or less on these dividends.

Then there is a group of 28 local cooperatives, all joint owners of the same regional wholesale. In this case the average dividend payment to stockholders was $2.17. Average amount withheld would be 22 cents.

What about wholesale cooperatives? Their stock like that of local cooperatives is very widely held and almost always in small amounts. Here is a typical case. This regional wholesale pays 4 percent annually on its stock.

Of its 2,702 individual stockholders, 462 individuals each own only 1 share of $100 per value stock, 992 individuals own stock in the amount of $200 and more but not in excess of $500, 601 individuals own between $600 and $1,000, 406 individuals own between $1,100 and $2,500, 185 individuals own between $2,600 and $5,000, 48 individuals own between $5,100 and $10,000, and only 8 individuals own over $10,000 par value of the capital stock.

On the basis of the foregoing, it is obvious that four-fifths of the individual investors own $1,000 or less and receive annual dividends thereon of $40 or less. There are 462 individual stockholders who receive dividends of only $4 each annually. It is obvious that the additional bookkeeping and labor involved complying with a withholding tax provision affecting dividends paid to stockholders would constitute a substantial percentage of the value of the dividend actually paid.

Now I have here complete records of all dividend payments made by a typical, well-run, successful cooperative in a midwestern rural community. This cooperative handles fertilizer, feed, farm machinery, petroleum products, appliances, and groceries. The bulk of its business is with farmers.

In the year 1949 this cooperative paid dividends to 1,645 stockholders. The total amount so paid out was $12,881.28.

Here is how these dividend payments were distributed.

Amount of dividend	Number receiving	Percent of total number
Less than $5	1,135	69
More than $5, but less than $10	171	10
More than $10, but less than $50	329	20
Over $50	10	1

The largest dividend payment made to any one individual was $80.

I am certain these figures speak for themselves as to the obvious wisdom of confining the withholding tax requirement to some reasonable amount and thus avoiding a clear ridiculous burden of accounting, record keeping and correspondence upon this business and a like burden of utterly unjustifiable checking by the Bureau of Internal Revenue, if indeed they ever paid any attention to enforcement of the provision at all so far as the smaller amounts are concerned.

Naturally enough, I am not in position to submit figures on dividend payments by corporations other than cooperatives. But I leave it to the committee's judgment whether a certain percentage of such payments will not be in such small amounts as to make the cost of withholding ridiculously out of proportion to any benefit to the Government.

For these reasons I would urge that dividend payments of less than $50 or $100 or $250 or some reasonable figure be exempted from the withholding tax provisions.

The bill however, would require a withholding not only against dividends but against patronage refunds of certain cooperatives as well. No testimony whatsoever was taken either pro or con to such a proposal by the House committee. It is ill-considered and would lead to very great difficulties. Patronage refunds have no relation at all to stockholders' dividends. They represent either a delayed payment of part of the sales price of a farm crop or else a refund of an overpayment made on goods purchased. These practices are by no means limited to cooperatives. But the bills requirements are limited to cooperatives, and in practical effect to certain farmer cooperatives. We believe this is clearly discriminatory and that if a withholding tax is to be required on cooperatives' patronage refunds it should also be required on any patronage refund or discount granted by any business, to the extent that such discount represents taxable income to the recipient.

In the second place, the present language of the bill as it affects patronage refunds would require withholding on such refunds regardless of whether they represented taxable income to the recipient at all or not. The only stipulation is that the cooperative be one—to quote the bill—"operated on a cooperative basis principally for the marketing of products of members or other producers, for the purchase of supplies and equipment used in the trade or business of members or other persons, for the furnishing of services incident to the trade or business of members or other person, or for any combination of such activities."

Now if a farmer buys feed or fertilizer or tractor fuel or a piece of farm machinery from his cooperative and if he then receives a patronage refund representing a portion of the price paid for these items it will affect his taxable income, either reducing the amount of his deductible expenses or adding to his income, whichever way you want to look at it. The farmer should, of course, and does now, pay a tax on that money the same as he does on every other part of his taxable income

But if the farmer's wife buys a flatiron from her cooperative and if a patronage refund of 50 cents were paid at the end of the year on that purchase the taxable income of the family would no more be increased than it would if she had bought the iron at a 3 percent reduction in price from another store. Hence under the present language of the bill withholding will be required of these farmer cooperatives on patronage refunds which do not constitute income under any definition. Every penny of such withholding could be claimed as a refund from the Treasury by the taxpayer. And Congress would furthermore have committed itself to a course the only logical end of which would be to attempt to tax every reduction in price in the whole gamut of American commerce as if that price reduction were taxable income to the person making the purchase.

Finally the facts in the case show conclusively how impractical this proposed withholding tax on patronage refunds would be even if it were fair and equitable.

I have assembled as many actual figures on patronage refunds as I possibly could in the short time since the bill was reported to the House and we knew for the first time what it actually contained.

Here are some figures for a whole State. The total of patronage refunds in that State are approximately $5,000,000 a year. These refunds go to about 150,000 farmers—or an average of a little over $30 apiece. Withholding would therefore, at the 10 percent rate, amount to an average of $3 each with the majority of them of course being even smaller. Yet a tremendous accounting job would have to be done—and one which would be so costly as in many cases to wipe out the possibility of any patronage refunds being paid at all—in which case Treasury revenue would actually be reduced, since most of these refunds do now constitute taxable income to the recipient and on which taxes are of course now being paid.

The problem can only be fully understood however if we look at what the local co-op would be up against.

Here is local co-op No. 1. In 1947, out of 1,071 patronage refund payments, 805 of them or more than 75 percent were for less than $5. Withholding on these refunds would range all the way from 4 or 5 cents each to no more than 50 cents. In 1948 this cooperative paid no patronage refunds at all. Figures for 1949 are not yet available.

Then here is co-op No. 2. 63 percent of its patronage refunds are in amounts less than $2.50. Withholding would amount to a maximum of 25 cents—84 percent of the patronage refunds of this co-op were less than $5, with withholding amounting to no more than 50 cents on each refund.

In co-op No. 3, 37 percent of its patronage refunds were for less than $1. Withholding would amount to 10 cents. But every one of these people would have to be informed in writing that 10 cents had been withheld. Here 64 percent of the refunds were for less than $5. Withholding would be no more than 50 cents each.

Then there are figures on 26 cooperatives associated with one regional wholesale. Their patronage refunds in 1949 averaged $10.69 each. Average amount withheld would therefore be about $1, but against the great majority of them would be for even less than that. And yet separate accounts would have to be kept on all these tiny patronage refunds and in many cases they would be subject to request for refunds from the Treasury.

Finally, I have complete figures on one typical, very well run cooperative in rural Wisconsin. This is the same one for which I submitted figures earlier as to dividends.

There were patronage refunds in total amount of $23,122.16 paid to 2,451 individuals in 1949 by this cooperative.

They were divided as follows:

Amount of patronage refund	Number receiving	Percent of total
Less than $5	1,566	64
More than $5, but less than $10	334	13
More than $10, but less than $50	448	19
More than $50	103	4

In other words two-thirds of all the patronage refunds paid by this cooperative would result in a withholding of less than $0.50, 96 percent of them would result in a withholding of less than $5.

The largest single patronage refund paid was for $351.80, and a total of $7,500 was involved in the 103 refunds of $50 and above.

This cooperative now follows the practice of informing its members fully as to their tax liabilities. It has invited officials of the Bureau of Internal Revenue to come and speak to its meetings to be perfectly certain that all taxes were paid in full both by the cooperative and its members. This cooperative, though it could no doubt do so, does not attempt to qualify under section 101 (12). In 1948 it paid $4,250 of Federal corporation income taxes in addition to all other taxes.

Surely it ought not to be required to go through all the expensive motions of withholding over 2,000 items against over 2,000 patrons three quarters of which would be in amounts of less than $1. And certainly it would do the United States Treasury no good if such a requirement were imposed.

At present this cooperative has an office force of four full-time and one half-time worker. It would, if the bill passed in its present form, be compelled to hire two additional office workers according to its competent manager. I need

hardly point out to the committee that such a 50-percent increase in office personnel would mean so sharp a reduction in its patronage refunds that everyone, including the United States Treasury, would be the losers.

For all these reasons we hope the committee will agree that the attempt to include patronage refunds in the withholding tax provisions is discriminatory, impractical, and ill-considered, and that subsection (c) of section 1310 will be stricken from the bill, at least until such time as such a proposal has been thoroughly discussed in committee hearings by representatives of the some 3½ million farmers who would be affected by it.

Should this not be done, then at the very least a limit should be provided as in the case of dividends, so that withholding would apply only to patronage refunds in amounts sufficiently large—say $50 or $100—to be somewhere near worth all the expense of record keeping, accounting, and claims up the Treasury for refunds. Otherwise there will be countless farmers' cooperatives whose benefits to their members will be severely and unjustifiably reduced by this action of Congress.

Now I want to make it quite clear that we are altogether in favor of the provisions in the bill which I understand would extend present requirements upon cooperatives as well as other corporations, that they report to the Bureau of Internal Revenue the amount of all dividends or taxable patronage refunds paid to any person and the date of payment. We also believe the requirement that the taxpayer indicate on his return the names of the payors of dividends to him is all right. This should give sufficient information to the Bureau of Internal Revenue to enable it to enforce the law effectively and prevent evasion. And this we understand is the main purpose sought to be achieved. The proposed withholding tax, therefore—especially on the smaller amounts—is unnecessary.

(The following additional material was later received from Mr. Voorhis:)

THE COOPERATIVE LEAGUE OF THE UNITED STATES OF AMERICA,
Chicago 4, Ill., July 14, 1950.

Senator WALTER F. GEORGE,
Chairman, Senate Committee on Finance,
Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: When I appeared before your committee on July 12, I realized how long was the list of witnesses and how great the burden of work which your committee faces—especially at this present time of crisis. Consequently, some of the questions which arose were, I feel, inadequately dealt with and I am writing this letter in order to do greater justice to some of them.

I believe it is quite generally accepted that moneys paid out by cooperatives in patronage refunds in accordance with binding obligations so to pay are not and could not in justice be subject to income tax against the paying business.

The point is a little less widely understood but of equal importance that the payment of patronage refunds is not confined to cooperatives and that any business which decides to distribute its earnings in the form of patronage refunds will no more be taxed upon that money than cooperatives are. Any possible "advantage" which cooperatives may be alleged to have in this respect arises not from the law but rather from the basic difference between the way cooperative businesses treat their patrons and the way proprietary businesses treat theirs. It it can be regarded as an "advantage" to assign all earnings into the ownership of the patrons of a business, then this "advantage" is as wide open to any other business as it is to co-ops.

I need hardly point out that this cooperative method has some obvious disadvantages from a purely financial viewpoint.

When, therefore, the representatives of the National Tax Equality Association contend that money obligated to be paid by a cooperative as patronage refunds should be taxed against the cooperative they are arguing not for tax equality but for gross tax inequity.

Whatever may be the minor differences between cooperatives and other types of partnerships, there is no essential difference between them so far as the question of tax equity is concerned. No partnership nor individually owned business pays corporation taxes. The partners do pay taxes on the income of the business as individual recipients of that income. Cooperatives qualifying under section 101-12 pay no Federal corporation taxes either. All other cooperatives do pay Federal corporation taxes on any savings they may make (including money used to pay dividends to stockholders) except only the amounts which legally belong to and must be paid to patrons as patronage refunds. But, Mr. Lester's misleading

statement to the committee notwithstanding, the patrons of any cooperative who receive patronage refunds in whatever form paid must, like partners, pay Federal income taxes on every penny of those refunds which would constitute taxable income to anyone. There is therefore tax equality now. And when the National Tax Equality Association asks that patronage refunds be taxed against the cooperative as well as against its patrons or members, it is asking for tax inequity unless it asks the same treatment for partnerships, which of course it does not do.

The question next arises—and this I think is the one that most needs clarifying—whether, nonetheless, cooperatives cannot accumulate funds for expansion purposes without paying taxes on them, whereas neither a partnership nor an ordinary corporation can do so. Disregarding for the moment section 101–12, under which a constantly decreasing number of cooperatives are attempting to qualify, the answer to that question is an unqualified "No".

The accumulation of reserves by cooperatives—for any purpose—are governed by the same laws and subject to the same taxes as apply against any business. The only difference arises, again, from a difference in method of operation. If an ordinary corporation decided to build a new plant and to sell additional stock to secure funds for doing so, no one would for a moment suggest that the proceeds from that stock sale be regarded as taxable income to that corporation. It would be investment money instead. The same would be true if partners in a business decided to put more money into it for expansion purposes. If, on the other hand, the corporation or partnership retained part of its earnings for the purpose of building the new plant, then taxes on those earnings would have to paid.

Now, if a cooperative needs to construct or acquire new facilities—such as additional storage facilities or a new fertilizer plant to meet its patrons' needs—it can do so in one of two ways, comparable in both cases in all essential respects to what other businesses can do. The first thing a cooperative can do (unless it is a 101–12 co-op) is to retain in its own name a part of the savings made as a result of its business and use that money for the required expansion. But if a cooperative does this it must pay every penny of tax on such funds that any other business would have to pay and it must pay them under exactly the same law. The other thing cooperatives can do (whether or not they are qualified under 101–12) is to secure investment funds from their patron-members. To be at all fair about this matter, it must be borne in mind that cooperatives do not have access to the sources of capital which other businesses enjoy. Cooperatives receive the great bulk of their capital funds from small investments by many, many people of modest means—their member-patrons. If a cooperative is to use this second method, one of two things must happen. Either the member-patrons having received their refunds in cash must reinvest them, or else the member-patrons must simply agree to receive their patronage refunds in stock instead of in cash. If they do so agree, then the cooperative must assign ownership over these funds to its patrons in proportion to their patronage, and this in turn means that ownership over the new facility, whatever it may be, will be broadly spread among all the patrons of that cooperative. Furthermore, it means that these co-op patrons have done nothing more nor less than exactly what the investors in a new issue of corporation stock (or partners putting more money into their business) would have done in the case of sale of a new stock issue. But on every dollar of the reinvested patronage refund which would be taxable income to anyone dealing with any business, the cooperative patron must pay a personal income tax just the same as if the money had been received in cash. This fact, if nothing else, shows clearly that what happens when a cooperative secures funds for expansion by paying patronage refunds in a form other than cash is on all fours with what happens when a corporation sells a new issue of capital stock. In neither case are investment funds treated as taxable income against the business. In both cases the money invested is regarded, taxwise and otherwise, as the property of the individual investor, as indeed it is.

Once again therefore let me point out that there is "tax equality" now.

The only remaining question has to do with those cooperatives which qualify for specific Federal corporation income tax exemption under section 101–12. Cannot they accumulate money for expansion purposes without assuming the same tax liability which another business would bear? The answer again is no.

To qualify under section 101–12, a farmer cooperative must limit its business substantially to marketing crops for or securing supplies for farmer-producers. It must limit its interest payments on stock to the legal interest rate. It must pay patronage refunds on the same basis to nonmembers as to members. This is the reason a cooperative operating under 101–12 cannot accumulate its savings for purposes of capital expansion. It will be obvious that these restrictions mean,

in effect, that 101–12 cooperatives must conduct a virtually nonprofit business in return for which they are told they will not be taxed on profits. The only real exemption they have is that, unlike all other cooperatives, they are not taxed on money used to pay interest to stockholders. (Their stockholders are of course taxed on this interest as individuals.) In addition, they may accumulate reserves deemed by the Bureau of Internal Revenue to be "necessary" to the efficient conduct of their business. Were this not the case then, since they are required to pay out all their margins in patronage refunds, they would be in a precarious position indeed.

If any cooperative qualifying under 101–12 violated any of the requirements of that section, it automatically loses its exemption and becomes subject to all taxes the same as all other cooperatives and all other businesses.

Assuming, therefore, that the Bureau of Internal Revenue—in whose hands rather than those of the cooperatives the whole matter rests—properly defines the word "necessary" as to reserves, it is hard indeed to see how even the 101–12 cooperatives enjoy any advantage over their competitors so far as taxes are concerned.

The great alarm voiced by opponents of cooperatives about the expansion of ownership by co-ops of physical facilities was answered most effectively by Mr. Loos before your committee. But it may be worth while to point out here, and in conclusion, that the factor that has enabled cooperatives to achieve such expansion as they have achieved has not been any tax advantage but rather the willingness of several million Americans, mostly farmers, to accept and pay taxes on stock in their cooperatives instead of insisting on cash patronage refunds. And the further fact is that this has meant a spreading of ownership over facilities essential to them among millions of American citizens, who could have acquired such ownership in no other way. I am sure you believe as I do that this is a 100 percent good influence on our economy and national life and a much-needed application of the basic principles of traditional Americanism.

I appreciate very much the time afforded me to testify before your committee.

Sincerely yours,

JERRY VOORHIS,
Executive Secretary.

The CHAIRMAN. We have time for one more witness, and then we must go to the floor.

Mr. Karl D. Loos? Will you identify yourself for the record, Mr. Loos?

STATEMENT OF KARL D. LOOS, WASHINGTON, D. C., APPEARING ON BEHALF OF NATIONAL COUNCIL OF FARMER COOPERATIVES, NATIONAL FEDERATION OF GRAIN COOPERATIVES, AND NATIONAL MILK PRODUCERS FEDERATION.

Mr. LOOS. Mr. Chairman, I am Karl D. Loos, of Washington, D. C., and I appear this morning on behalf of the three national organizations of farmer cooperatives, namely, the National Council of Farmer Cooperatives, the National Federation of Grain Cooperatives, and the National Milk Producers Federation.

To conserve the time of the committee, we have prepared a statement, and these three national organizations have agreed on just one witness to appear for them. To further conserve the time of the committee, I am not going to read this statement, but I ask permission to file it. It contains a description of these three national organizations, which perhaps are already known to you, so I will not stop to describe them at this time.

The CHAIRMAN. You may file it for the record, Mr. Loos.

(The statement referred to follows:)

STATEMENT BY KARL D. LOOS, WASHINGTON, D. C., ON BEHALF OF NATIONAL COUNCIL OF FARMER COOPERATIVES, NATIONAL FEDERATION OF GRAIN COOPERATIVES, NATIONAL MILK PRODUCERS FEDERATION

To conserve the time of the committee the three national organizations of farmer cooperatives are joining in a single statement to be presented through one witness. These three organizations are:

The National Milk Producers Federation is the oldest and largest national farm commodity organization in the United States. It had its inception in 1916, incorporated the following year and has been in existence continuously from that date. Its membership presently consists of 86 member cooperative associations and over 600 local cooperative affiliates, all owned, controlled and operated by approximately 425,000 dairy farmers in 47 States. These members in 1949 produced over 20 billion pounds of whole milk equivalent, which is approximately one-fifth of the total milk and cream distributed to the consuming public. It is estimated that 60 percent of the dairy farmers in the United States belong to cooperatives.

The National Federation of Grain Cooperatives has as its members 16 regional cooperative marketing organizations serving all of the principal grain producing areas of the United States. It was organized in 1939 and its board of directors of 16 persons meets three or four times annually. The regional grain marketing organizations market grain for more than 2,500 local cooperative marketing associations maintained by farmers producing wheat, corn, oats, barley, rye, soybeans, flaxseed, grain sorghums and dry beans. Services provided farmers include selling grains and oil seeds, conditioning, storage and handling.

The National Council of Farmer Cooperatives is the largest cooperative organization in the United States and the associations which comprise its membership handle all major types of agricultural products and farm supplies.

The national council is composed of 115 direct members with approximately 5,000 local and county affiliated associations—both marketing and purchasing farmer cooperatives. These serve about 2,600,000 farmer members throughout the United States.

The council's members are classified in the following divisions based upon their major commodity or functional business activity:

Citrus and subtropical fruits, cotton, dairy, deciduous fruits, general service, grain and seed, livestock, miscellaneous, miscellaneous fruits and vegetables, nut, potato, poultry, processed fruits and vegetables, purchasing, State councils, tobacco, wool.

There is some overlapping in the membership of these three organizations. The majority of the farmer cooperatives of the country are members of one or more of these organizations. Together they represent a very large number of farmer members.

In view of the committee's admonition to avoid repetition of evidence presented at the hearings before the Ways and Means Committee, we are not submitting any statement with respect to the exemption of farmer cooperatives contained in section 101 (12) of the Internal Revenue Code or with respect to the treatment of patronage refunds in connection with the taxation of nonexempt farmer cooperatives. Both subjects are fully covered not only by the recent hearings held by the House Ways and Means Committee in February 1950 but also by the more extensive hearings held in November 1947. The hearings dealing with cooperatives in 1950 were held on February 22 and 23, and the record is contained in volume II of the hearings on Revenue Revision of 1950 before the Ways and Means Committee, pages 2015–2304. The hearings in 1947 ran continuously from November 4 to 26, and the record is in part 4—Tax Exempt Organizations (Cooperative Organizations) of the hearings on Revenue Revisions 1947–48 before the Ways and Means Committee. This volume consists of pages 1867–3161.

In addition to these two hearings before the Ways and Means Committee, the subject of farmer cooperatives was treated exhaustively at two hearings before the House Small Business Committee. The first, held pursuant to House Resolution 64 of the Seventy-ninth Congress, took place during the months of March to June 1945. The record is printed in two volumes under the title "A Study and Investigation of the National Defense Program in Its Relation to Small Business—Financial Problems of Small Business." Following those hearings, the committee issued its first interim report entitled "The Competition of Cooperatives With Other Forms of Business Enterprise" House Report No. 1888, Seventy-ninth Congress, second session, April 9, 1946.

The second hearings were held in August and September of 1947, and the record is contained in a single volume under the title "Government Competition With and Assistance To Business."

Such exhaustive consideration has thus been given to the subject of farmer cooperatives in relation to Federal income taxes that we think there is nothing new to be said on the subject. Accordingly, we are not submitting any statement with respect to the exemption of section 101 (12) of the Internal Revenue Code or with respect to the tax treatment of patronage refunds. However, if anything is presented to the committee in opposition to the present tax treatment of farmer cooperatives, we hope we may have an opportunity to answer it.

PROPOSED WITHHOLDING TAX

The provisions relating to the withholding tax on dividends appear in section 601 of the bill at pages 137–150. Dividend is defined to include not only dividends on corporate stock but also patronage dividends, rebates, or refunds paid by an association operated on a cooperative basis. Such cooperatives would include not only farmer cooperatives but many other types of cooperatives whose activities relate to business operations of the members and patrons. It is believed that the proposal to impose a withholding tax in connection with patronage dividends was not discussed at any of the hearings before the Ways and Means Committee. The group of farmer cooperatives here represented did not submit any testimony or statement on this subject while the bill was pending before the House.

WITHHOLDING TAX SHOULD NOT BE APPROVED

It is our view that the proposed withholding tax, in its application to ordinary corporations as well as to cooperatives, is unjust and inequitable; that it will not yield any substantial amount of additional revenue; that any extra revenue it might yield would be revenue collected in small amounts from a large number of persons who are not liable to tax; that it would impose undue burden and expense upon both corporations and cooperatives making distributions to large numbers of individuals in small amounts; and that this form of collection at the source is therefore undesirable and unnecessary.

Collection at the source is by no means essential to obtaining information at the source. The present law, in sections 147 and 148 of the Internal Revenue Code, contains adequate authority for information returns. Section 147 applies to all forms of determinable income, other than dividends, and is subject to a minimum of $600 total amount paid to any one person in a year. Section 148 applies to dividends and has no minimum prescribed by the statute, although the regulations as issued by the Commissioner fix a minimum of $100 in total payment to any one person in 1 year.

The information necessary to obtain the data for checking returns of individual taxpayers can be obtained without imposing any withholding tax. With adequate information, there should be no loss of revenue on account of failure of taxpayers to report receipts. Certainly the imposition of a 10-percent withholding tax would not in any way remedy any losses of revenue that may exist on account of inadequate information. The only effective remedy for such losses is to make the information adequate; the statute already contains ample authority for that. Once the information is adequate to permit accurate and complete check of returns, the withholding tax is wholly unnecessary.

The greatest inequity of the withholding tax is in its effect upon thousands of individuals whose net incomes are less than their statutory exemptions. There are many such individuals among the farmer cooperative members and patrons who receive patronage refunds. There are doubtless many such individuals also who receive corporate dividends. In many of these cases, the amount of the tax withheld would be so small as not to justify the expense and trouble involved in filing returns of claims for refund to recover the tax withheld. Thus, where the amounts of tax withheld involved are small, there would be thousands and thousands of individuals who would be unjustly taxed, even though the income-tax law intended to excuse such individuals from the payment of any income taxes.

In a similar manner, there would be many exempt institutions, such as churches, schools, charitable organizations and others whom the law intends to exempt from tax but who would have taxes taken out of small amounts of dividends payable to them and who, because of the small sums involved, could not afford to seek their recovery through the prosecution of claims for refund.

While such sums in the aggregate might amount to some additional revenue, it is certainly not the kind of revenue which an honest Government should exact from its citizens.

Even in those cases where the amount involved was sufficient to warrant the necessary steps to obtain refunds, there would be an injustice to the affected individuals and institutions not liable to tax, in that a portion of their incomes would be retained by the Government. Since such retention would go on from year to year and since substantial time would necessarily be involved in the refunding process, the Government would permanently have in its possession a portion of income of these small-income groups. This is almost as bad as taking it away from them entirely, because they would never have the opportunity of spending their full incomes.

The force of these and other reasons against the enactment of the proposed withholding-tax provisions will become clearer upon considering specific cases which will reveal the large number and small amounts involved in patronage refunds of many farmer cooperatives. The time since the passage of the House bill has not been sufficient to permit any analysis of a large number of cooperatives. However, a number who were able to assemble statistical information quickly have made reports. It is believed that these are representative of the great majority of farmer cooperatives, both marketing and purchasing, and there are sufficient number to illustrate the consequences of enactment of the withholding provisions as contained in the House bill:

ILLUSTRATIONS OF NUMBER AND AMOUNTS OF DIVIDENDS AND PATRONAGE REFUNDS

The Cotton Producers Association, Atlanta, Ga.

The Cotton Producers Association is a farmer marketing cooperative with headquarters in Atlanta, Ga. It markets cotton for growers located in Georgia, South Carolina, Alabama, and Florida. It also does considerable purchasing of farm supplies for its growers. Its business operations are conducted through 30 affiliated cooperative associations and some 40 private agencies, the latter being local merchants who operate under a franchise in servicing growers who are direct members of the Cotton Producers Association in certain areas. Time has not permitted an analysis of all of these associations and agencies, but the statement on the following page shows the number and amounts of patronage refunds made by three of the associations and three of the agencies. It is considered that these are representative of all.

Analysis of patronage refunds paid by 3 affiliated associations of the Cotton Producers Association, Atlanta, Ga., as of June 30, 1949

Range of patronage refunds	No. 1 association			No. 2 association			No. 3 association			3 associations consolidated		
	Patrons	Amount	Average	Patrons	Amount	Average	Patrons	Amount	Average	Patrons	Total	Average
$0 01 to $0.99	1,490	$336 52	$0 23	717	$226 19	$0 31	22	$14.45	$0.66	2,229	$577.16	$0.26
$1 to $9.99	416	1,399.20	3.36	387	1,569.33	4 05	43	169.32	3.94	846	3,137.85	3.71
$10 to $49 99	203	4,458.98	21 97	135	2,612.47	19.35	50	1,375.31	27.50	388	8,446.76	21.77
$50 to $99 99	15	1,009.73	67.31	23	1,551 22	67 44	16	1,131.77	70.73	54	3,692.72	68.38
$100 and over	14	2,702 18	193 01	10	1,464.74	146.47	27	5,724.91	212.03	51	9,891.83	193.96
Total	2,138	9,906 61	4 63	1,272	7,423 95	5.84	158	8,415.76	53 26	3,568	25,746.32	7.22

Analysis of patronage refunds paid by 3 private agencies of the Cotton Producers Association, Atlanta, Ga., as of June 30, 1949

Range of patronage refunds	No. 1 agency			No. 2 agency			No. 3 agency			3 agencies consolidated		
	Patrons	Amount	Average	Patrons	Amount	Average	Patrons	Amount	Average	Patrons	Total	Average
$0 01 to $0 99	3	$2 49	$0 83	86	$27 64	$0.32	41	$13.15	$0.32	130	$43.28	$0.33
$1 to $9 99	51	222 33	4 36	83	374 67	4 51	16	47 90	2 99	150	644 90	4.30
$10 to $49 99	23	362 13	15 74	36	632 86	17 58	9	148 00	16.44	68	1,142 99	16 80
$50 to $99 99	1	59 38	59 38	3	196 19	65 40	0	0	0	4	255.57	63.89
$100 and over	0	0	0	0	0	0	0	0	0	0	0	0
Total	78	646 33	8.28	208	1,231 36	5 92	66	209.05	3 16	352	2,086 74	5.93

Southern States Cooperative, Richmond, Va.

Southern States Cooperative is a farmer purchasing cooperative doing business in the States of Virginia, West Virginia, Tennessee, Kentucky, Delaware, and Maryland. It is one of the largest farmer purchasing cooperatives and also does some marketing of farm products. It has capital stock and pays dividends on that stock in addition to making patronage refunds. An analysis of the patronage refunds and dividends on capital stock for the fiscal year ended June 30, 1949, follows:

Range	Fiscal year ended June 30, 1949					
	Patronage refunds to patrons			Dividends on outstanding capital stock		
	Number of payments	Total amount paid	Average payment	Number of payments	Total amount paid	Average payment
$0.01 to $0.99	126,821	$54,943.41	$0.43	176,482	$47,365.64	$0.27
$1 to $9.99	101,974	567,417.38	5.56	46,238	98,030.60	2.12
$10 to $49.99	10,563	340,068.48	32.19	5,041	72,303.38	14.34
$50 to $99.99	746	54,751.36	73.39	303	16,588.86	54.75
$100 and over	163	41,785.41	256.35	513	143,813.88	280.33
Total	240,267	1,058,966.04	4.41	228,577	378,102.36	1.65

The mere reporting of the patronage refunds to 240,267 patrons and dividends paid on corporate stock to the 228,577 stockholders for the 1 year would have required more than 160 miles of paper 8½ inches wide.

The Farm Bureau Cooperative Association, Columbus, Ohio

The Farm Bureau Cooperative Association is a large purchasing cooperative with headquarters at Columbus, Ohio. It operates through county farm bureau cooperative associations. The central makes refunds to the local associations, and the local in turn makes refunds to the farmer patrons. The following table shows the refunds made to the local associations for the last full year:

Tabulation of patronage refunds to local associations, 1949

Range	Number of refunds	Amount	Average
$0 01 to $0.99	1,243	$153.21	$0.12
$1 to $9.99	214	647.81	3.03
$10 to $49 99	71	1,521.12	21.42
$50 to $99.99	11	698.68	63.52
$100 and over	145	644,016.21	4,441.50
Total	1,684	647,037.06	384.23

The following tables show an analysis of patronagere funds made by four of the local county associations of the Farm Bureau Cooperative Association, Columbus, Ohio.

Tabulation of patronage refunds, 1949

ADAMS COUNTY FARM BUREAU COOPERATIVE ASSOCIATION, CHERRY FORK, OHIO

Range	Number of refunds	Amount	Average
$0.01 to $0.99	282	$144.65	$0.51
$1 to $9.99	702	2,899.89	4.13
$10 to $49.99	305	6,191.19	20.30
$50 to $99.99	21	1,447 17	68.91
$100 and over	13	3,070 45	236.19
Total	1,323	13,753.35	10.40

CLARK COUNTY FARM BUREAU COOPERATIVE ASSOCIATION, SPRINGFIELD, OHIO

Range	Number of refunds	Amount	Average
$0.01 to $0.99	4,875	$1,072.18	$0.22
$1 to $9.99	1,254	4,563.07	3.64
$10 to $49.99	372	8,219.10	22.09
$50 to $99.99	38	2,558 85	67 34
$100 and over	6	662 46	110.41
Total	6,545	17,075.66	2.61

HANCOCK COUNTY FARM BUREAU COOPERATIVE ASSOCIATION, INC., FINDLAY, OHIO

Range	Number of refunds	Amount	Average
$0.01 to $0.99	2,558	$622.86	$0.24
$1 to $9.99	1,655	6,455.42	3.90
$10 to $49.99	894	19,390 35	21 67
$50 to $99.99	133	8,834.26	66.42
$100 and over	10	1,351.80	135.18
Total	5,250	36,654.69	6 98

MADISON FARM BUREAU COOPERATIVE, INC., LONDON, OHIO

Range	Number of refunds	Amount	Average
$0.01 to $0.99	1,764	$382.53	$0 22
$1 to $9.99	828	3,084 91	3 72
$10 to $49.99	440	9,785 97	22 24
$50 to $99.99	96	6,497 10	67.68
$100 and over	34	7,477 40	219.92
Total	3,162	27,227.91	8.61

North Carolina

Three cooperatives operating in North Carolina were selected for analysis, one a small cooperative operating in the Piedmont region, the other a medium-sized cooperative operating in the mountain region, and the third a large cooperative operating in both eastern and Piedmont regions. The second and third cooperatives paid dividends on capital stock as well as patronage refunds. The number of patronage refunds and dividend payments within the indicated amounts for each of these three cooperatives for the year 1949 were as follows:

DAVIDSON FARMERS MUTUAL EXCHANGE, INC., LEXINGTON, N. C.

	Number	Percent
3,349 patronage refunds:		
Less than $1	1,405	42.0
$1 to $10	1,572	46.9
More than $10	372	11.1
Total	3,349	100.0

FARMERS FEDERATION, ASHEVILLE, N. C.

	Number	Percent
9,194 patronage dividends:		
Less than $1	4,367	47.5
$1 to $10	4,119	44.8
More than $10	708	7.7
Total	9,194	100.0
15,415 dividends on stock:		
Less than $1	3,468	22.5
$1 to $10	4,825	31.3
More than $10	7,122	46.2
Total	15,415	100.0

FARMERS COOPERATIVE EXCHANGE, RALEIGH, N. C.

[Total accounts, 104,743]

	Number	Percent
Patronage refunds (based on sample of 11,425 analyzed):		
Less than $1	63,893	61
$1 to $10	36,660	35
More than $10	4,190	4
Total	104,743	100
Dividends on stock (based on sample of 5,988 analyzed):		
Less than $1	81,700	78
$1 to $10	17,806	17
More than $10	5,237	5
Total	104,743	100

Missouri Farmers Association, Columbia, Mo.

The Missouri Farmers Association is a purchasing and marketing cooperative with headquarters at Columbia, Mo. It is composed of a number of local cooperatives and 18 of these locals were analyzed to determine the number and amount of patronage refunds with the following results:

Cooperative No.	Number of refunds	1 cent to 99 cents	$1 to $9.99	$10 to $49.99	$50 to $99.99	Over $100	Total of refunds
1	831	449	345	36	1		$1,951.29
2	693	299	323	71			2,619.67
3	2,370	1,282	842	230	14	2	9,541.97
4	1,269	737	471	58	2	1	2,715.15
5	722	269	236	171	34	12	9,028.43
6	343	187	136	19			864.97
7	1,069	694	369	6			1,363.12
8	883	512	298	73			2,554.49
9	723	206	371	142	3	1	4,527.43
10	1,087	578	442	66	1		2,882.76
11	1,113	464	426	200	17	6	8,584.95
12	750	285	345	115	5		3,561.42
13	1,925	591	922	373	35	4	15,356.71
14	1,945	447	993	398	78	29	22,629.43
15	643	216	246	154	20	7	6,845.04
16	4,380	2,205	1,515	573	58	29	29,319.94
17	3,062	2,413	587	62			3,390.88
18	1,712	808	708	182	14		7,616.14
Total	25,519	12,642	9,575	2,929	282	91	135,353.79
Percent	100 00	49.54	37.52	11.48	1.11	.35	

Range	Number of patronage refunds	Percent of total
$0.01 to $0.99	12,642	49.54
$1 to $9.99	9,575	37.52
$10 to $49.99	2,929	11.48
$50 to $99.99	282	1.11
$100 and over	91	.35
Total	25,519	100.00

The average of all 25,519 patronage refunds was $5.30.

Farm Bureau Services, Inc., Lansing, Mich.

Farm Bureau Services, Inc., is a large purchasing cooperative with headquarters at Lansing, Mich., and serves farmers in that State. It pays dividends on capital stock as well as paying patronage refunds. Such distributions for the last fiscal year were as follows:

Patronage dividend distributions, Aug. 31, 1949

Range of size of payment	Number of refunds	Total amount of refund	Average
1 cent to $9.99	14,022	$26,988 16	$1 92
$10 to $49.99	1,415	26,110.95	18 45
$50 to $99.99	86	5,602 31	65.14
$100 and over	25	4,888.94	195.56
Total	15,548	63,590.36	4.09

Distribution of dividends on stock, Aug. 31, 1949

Range of size of payment	Number of refunds	Total amount of refund	Average
1 cent to $9 99	6,771	$6,933 00	$1 02
$10 to $49 99	38	603.60	15 88
$50 to $99.99	1	51.90	51.90
$100 and over	None	None	
Total	6,810	7,588.50	1.11

Washington Cooperative Farmers Association, Seattle, Wash.

Washington Cooperative Farmers Association is one of the largest cooperatives on the west coast. It performs both marketing and purchasing services. It has made three distributions to its membership recently. The first of these was a distribution issued as of January 1, 1950, as patronage refunds covering the preceding year's business. Amounts of $10 or more are issued in the form of finance fund certificates. Amounts less than $10 are paid in cash, since it is not practical to issue certificates for the smaller amounts. The second distribution shown was a repayment of the 1943 emergency reserve fund, all of these payments being made in cash. This probably would not be considered a patronage dividend, because the certificates when issued in 1943 constituted the patronage dividend. The 1949 payments were a cashing of the certificates previously issued in 1943. The third distribution represents 4-percent interest checks on the outstanding finance fund certificates covering the year 1949. If considered interest payments, as they are termed, these payments would not be subject to withholding tax or reporting requirements. However, if they should be considered the equivalent of dividends on capital stock, they might be subject to such requirements. The information is of interest, however, as indicating the small size of such distributions.

A summary of the three distributions above described follows:

69474—50——48

1949 patronage refunds

Range	Number	Amount	Average
1 cent to $9.99	13,150	$49,949.70	$3.80
$10 to $49.99	13,502	324,856.51	24.06
$50 to $99.99	3,134	216,186.38	68.98
$100 and over	2,775	728,156.92	262.40
	32,561	1,319,149.51	40.51

Retirement of 1943 reserves

Range	Number	Amount	Average
1 cent to $9.99	23,411	$52,382.08	$2.24
$10 to $49.99	3,083	57,892.55	18.78
$50 to $99.99	142	9,180.33	64.65
$100 and over	25	4,288.52	171.54
	26,661	123,743.48	4.64

1949 interest on finance fund certificates

Range	Number	Amount	Average
1 cent to $9 99	18,154	$43,074.62	$2.37
$10 to $49.99	3,352	75,122.68	22.41
$50 to $99.99	657	46,045.80	70.08
$100 and over	606	147,966.82	244.22
	22,769	312,209.92	13.71

Pacific Supply Cooperative, Walla Walla, Wash.

Pacific Supply Cooperative is another west coast purchasing cooperative with headquarters at Walla Walla, Wash., serving a large number of farmers in that area. The analysis of patronage refunds made by this cooperative covering four of its local associations gives only the number of patrons and the percent of the total number in each of the ranges indicated for the individual payments. The analysis is as follows:

Range	Patrons	Percent
1 cent to $0.99	1,670	21.2
$1 to $9.99	3,141	39.9
$10 to $24.99	1,236	15.7
$25 and over	1,832	23.2
Total	7,879	100.0

Pennsylvania Farm Bureau Cooperative Association, Harrisburg, Pa.

Pennsylvania Farm Bureau Cooperative Association is a large purchasing cooperative with headquarters at Harrisburg, Pa. It has 24 local associations which make distributions of patronage refunds. Nineteen of these have compiled their refunds; the other five did not have time to complete the figures. The detailed analysis for the 19 locals appears in the following table:

Analysis of patronage refund payments of 19 cooperatives which are members of Pennsylvania Farm Bureau Cooperative Association, Harrisburg, Pa.

Name of association	Refunds, 1 cent to $9.99		Refunds, $10 to $49 99		Refunds, $50 to $99.99		Refunds, $100 and over		Total	
	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number of patrons	Patronage amount
Adams County Farm Bureau Cooperative Association	1,795	$3,056	136	$2,527	1	$61	0	0	1,932	$5,644
Armstrong Farm Bureau Cooperative Association	676	4,004	164	3,192	6	420	1	$126	847	7,742
Berks County Cooperative Association	6,922	8,747	603	13,832	48	3,215	12	1,749	7,585	27,543
Clarion County Farm Bureau Cooperative Association	1,766	7,194	334	7,051	32	2,061	9	1,451	2,141	17,757
Cove Farm Bureau Cooperative Association	1,898	5,295	282	5,902	9	592	2	326	2,191	12,115
Greene Farm Bureau Cooperative Association	1,032	1,719	100	1,850	14	850	7	710	1,153	5,129
Jefferson Farm Bureau Cooperative Association	1,601	2,713	136	2,535	5	310	0	0	1,742	5,558
Lancaster County Farm Bureau Cooperative Association	4,585	7,474	179	2,984	6	347	0	0	4,770	10,805
Lawrence Farm Bureau Cooperative Association	174	479	20	369	4	230	0	0	198	1,078
Lebanon Valley Farm Bureau Cooperative Association	3,445	3,672	53	899	3	174	1	161	3,502	4,906
Mercer Farm Bureau Co-op Association	3,670	10,988	200	3,523	5	301	0	0	3,875	14,812
Montgomery-Bucks Farm Bureau Co-op Association	3,005	12,889	933	18,818	134	9,412	138	27,216	4,210	68,335
Northampton Farm Bureau Co-op Association	3,086	6,648	400	7,994	34	2,358	10	1,548	3,530	18,548
Perry Farm Bureau Co-op Association	2,449	2,305	105	2,502	5	294	1	129	2,560	5,230
Schuylkill Farm Bureau Co-op Association	677	1,443	90	1,914	17	1,193	19	3,374	803	7,924
Somerset Farm Bureau Co-op Association	7,665	352	314	6,700	22	1,429	6	683,683	8,007	9,164
Union Farm Bureau Co-op Association	1,483	4,274	281	5,572	19	1,215	1	480	1,784	11,541
Washington County Farm Bureau Co-op Association	1,981	4,692	275	4,929	13	840	1	129	2,270	10,590
York Farm Bureau Co-op Association	4,915	5,854	93	1,541	0	0	0	0	5,008	7,395
Totals	52,825	93,798	4,698	94,634	377	25,302	208	38,082	58,108	251,816

The foregoing statistics cover a few of the well-known farmer cooperative associations operating in the United States. It is believed that their experience would be representative of the experience of the others with respect to the number and amounts of patronage refunds and dividends on stock. It is evident that large numbers of these distributions are in very small amounts and that any withholding or reporting requirements with respect to such small amounts would impose exceedingly onerous burdens upon the reporting organizations and would give the Treasury a mass of reports which would be entirely useless to it.

EXEMPTION NOT REQUESTED

The farmer cooperatives do not suggest that they be added to the exemptions specified in paragraph (2) of proposed section 1311 at page 140 of the bill. It is noted that such exemptions are provided in the House bill for rural electrification cooperatives, building and loan associations, mutual savings banks, and several other groups. Nevertheless, the farmer cooperatives do not suggest corresponding action in the case of those farmer cooperatives qualifying under section 101 (12).

Our reason for this position is that, to whatever extent patronage dividends and refunds constitute income, they are income, not to the cooperatives, but to the members and patrons who are the recipients. There are differences between an ordinary corporate dividend and a patronage dividend or refund, some very fundamental differences. However, the taxation of patronage dividends and refunds to the recipient does not involve any violation of basic concepts of income such as is involved in any attempt to tax such amounts as income to the cooperatives making the distribution. Therefore, if it is the decision of Congress to apply withholding tax on dividends as a means of collection at the source of a tax payable by the recipient of dividends, we do not claim that the farmer cooperatives as a group should be exempted from this requirement.

Certainly there would be no basis for exempting only those farmer cooperatives which presently comply with the requirements of section 101 (12) and which thereby are exempted from the payment of the Federal income taxes on corporate income. Any reasons that might support exclusion of patronage refunds of farmer cooperatives, now enjoying the statutory exemption, from the requirements of the withholding tax would be equally applicable to those farmer cooperatives which do not meet the requirements of the statutory exemption and which are ordinarily referred to as nonexempt farmer cooperatives. The argument might well be made that because such a large part of patronage refunds of farmer cooperatives are in exceedingly small amounts, the withholding requirements should not apply to any farmer cooperatives. And it could be said that because many patronage refunds are in small amounts, because sometimes they are not taxable income at all, and because they differ in many respects from corporate dividends, the withholding tax should not apply to any patronage dividends. However, there are some cooperatives which have a small number of members and make refunds in substantial amounts. Also most of the patronage dividends (as distinguished from progressive payments on products marketed) of farmer cooperatives do constitute income to the recipient usually in the form of a reduction of business costs. Therefore we are convinced that the subject should not be considered on whether particular units are farmer cooperatives or some other types of cooperatives or ordinary business corporations. We prefer to place our argument on broader grounds which apply to ordinary business corporations as well as to cooperative business corporations.

MINIMUM

If the withholding tax on dividends is retained, there should be some minimum below which withholding and reports should not be required. The minimum currently in effect with respect to reporting of dividends is $100. If the total payments to any one person in a year do not exceed $100 there is no reporting requirement present. That is a matter of regulation; the statute (sec. 148 of the Internal Revenue Code) permits the Commissioner to prescribe regulations for reporting without any limitations as to amount.

If the withholding tax is imposed, the statute itself should carry some provision with respect to minimum. It would be inappropriate for regulations to relieve a person of tax imposed by statute. However, with respect to reporting requirements, the statute can well leave the matter to the regulations issued by the Commissioner.

If a minimum of $100 were prescribed by the statute as the minimum with respect to which the withholding tax would apply, that would involve a with-

holding tax of only $10. It is questionable whether any lower amount of tax would justify the burden and expense to both the corporation and the Bureau of Internal Revenue, of computing the withholding tax, reporting it, transmitting the tax, checking the returns of the recipient, and refunding in the numerous cases where refunds would be necessary.

It is evident from the foregoing examples of cooperative patronage dividends that the vast majority of payments are small in amount. If withholding taxes, with the necessary reports, were to be required on all patronage dividends or refunds regardless of amount, the cost to the organizations of computing and handling the withheld taxes and making the reports and the cost to the Government of using the data so made available would be preposterous in relation to the amount of tax involved.

If a minimum of $100, as presently specified in the regulation covering reporting of dividends, is considered too high, a minimum of half that amount—$50—would appear to be a proper substitute. Here the amount of withholding tax involved would be only $5. When tax amounts are any less than this, neither the Bureau nor the reporting organization can afford the expense involved in the handling of each such item as a separate case.

REPORTING REQUIREMENTS

If the withholding tax provisions are taken out of the bill, there still remains a question as to reporting requirements. No change in the statute is required because section 148 already authorizes reports of dividends paid, without limitation as to amount. The Commissioner is empowered to issue regulations and he can change the present minimum of $100 to a lower amount if that seems desirable.

On this subject the House committee report, at page 34, indicates that the Bureau expects to amend its present regulation so as to require reporting of dividends regardless of amount. In view of the very large number of small amounts involved, a rigid requirement for reporting of all dividends would be wholly unwarranted. The Bureau could not possibly use the thousands and thousands of reports that would be received covering dividends of small amounts. The mere processing and distribution of any such volume of reports involving small amounts would cost the Government far more than any tax that could be collected on these small amounts. Probably on the great majority of small amounts, the recipients would not be liable for tax in any event.

On this matter of reporting requirements, no change is needed in the statute. The matter of the minimum for reporting requirements can well be left to the discretion of the Commissioner of Internal Revenue. However, it should be made clear that he has such discretion and is not bound to require reports of all such payments regardless of amount.

DUPLICATIONS OF WITHHOLDING TAX SHOULD BE AVOIDED

Many farmer cooperatives operate in federated groups, with a central marketing or purchasing organization which distributes patronage refunds to district or regional cooperatives and those in turn distribute to locals. Under the provisions of the House bill as they now stand, the central would be required to retain 10 percent of the distribution it makes. Then when the district or regional cooperative distributes this same refund to the locals, it will be required to retain 10 percent of the amount it distributes. Then as each local makes its distribution of the same refunds to the members or patrons, it is required to retain 10 percent of the amount it distributes. This means three bites before the refund gets to the patron; but he will be allowed a credit only for the amount retained by the local.

The result in such a situation is that the Government will receive 10 percent of the original patronage refund from the central, 9 percent (10 percent of 90 percent) from the regional and 8 percent (10 percent of 80 percent) from the local—a total of 27 percent; whereas the patron will receive a credit of only 8 percent (the 10 percent of the 80 percent withheld by the local). Such a result would be exceedingly unjust both to the cooperative organizations and to the patrons who were the ultimate recipients of what was left of the patronage refunds.

In the event the regional and local cooperatives were themselves exempt, they would be able to obtain the refund of the amounts withheld by the central and regional, respectively. However, this would involve delay and complications in accounting since it is the objective of each one of the cooperatives to refund all of the margins. Obviously the local and regional, respectively, could not pass on the patronage refunds representing the amounts withheld until their claims for refund had been allowed and paid.

However, many cooperatives are not exempt under section 101 (12) of the Internal Revenue Code. Those cooperatives operate on a cost basis and refund their entire margins in one form or another, just as do the exempt cooperatives. Therefore, they have little or no tax to pay and they would be in a position of not being able to obtain a refund of the tax withheld on patronage dividends received by them; neither would they be in a position to use the amount withheld as a tax credit because their total tax payable would not equal any such amount.

Results of this character have been avoided in the case of corporate dividends by including in the bill provision for exempting from the tax requirement such dividends as are paid by one corporation to another corporation if both are members of the same affiliated group which is required to file a consolidated return. This is in subparagraph (10) of proposed section 1311 (g), at page 141 of the bill.

A corresponding provision should be included with respect to cooperatives. Cooperatives, however, particularly farmer cooperatives, are not in position to file consolidated returns. This is because there are often some exempt cooperatives and some nonexempt cooperatives in the same group. Obviously a nonexempt and an exempt organization cannot file consolidated returns. So such a condition would be inappropriate in the case of cooperatives. Furthermore, cooperative corporations may deal with one another without being in any closely affiliated groups. One local, for example, may market products or acquire farm supplies through several different regionals. But in all such cases it is the objective of all to pass back all savings to members or patrons. Therefore any distribution by one cooperative to another should not be subject to the withholding requirement. This could be accomplished by adding to section 1311 (g) a paragraph such as the following:

"(11) A cooperative corporation to another cooperative corporation."

DEFINITION OF PATRONAGE DIVIDENDS

In defining the dividends subject to the withholding requirement, the bill (p. 137) states that the term "dividend" includes "a patronage dividend, rebate or refund paid * * * by an association operated on a cooperative basis * * *." The term "patronage dividend" is not further defined; but this term has a well recognized meaning, particularly when used in conjunction with the terms "rebate or refund" In the case of a purchasing cooperative, the farmer member or patron pays a charge upon receipt of the farm supplies acquired and that charge is usually somewhat in excess of actual costs. When the costs are determined, the difference between the actual cost and the charge paid by the patron is refunded to the patron and that is a patronage refund, or, as it is often called, a patronage dividend. In the case of a marketing cooperative, a commission or marketing assessment may be deducted from the proceeds or assessed separately (after returning the entire proceeds of sale). That charge is ordinarily computed at something above actual cost. When the marketing costs are determined, the difference between the amount collected through the retain or assessment and the actual cost is then refunded to the patron. Such a refund is a patronage refund or patronage dividend.

Patronage dividends are thus the refund or rebate of something that has previously been paid by the patron to the cooperative. Patronage dividends must be distinguished from progressive payments of proceeds of marketing. Many marketing cooperatives do not collect commissions or marketing expense assessments; they simply agree to pay to the farmer patron all proceeds of sale less actual marketing expenses. In such cases advances are made at the time of receipt of products and additional payments are made from time to time. In such operations, all payments are merely progressive payments of marketing proceeds. The last is no different from the first. None of them are patronage dividends. Marketing cooperatives operating in such a manner do not pay patronage dividends at all and there would be nothing to which to apply a withholding tax since there are no patronage dividends. The withholding tax applies only to dividends; it does not apply to payments by one person to another for the purchase of goods.

For this reason the examples given of patronage refunds do not include many cases of cooperative marketing associations. The illustrations do not include any dairy cooperatives. Many cooperatives marketing dairy products make progressive payments of marketing proceeds and do not pay patronage dividends. In such cases, however, many of the progressive payments, and particularly the final payments, are in small amounts and many of the cooperatives marketing dairy and other farm products have large numbers of members. The reports received from dairy cooperatives, for example, indicate that the overwhelming proportion of their final payments are in small amounts. The tabulation of returns received from a representative group of dairy cooperatives discloses that the highest per-

centage of final payments made to farmer patrons is in the range of $10 to $50. The next highest percentage is in the $1 to $10 range.

It must also be recognized that patronage dividends are not in themselves net income; they are merely one of the component parts of a transaction which might result either in net income or net loss. In acquiring farm supplies through a cooperative, the farmer would charge the amount he paid for such supplies to his cost of operation. The patronage refund would reduce this cost of operation. There would be net income only in the event his proceeds of sale exceeded his operating costs. Likewise in the case of a marketing cooperative of the commission type, the farmer would return as his sales the total amount he received from the cooperative less any retain or assessment that might be made. Then when he received the patronage refund he would add this to his total sales. That would be net income only in the event the total sales exceeded the operating costs.

There are also instances when patronage dividends received from a purchasing cooperative would not affect taxable income. That would be true in the case of acquisition of supplies used for household use; these represent a part of the living expenses of the farmer and would not be deductions from income. So when a patronage refund is received it would reduce the farmer's living expenses and since those expenses are not taken into account in computing income subject to taxation such patronage refunds would not affect taxable income. Also in case of a purchase of a capital asset like a tractor or a combine through a purchasing cooperative, a patronage refund on that would not affect taxable income. The cost of the item would neither reduce the cost of operation nor increase the income in such a case.

Therefore it must be recognized that if patronage dividends are required to be separately reported and taxes withheld on them, the amounts of such dividends will enter into the farmer's tax returns as reductions in operating costs or increases in sales proceeds or perhaps may not affect the taxable income at all. Only in the event the farmer shows a taxable net income in excess of the exemptions to which he may be entitled, will there be a tax due. So a farmer might receive substantial amounts of patronage dividends on which a tax had been withheld and still show no taxable net income. In any such case the individual farmer would be entitled to a refund of the tax withheld.

The foregoing observations indicate that there are substantial and fundamental differences between dividends on corporate stock and patronage dividends. As suggested earlier in this statement, an argument could be made for the elimination of patronage refunds from withholding requirements, by reason of these fundamental differences in character. However we believe that the whole concept of the withholding tax on dividends, as proposed in the pending bill, is unwise. Therefore we will not further develop these fundamental distinctions between corporate dividends and patronage dividends; we rest our case on the broader considerations heretofore given which apply equally to dividends on corporate stock and to patronage dividends.

It should also be recognized that if a withholding tax is to apply to patronage dividends, it should apply only when the patronage dividends are first issued as such. If they are issued in the form of capital stock or revolving fund certificates, for example, and later the capital stock or those certificates are redeemed in cash, the redemption would not be a patronage dividend. The original issue would constitute the dividend and the withholding requirement would apply to it. When redeemed, there would be no patronage dividend involved and there would be no withholding on the amounts expended for purposes of redemption.

SUMMARY

We respectfully submit that the proposed withholding tax is unjust and unnecessary, both with respect to dividends on corporate stock and with respect to patronage dividends, rebates, or refunds. Therefore the proposed withholding tax provision should not be enacted.

If, however, Congress concludes that a withholding tax of this character should be imposed, at least two amendments should be made to the provisions as contained in the House bill:

(1) A reasonable minimum should be prescribed below which neither the withholding requirements nor the reporting requirements would apply. Such minimum should be applicable to both dividends on corporate stock and patronage dividends, rebates or refunds.

(2) Double, triple, or other multiple taxation should be avoided in the case of cooperative associations, as well as ordinary business corporations, when making distributions to other organizations which in turn distribute the same dividends. The bill already takes care of this for ordinary business corporations in section

1311 (g) (10) (p. 141) by eliminating from the withholding requirement a dividend paid by a corporation to another corporation if both are members of the same affiliated group. A like provision should be inserted with respect to cooperatives by providing that the withholding requirements shall not apply to a dividend paid by one cooperative association to another cooperative association.

Mr. Loos. In answer to what the gentlemen who preceded me, Mr. Kile and Mr. Lester, have said, I would like to say just two or three things. I think the subject of this cooperative taxation has been exhaustively covered in the House hearings, and I am not going to try to even summarize it. But I do want to say that the billion dollars of additional revenue that Mr. Lester talked about, and the $350,-000,000 that Mr. Kile claims would come from the cooperatives if the tax exemption were removed, are not well established facts, as Mr. Lester and Mr. Kile said they were, but they are pure figments of the imagination.

Now, you don't have to guess at what the tax will be, if the tax exemption were repealed on farmer cooperatives. It is right there in the statistics that the Bureau of Internal Revenue has assembled and published for 1943 and 1946, showing the summation of the Form 990 returns of these tax exempt organizations. And on the basis of the 1946 statistics, all there could possibly be in additional taxes, if the tax exemption on farmer cooperatives were repealed, would be about $6,000,000. Now, that is just all there is in it.

And on the matter of patronage refunds taxation, I won't go into that except to say that patronage refunds are not income to the co-operative any more than a bank deposit is income to a bank. It is received with an obligation to pass it on to the patron. And it isn't taxable as income, and you couldn't tax it as income under the Constitution if you wanted to, but I am sure you won't want to.

That subject also was thoroughly covered in the hearings before the House Ways and Means Committee, and I won't go into it further unless some of you gentlemen wish to do so.

With respect to the claim that cooperatives have grown rapidly: Mr. Lester, I think it was, referred to a cooperative recently organized that had grown tremendously. Sure. You can find instances where some cooperative has grown rapidly in the last 2 or 3 years, and you can find instances where some private corporations have grown very rapidly. But when you look at the whole picture, as you can, by reason of the very full statistics that are published by the Farm Credit Administration, it is perfectly evident that the cooperatives are not doing any larger share of the farmers' business now than they have been in the past. In fact, they are doing a lesser share now.

I will just cite one example of that. In the case of marketing co-operatives, by relating the total volume of business of the marketing cooperatives to the total cash income of farmers, current statistics which are regularly published from year to year by the same source, we find that the highest proportion of the business done by farmer cooperatives in the marketing of farm products was in 1931 and 1932, when 31.4 percent of the farmers' products were marketed through his cooperatives. And today, that percentageis only 23.8 percent. So we have readlly lost proportionately.

Now, when you look at figures, in the absolute, of course they are greater, because the value of the dollar has diminished, the total population has grown, the total business has grown, everybody's business has grown. But relatively the farmers are not doing as much of

their business today through the farmer cooperatives as they did back in the early thirties.

The fundamental distinction between a farmer cooperative or any other kind of a cooperative, for that matter, and an ordinary business corporation, is simply this: The business corporation is in business to make a profit out of its patrons for itself and for its investors. The cooperative is in business to make a profit for its patrons and not for itself. It does business at cost. And the reason for the competitive advantage, if there is any, of the cooperatives, is the fact that they do business at cost and perform a much more economical service than can be performed by a business which attempts to make a profit out of its patrons. And I am not speaking disparagingly there. It is entirely proper that they should do that. But how can a business operated at cost have any profit? And that is why there is no profit, no income, on which cooperatives would pay tax even if the tax exemption were removed.

So much for the general treatment of the subject of cooperative taxation. As I say, it was fully considered, fully covered, in the previous hearings, and I won't say anything more about it at this time.

But I do want to refer to the withholding provisions and the reporting provisions of this bill. That was not the subject of any consideration, at least so far as we were concerned, at the Ways and Means Committee hearings.

Your committee has heard a number of statements on this, and I think you are pretty well familiar with the various reasons that are assigned against the withholding provisions of the present bill, so I will not repeat them. They are in our statement, and I won't attempt to even summarize them. But our proposition is that the withholding provisions both with respect to ordinary business corporations and with respect to cooperative business corporations are unwise. And I think the best use I can make of the short time I want to take is to refer your committee to some of the statistics which we have in this statement which we are filing.

Now, we are not coming here with generalizations only. We are coming here with as full statistics as we could get, of the actual number and the actual amounts of payments of patronage refunds and corporate dividends. Because they do pay dividends on corporate stock; some of them. And we have here the statistics which will show you what a tremendous number there are of these payments and how many of them are in such small amounts.

The first one we have is at page 7 of our statement, and that shows the results of six of the local units of the Cotton Producers Association of Atlanta, Ga. That is a marketing cooperative which also does a purchasing business. And we show here the total number of refunds in 1949 were 2,229 below $1, averaging 26 cents; 846 between $1 and $10, averaging $3.71; and when you get above $50, there were only 54 in the $50 to $100 bracket, and only 51 in the over $100 bracket.

On the next page we have a statement for the Southern States Cooperative. I am going to mention this one, and then not mention any other individual companies, because I think this one does portray rather dramatically the terrific burden that there would be not only on the reporting organization but on the Treasury itself to have all these returns, all these reports, and withholding on all these refunds and dividend payments.

That Southern States Cooperative in 1949 had 240,267 patrons, to whom patronage refunds were made; 126,000 of those were less than $1; 101,000 were between $1 and $10; and the rest, only about 11,000, were over $10; only 800 were over $50.

On the dividend payments that were made, 176,000 out of 228,000 were less than $1; 46,000 were between $1 and $10; 5,000 between $10 and $50; and only 900 above $50.

Now, what is the significance of these figures? Try to visualize the number of reports that would have to be made to report these 240,267 patronage refunds and the 228,577 dividend payments. It is terrific. And the best way we think we can visualize it is to say, on the basis of the computations we have made, that it would take 160 miles of paper 8½ inches wide to make the reports for this one cooperative corporation for 1 year. Now, what would the Treasury do with those thousands and thousands of reports with amounts less than $10? They couldn't do a thing with them.

Now, we have others, from Ohio. We have even the Madison County, Ohio, Farm Bureau Cooperative that Mr. Kile referred to. That is on the bottom of page 10. That local is shown. It had 1,764 refunds, averaging 22 cents, less than a dollar. There were 1,764 of them that were less than a dollar; 828 between $1 and $10; 440 between $10 and $50; and only 130 over $50.

Senator MILLIKIN. How many miles does that make?

Mr. LOOS. Well, I haven't computed that one. It would be two or three, I guess.

We also have these from Missouri, from Michigan, from Pennsylvania, from Washington, and from various other parts of the country. I won't pause to mention them. The one with respect to Pennsylvania, however, at pages 17 and 18, is in great detail.

But I do want to say that I have attempted to add these all together these reports that we have received, and, believe it or not, we have received reports that represent an aggregate of 929,000 payments of patronage refunds and dividends, 929,000 individual payments. And these aggregate results are important, I think. I don't have them in my prepared statement, because we didn't have time to get it all assembled and put together. But of the 929,000, 563,000 are less than $1, 60 percent; 285,000 more are between $1 and $10; or 849,000, in round numbers, that are less than $10, out of the 929,000, or 91.4 percent.

Now, of the money that is involved, while some 91.4 percent of the returns, number of returns, would be in the bracket below $10, only 23.8 percent of the money would be in that bracket; so that 8.6 percent of the returns would give a report on 76 percent of the total money involved. And that is where your taxable money is, if there is any; that is, taxable to the individual recipients. These people that get checks for less than a dollar, less than $10, and many of them that get checks for $10 to $25 or $25 to $50, don't have high enough individual incomes to pay any income tax. There just can't be any sense in requiring all those reports.

Senator MILLIKIN. What is the total amount represented by all of those?

Mr. LOOS. The total amount represented is $4,394,000 in the patronage dividends and refunds.

Senator MILLIKIN. The Treasury would be holding $400,000, by way of income tax.

Mr. Loos. Yes, sir; they would. And much of that would have to be refunded, because they are nontaxable.

I think that demonstrates either that these withholding tax provisions should not be enacted, or, if they are enacted, there should be a reasonable minimum. And that reasonable minimum, I think, should be not lower than $50. Because there just can't be any justification in handling as a separate case amounts involving taxes of $5 or less, which would be the withholding tax on the $50.

I want to say also that we feel that the reporting requirements, too, even if you don't have a withholding tax, should not require the tremendous burden of all these reports, of amounts that cannot possibly be used to any advantage by the Treasury; and there should be a reasonable minimum there. Now, you don't have to take care of that in this statute, because the statute already authorizes the Secretary of the Treasury or the Commissioner to issue regulations, and it doesn't prescribe any minimum. The Commissioner himself has prescribed a minimum of $100. Now, he can reduce that minimum, and the House report suggests that he ought to take it out altogether. We submit that it shouldn't be taken out altogether, and if it is reduced it should be reduced but with a reasonable minimum continued, and it should be made clear that the Secretary of the Treasury or the Commissioner has the discretion to have such a reasonable minimum. Otherwise you will impose a simply preposterous and insurmountable burden not only on cooperatives but on any business corporation that has a large number of small stockholders who receive dividends in very small amounts.

Senator Millikin. You are opposed to the whole thing. That is your first position, all the way across the board?

Mr. Loos. Yes, sir.

Senator Millikin. For the cooperatives and the corporations?

Mr. Loos. Yes, sir. We make no distinction between them.

Senator Millikin. And your second is that if we should have something of that kind, then it should be brought within a limitation of the kind you are talking about?

Mr. Loos. There should be a reasonable minimum below which reporting requirements should not apply.

There is just one other point, and that is that cooperative associations which operate together in federated groups, together or otherwise pass their patronage dividends from the central to the regional, from the regional to the local; and the way this bill is written, you would take a 10 percent bite each time there was a passage from one to the other, and on down the line, so that by the time it went through three channels, for example, the Government would have 27 percent of the total, and yet the ultimate recipient, who gets the 73 percent that is left, would have a tax credit only for the last 8 percent that was taken out.

Now, you have taken care of that in the case of ordinary business corporations, or rather the House bill takes care of it, by saying that when one corporation pays to another corporation, a member of an affiliated group, the withholding provision shall not apply. We suggest there should also be a similar provision for cooperative associations, so that when there is a distribution of a patronage refund or a dividend by a cooperative association to another cooperative association, the withholding provision should not apply, but it should

apply only when it goes from the last cooperative association to the members and patrons.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you very much, Mr. Loos, for your appearance.

Your full statement will be entered in the record.

Mr. LOOS. Thank you.

The CHAIRMAN. The committee will be compelled to recess until 2:30 today, because we have a vote coming up, under the rules of the Senate.

(Whereupon, at 12:25 p. m., the committee recessed until 2:30 p. m., this same day.)

AFTERNOON SESSION

(The committee reconvened at 2:30 p. m.)

The CHAIRMAN. The committee will come to order.

The Council of State Governments desires a statement be placed in the record with reference to the Bureau of Internal Revenue's interpretation of section 3482 relating to documentary stamp taxes upon deeds, instruments or other writings issued by State or political subdivisions.

(The statement referred to follows:)

JULY 12, 1950.

Hon. WALTER F. GEORGE,
Chairman, The Senate Committee on Finance,
Senate Office Building, Washington, D. C.

DEAR SENATOR GEORGE: The several undersigned organizations of State and political subdivisions and of Government officials respectfully urge the Committee on Finance to consider the effect of a recent ruling by the Bureau of Internal Revenue by which States and political subdivisions have been subjected to what we believe is an improper interpretation of section 3482 of the Internal Revenue Code levying documentary stamp taxes upon deeds, instruments, or other writings.

In the decision of May 1, 1950, a copy of which is attached, the Bureau of Internal Revenue revoked a ruling of 10 years' standing, and in effect has imposed the stamp taxes on conveyances of real estate to or by States and political subdivisions. This will mean that in buying highway rights-of-way, for example, and in acquiring real estate needed to discharge their governmental activities and more particularly in the disposition of such real estate, the State and political subdivisions will be required to pay the Federal Government a direct tax on the conveyance of such property.

While it has been previously interpreted that an exemption from the incidence of this tax was provided by section 1808 of the Internal Revenue Code under which any "bond, note, or other instrument" is exempt, the Bureau of Internal Revenue has, nevertheless, ruled that conveyances are not other instruments within the meaning of section 1808. It, therefore, appears necessary to amend section 3482 so that such section will contain the specific exemption. It is believed that the attached language will accomplish this purpose.

We respectfully urge that the excise-tax-reduction bill, H. R. 8920, be amended to reestablish the exemptions of the State and political subdivisions from the incidence of the documentary-stamp taxes.

Respectfully submitted.

COUNCIL OF STATE GOVERNMENTS,
By FRANK BANE, by T. G. DRISCOLL.
AMERICAN MUNICIPAL ASSOCIATION,
By DONOH W. HANKS, JR., *Assistant Director.*
NATIONAL ASSOCIATION OF COUNTY OFFICIALS,
By KEITH L. SEEGMILLER.
NATIONAL INSTITUTE OF MUNICIPAL LAW OFFICERS,
By CHARLES S. PLEYNE, *General Counsel.*
UNITED STATES CONFERENCE OF MAYORS,
By PAUL W. DITTERS, *Executive Director.*
NATIONAL INSTITUTE OF GOVERNMENTAL PURCHASING,
By ALBERT N. HALL, *Executive Director.*

PROPOSED AMENDMENT TO SECTION 3482 OF THE INTERNAL REVENUE CODE

CONVEYANCES

Deed, instrument, or writing (unless deposited in escrow before April 1, 1932) whereby any lands, tenements, or other realty sold shall be granted, assigned, transferred, or otherwise conveyed to, or vested in, the purchaser or purchasers or any other person or persons, by his, her, or their direction, when the consideration or value of the interest or property conveyed, exclusive of the value of any lien or encumbrance remaining thereon at the time of sale, exceeds $100 and does not exceed $500, 55 cents; and for each additional $500 or fractional part thereof, 55 cents. This section shall not apply to any instrument or writing given to secure a debt, *nor shall it apply to any deed, instrument, or writing to which a State, or political subdivision or instrumentality thereof, is a party grantor or party grantee.*
(The italicized language constitutes the proposed amendment.)

INTERNAL REVENUE CODE

STAMP TAXES

SEC. 3482 (as amended).—CONVEYANCES.—Taxability, for Federal stamp-tax purposes, of conveyances of real property to or by a State or a political subdivision or corporate instrumentality thereof. (S. T. 897 (C. B. 1940–41, 256) revoked.)

Advice is requested regarding the application of the documentary stamp tax imposed by section 3482 of the Internal Revenue Code to conveyances of real property to or by a State or a political subdivision or corporate instrumentality thereof.

It is held that conveyances of real property to or by a State or a political subdivision or corporate instrumentality thereof are not exempt from documentary-stamp tax merely by reason of the governmental character of one of the parties to the transaction. Accordingly, S. T. 897 (C. B. 1940–41, 256), in which it was held that a conveyance of realty to a local housing authority, which is an instrumentality of either a State or a political subdivision thereof, is not subject to stamp tax, is revoked.

The CHAIRMAN. The International Paper Co. desires to submit a statement for the record in lieu of appearance suggesting the pricing of inventories at the lower of cost or market under the so-called LIFO method.

(The statement referred to follows:)

INTERNATIONAL PAPER COMPANY,
New York, July 10, 1950.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
Washington, D. C.

DEAR SENATOR GEORGE: Enclosed herewith is a statement calling attention to the desirability of pricing inventories at the lower of cost or market under the so-called LIFO method. I believe that an amendment to the present law regarding this matter is desirable for the reasons outlined in the statement.

Very truly yours,

H. R. WEAVER,
First Vice President.

STATEMENT RE "LIFO" INVENTORY PRICING

The valuation of inventories at the lower of cost or market should be permitted to taxpayers who use the "last in, first out" inventory method on their income-tax returns. The restriction that "LIFO" inventories shall be priced solely at cost works an injustice to a vast majority of taxpayers employing this inventory method.

Code section 22 deals with inventories and provides five methods of valuing inventories. These are (1) cost, (2) cost or market, (3) market (used by security and commodity dealers), (4) the retail method, and (5) "LIFO." Essentially, however, these methods dovetail into two alone: (1) Cost and (2) cost or market.

Although Code section 22 (c) provides that inventories shall be taken by taxpayer upon such basis as the Commissioner may prescribe which conforms as

nearly as may be to the best accounting practice in trade or business and most clearly reflects the income, the history of the treatment of inventories in Federal income taxation discloses a cautious, even tardy, acceptance by the Government of recognized principles of accounting. Not until 1918 did the Congress mention inventories and enact words which conform closely to 22 (c) mentioned above. When the Bureau first allowed inventories under the 1918 act, it apparently considered cost the only permissable determinative of value and it was not until the promulgation of T. D. 2609 in 1918 that the Bureau permitted the valuation of inventories at cost or market, whichever was lower. However, the taxpayer, in order to adopt this valuation method (cost or market), had to obtain permission and thereafter adhere to that method.

The "LIFO" method is largely an outgrowth of the base-stock method of taking inventories and received more or less wide publicity in the NRA codes for the metal and oil industries in 1934 and 1935. However, the Treasury Department as early as 1919 had prohibited use of the base-stock method of accounting and had clung to that attitude for a good many years (see regulations since 1924). The "LIFO" method is essnetially a reversion to the cost valuation method and was first adopted for the metal and tanning industries in 1938 and then in 1939 under the 1939 act was extended to all industries who wished to adopt it. In connection with this section it is interesting to note the opinion of a well-known tax authority when this section 22 (d) was first enacted. He said, "It is the opinion of the author that the Treasury has sufficient authority to permit the use of the 'last in, first out' method without the special statutory provision of 22 (d). Taxpayers would be better off without the handicaps of the limiting language now in the law and regulations." It was because of the Treasury's adamant prohibition of the use of base-stock inventories that 22 (d) was enacted by law.

In *Lucas* v. *Kansas City Structural Steel Co.* ((281, U. S. 264) 1930), the court stated that since few businesses used the base-stock method, it could not be considered in accord with the best accounting practice and to permit its use would create an unfair discrimination in favor of these few. (Note.—But in 1938, 38 percent of 826 enterprises used "LIFO.") In the congressional discussion of the 1938 act, in which the use of "LIFO" for certain industries was advocated, it was brought out that these industries use "LIFO" in accordance with the best accounting practices as of that period, and it was deemed applicable only to companies whose inventory prices were fairly stable, or one where the normal stock was fairly consistent, although prices fluctuated a great deal. A taxpayer who had received permission to change to the "LIFO" (cost) method of valuation could not change back again to the cost or market (FIFO) unless he had received permission to do so and had made the necessary changes in his income. During the recent war the Treasury considered the question of fluctuation in quantity of inventories in the case of taxpayers who had adopted the "LIFO" method and as a result a special law was enacted (sec. 119 of 1942 R. A.) to provide for replacement of liquidated inventories and consequent adjustment of the profit-and-loss and inventory basis, thus affording a measure of relief from the consequences of involuntary liquidation.

The Senate Finance Committee report in dealing with this revision of section 22 (d) said, "Your committee proposes to afford to taxpayers using the elective inventory method authorized by section 22 (d) of the code, a measure of relief from the consequences of involuntary liquidation of their *base stock inventory resulting from prevailing war conditions.*" (Italicized by the writer.) It is apparent from consideration of the entire committee report that it was believed that this quantity was a static figure and Congress did not consider the question of taxpayers who, due to change in economics of their business or to additional facilities, were required to increase their "base stock."

The fact that the taxpayer has adopted the "LIFO" method, which is a special variant formula for identifiying units when the cost method of valuation is employed should not prevent him from obtaining relief when the circumstances present a different set of facts than was contemplated by all parties when the method was first established and adopted. While the law and regulations term this an elective method in that the taxpayer must signify his desire to adopt the same and thereafter price at cost only, it is pertinent to point out at this point that the Treasury recognizes that there are cases when a market value should be considered in this type of valuation.

This is emphasized by the regulations regarding financial accounts being published at the end of the year to creditors and stockholders. The taxpayer is permitted to write down its inventory to market value for these statements without being considered to be in violation of the election made under section

22 (d). The question naturally arises if it is accepted accounting practice, why is not the language of 22 (d) modified by the language of 22 (c) which specifies that the method of valuation most clearly reflecting the income and conforming to the best accounting practice should be used. It is clear, however, that the manner in which the law and regulations are set up at the present time necessitate a change in the law by Congress in order for a taxpayer to be permitted the use of "market" in addition to "cost" method of valuation for "LIFO" purposes.

It would appear that the regulations using "LIFO" answers any possible court objection as to the best accounting practice, and in fact recognizes that the best accounting practice contemplates the use of cost or market valuation.

Since the taxpayer corporations in their annual reports do not report such unrealized income to their stockholders and creditors and neither do their annual profits and surplus include such unrealized income, it would seem that the Congress should recognize this best accounting practice and permit the taxpayer corporations to price "LIFO" inventories on the basis of cost or market, whichever is lower. This would relieve the accounting work of a great many corporations which now of necessity must keep two sets of inventory records; one based on pricing for stockholders and creditors, and another for the United States Government. It is realized that section 214 of H. R. 8920, permitting a 5 year carry-over of the operating losses, is one method in which this adverse treatment of inventories can be adjusted. This issue was likewise discussed by Congress in passage of 1938 act and it was emphasized that the taxpayers do not wish to pay on unrealized income even though they know that it will be adjusted in a subsequent period. In other words, they wish to pay taxes as far as possible on the same income which they report to their stockholders. Industry expansion during period of high prices, particularly in the case of taxpayer corporations, which have adopted "LIFO" is handicapped by the fact that the increased inventory at new or expanded plants is inventoried at high prices.

Congress is urged to make the law regarding "LIFO" conform to the best accounting practices utilized by most taxpayer corporations and recognized by the Treasury Department, but not permitted in tax returns, and permit "LIFO" inventory pricing on the basis of cost or market, whichever is lower.

The CHAIRMAN. Mr. James W. Haley.

STATEMENT OF JAMES W. HALEY, SOUTHERN BUILDING, WASHINGTON, D. C., SECRETARY OF THE SPECIAL TAX COMMITTEE, NATIONAL COAL ASSOCIATION, ACCOMPANIED BY L. H. PARKER, CHAIRMAN

Mr. HALEY. Mr. Chairman and members of the committee, my name is James W. Haley. My address is Southern Building, Washington 5, D. C. I am secretary of the special tax committee of the National Coal Association and I am accompanied here today by Mr. L. H. Parker, who is chairman of the committee. I am also vice president of Jewell Ridge Coal Corp., operating coal mines in the States of Virginia and Kentucky, and vice president of Virginia Smokeless Coal Co., which is engaged in the sale of bituminous coal in the eastern and midwestern markets. Prior to my affiliation with the Jewell Ridge Coal Corp. and Virginia Smokeless Coal Co., I was secretary and general counsel of the National Coal Association.

The National Coal Association is the trade association of bituminous coal-mine owners and operators of the United States and has in its membership coal producers in every major coal-producing State in the Nation, and represents approximately 75 percent of the total commercial production of bituminous coal of the Nation.

My principal purpose in appearing before the committee today is to urge you to recommend that the Senate concur in the House action in raising the gross depletion for coal from 5 to 10 percent. I also deal with the necessity for clarifying the Internal Revenue Code

with respect to what constitutes gross income from the property for purposes of interpreting the depletion allowance and also with respect to corporate earnings and profits accumulated prior to March 1913.

I might say, Mr. Chairman and gentlemen, that I do not intend to read the entire statement. I shall read the main portions and refer to the balance.

A. WHY COAL SHOULD GET 10 PERCENT DEPLETION

For the four war years, 1942 through 1945, the bituminous coal industry supplied the country with 49.3 percent of its total fuel and energy requirements. For this period the bituminous coal-mining industry was allowed depletion at an average rate of only 6.6 cents per ton, to replace the only thing the industry has to work with, the coal itself. During this same 4-year period, 1942 through 1945, the oil and gas industry supplied only 41.6 percent of total fuel and energy requirements of the country but was allowed an average depletion allowance equivalent to approximately 19.7 cents per ton on a coal equivalent basis.

Under the Internal Revenue Code as presently drawn, coal receives only 5 percent depletion. Its principal competitors, oil and natural gas, receive 27½ percent. Under the present Internal Revenue Code, coal is the only natural resource with a rate of less than 15 percent.

Senator MARTIN. Might I ask the witness a question?

The CHAIRMAN. Yes.

Senator MARTIN. How much does it cost you per ton to discover coal?

Mr. HALEY. I have no figures on what it costs per ton to discover coal. The general reserves of the Nation are pretty generally located.

Senator MARTIN. Are they not located generally by the geologists of the various States and universities and colleges? You do not have to drill any dry holes to find coal, do you?

Mr. HALEY. All the holes we drill are dry but we certainly do have to drill holes before we can locate an acceptable mining property.

Senator MARTIN. That does not cost very much. You diamond drill the coal, of course, but that is not very expensive. You know the coal is there before you start to drill.

Mr. HALEY. That is correct. We know that a geological formation is present but before any responsible company would locate a coal mine in any given area, it would necessitate quite a bit of drilling and experimentation.

Senator MARTIN. That is a very small part of your expense?

Mr. HALEY. That is correct. Yes, sir, Senator, you are absolutely correct, and I might say nothing like the expense involved in similar activities in the oil and gas industry.

H. R. 8920, the House bill, tends to correct this long standing inequality by raising the gross percentage depletion rate on coal from 5 to 10 percent.

The action of the House in raising the depletion for coal from 5 to 10 percent is a sound move from the standpoint of coal producers, coal consumers, and the Nation generally. Certainly the coal industry should have at least 10 percent depletion when oil and gas receive 27½ percent. Coal, oil, and gas are highly competitive, and the House action merely reflects a tendency in the direction of equitable treatment among competing taxpayers.

It should be understood that the bituminous coal-mining industry is making no allegation that the 27½ percent gross depletion rate allowed to oil and gas is excessive, in view of the necessity for increased oil and gas reserves in times of peace for use in case of war. It is my opinion, and I believe the opinion of many others in and out of the coal industry, that the United States was very fortunate during the last war in that the Congress had shown the wisdom and the foresight to develop a tax structure which permitted this country to produce a supply of petroleum without which the war could not have been won.

Your attention is invited to tables I and II attached to my statement. As shown on table I, reflecting information from official United States Bureau of Internal Revenue sources, in 1946, the latest year for which the information is available, the depletion allowance for the bituminous coal industry was only 3 percent of gross sales, whereas for the petroleum and natural gas industry the percentage was 18.2. Table II, also taken from official Treasury sources, shows that the petroleum-natural gas industry for 1946 was permitted a depletion allowance of $124,056,000, while the bituminous coal industry was permitted a depletion deduction of only $40,508,000.

Table III shows production of bituminous coal and bituminous coal equivalent of crude petroleum-natural gas, and depletion per ton and per ton equivalent, 1938 through 1946.

Raising the depletion on coal from 5 to 10 percent will be beneficial to the coal-producing industry in that it will afford to the industry an opportunity to acquire some reserve with which to maintain its physical properties. Certainly the value of coal, like the value of everything else, has increased in the last 10 years. Moreover, the acquisition and mining of desirable coal properties has become in recent years increasingly difficult and expensive. Also increased depletion for coal will help labor in that it will mean more running time, more work and more wages.

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Raising the depletion on coal from 5 to 10 percent will be beneficial to coal consumers. In the long run it will enable the coal operators to offer coal to coal consumers at a relatively lower price. Due to the highly competitive nature of the coal-mining industry, this is certain to be the case.

From the standpoint of the national welfare, raising the depletion rate on coal from 5 to 10 percent will be highly beneficial for the reason that it will afford much needed encouragement to the coal mining industry to install and maintain the plant and equipment necessary to meet the needs of the nation, not only in peacetime but particularly in times of national emergency.

Senator MILLIKIN. What is your average royalty per ton of coal?

Mr. HALEY. I have no figures on the average royalty per ton.

Senator MILLIKIN. Can you give us a rough idea?

Mr. HALEY. Roughly I would say the royalty per ton of coal would range from 8 cents to 25 cents, depending upon the kind of coal, location, and so forth.

It will be remembered that during the last war the principal burden of fueling America fell upon the bituminous coal-mining industry.

It should always be remembered in the case of percentage depletion that the taxpayer never gets tax exemption or a subsidy free of taxation, because such depletion allowances are under the law limited to 50 percent of the net income from the property. It should also be remembered that the definition of property contained in the statute is limited to each separate tract or lease, and usually a mine operator has many such separate tracts or leases, with the result that percentage depletion may not result in any benefit except in the case of a few of such leases. Finally, the law further restricts the benefit of percentage depletion by excluding such deductions in computing an operating net loss to be carried forward to another year. In the case of depreciation, such deductions are taken into account. It should also be kept in mind that unless the taxpayer has net income, no percentage depletion whatever is available to him.

According to official Treasury reports, the bituminous coal-mining industry as a whole operated at a loss from the years 1925 through 1939, a period of 15 years. During the 8-year period, according to the same report, 1940 through 1947, during which time the industry was called on to furnish fuel and power for the United States as well as our allies, there was a small profit amounting to about 10 cents per ton. In this connection, it should also be remembered that even during the war years about 40 percent of the coal companies in America operated at a loss, or at least without any profit. In the 20-year period, 1928 through 1947, after paying Federal income taxes of $343,000,000, the entire bituminous coal-mining industry showed a profit of only $96,000,000, about 1 cent per ton.

The difficulties that the coal industry has encountered in recent years are a matter of common knowledge. The industry is highly competitive within itself as well as being competitive with other fuels and sources of energy. In addition, indirect taxes, such as the social security tax, are unduly and discriminatorily oppressive on the coal industry. The social-security tax, predicated as it is on payroll, is many times as oppressive on the coal industry as it is on practically all large industries in the United States, due to the fact that approximately 60 percent of the total cost of producing coal goes for the payment of wages. Your attention is invited to table IV for a showing of how the coal industry has suffered competitively in recent years.

I would like to direct particular attention to that table which shows that in the last year before the war in 1941 the bituminous coal-mining industry contributed 54.6 percent of the total energy requirements in the United States. In 1949 that percentage of contribution had fallen to 39.3.

The Ways and Means Committee carefully considered the subject of percentage depletion for the natural resource industries. Your

particular attention is invited to the fact that in its report the Ways and Means Committee stated:

> * * * The testimony received by your committee indicated also that the 5-percent rate allowed in the case of coal is of little practical value, and that the coal-mining industry is peculiarly in need of more favorable tax treatment because of the inroads on its potential markets by alternative sources of energy, particularly oil and gas (p. 65).

B. TRANSPORTATION COSTS AND PERCENTAGE DEPLETION

The House bill, H. R. 8920, page 52, line 13 through line 18, provides the following so-called technical amendment:

> (c) GROSS INCOME FROM MINING.—The second sentence of section 114 (b) (4) (b) (relating to definition of gross income from property) is hereby amended by inserting before the period at the end thereof the following: ", but such term shall in no case include transportation beyond the property."

The report of the Ways and Means Committee, page 65, states in connection with the above-quoted proposed amendment:

> The rates used under the percentage depletion option are, of course, applied to the gross income from the property. In order to restrict depletion to the actual product of mineral extraction, it is stipulated in your committee's bill that the gross income to which the percentage depletion rate is to be applied should not include income resulting from the transportation of the product beyond the property.

And, page 84 of the report, last paragraph:

> Section 114 (b) (4) (B) of the code (relating to the definition of gross income from the property) is amended so as to provide, in effect, that, in computing gross income from the mineral property, the gross income shall not be augmented by value added as the result of transportation of the crude mineral product from the property. The amendment is merely declaratory of existing law.

Particular attention is called to the last sentence of the House report quoted above, reading: "The amendment is merely declaratory of existing law." We submit that this is not the case. The amendment in the House bill is substantive and not technical. Even a brief examination of the statute and the interpretations thereof will prove this.

The difficulty lies in the definition of "the property" which has been the subject of long and difficult controversy with the Bureau of Internal Revenue. There have been a number of court cases on the subject. It has been the subject of Law Review articles. Congress has been asked to clarify the situation on several occasions. But today the narrow interpretation applied to the meaning of "the property" by the Bureau of Internal Revenue continues to confuse taxpayers.

For several years the Bureau of Internal Revenue has been attempting to diminish the effect of percentage depletion by excluding certain costs involved in getting the coal from the mine to the tipple. The Bureau has diligently tried to exclude this and other items of cost from depletion computation in spite of the fact that the Internal Revenue Code as presently drawn contains the following language (in sec. 114 (b) (4) (B):

> The term "ordinary treatment processes," as used herein, shall include the following: (i) In the case of coal—cleaning, breaking, sizing, and loading for shipment: * * *

The effect of the amendment contained in the House bill stems from the very narrow definition of "the property" contained in the regulations of the Bureau of Internal Revenue, Regulations III, section 29.23 (m)-1 (i) reading as follows:

"The property," as used in section 114 (b) (2), (3) and (4) and sections 29.23 (m)-1 to 29.23 (m)-19, inclusive, means the interest owned by the taxpayer in any mineral property. The taxpayer's interest in each separate mineral property is a separate "property," but, where two or more mineral properties are included in a single tract or parcel of land, the taxpayer's interest in such mineral properties may be considered to be a single "property," provided such treatment is consistently followed.

The record of dealings with the Bureau of Internal Revenue in connection with this matter demonstrates the narrow interpretation given to the word "property." Each separate economic interest is considered a separate property. It is true that the Bureau has permitted the aggregating of properties where the ultimate tax liability would be unaffected thereby. But unquestionably, if the amendment contained in the House bill is enacted into law, the Bureau will still further narrow the concept of the word "property" for purposes of computing the depletion deduction and will thereby substantially diminish the depletion allowance available to the coal industry.

It is suggested that this situation be corrected and clarified by the following amendment:

Page 52, H. R. 8920, strike out lines 13 through 18 and insert in lieu thereof the following:

"(c) Gross Income From Mining.—Section 114 (b) (4) (B) (relating to definition of gross income from property) is hereby amended by inserting after the end of the third sentence a new sentence as follows:

" 'The term "mining" as used herein, shall also be considered to include the transportation of the ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plant or mill in which the ordinary treatment processes are first applied thereto.' "

That concludes what I have to say on the transportation problem. I would like to refer very briefly to corporate earnings and profits accumulated prior to March 1913. I believe that has been very carefully covered by other witnesses. I list some reasons why that should not be accepted by the Senate and I conclude by saying:

Finally, the added annual revenue to be secured by section 205 is officially estimated at only $1,000,000. This amount becomes insignificant when we are considering a Federal tax burden of over $40,000,000,000.

That concludes my statement, Mr. Chairman.

The Chairman. Mr. Parker, do you desire to make a statement?

Mr. Parker. No, Mr. Chairman.

The Chairman. Very well, thank you for your appearance.

Mr. Haley. Thank you, Mr. Chairman.

(The complete statement follows:)

Statement of James W. Haley, Secretary, Special Tax Committee, National Coal Association

Mr. Chairman and gentlemen of the committee, my name is James W. Haley. My address is Southern Building, Washington 5, D. C. I am secretary of the special tax committee of the National Coal Association, and I am accompanied here today by Mr. L. H. Parker, who is chairman of the committee. I am also vice president of Jewell Ridge Coal Corp., operating coal mines in the States of Virginia and Kentucky, and vice president of Virginia Smokeless Coal Co., which is engaged in the sale of bituminous coal in the eastern and midwestern markets.

Prior to my affiliation with the Jewell Ridge Coal Corp., and Virginia Smokeless Coal Co., I was secretary and general counsel of the National Coal Association.

The National Coal Association is the trade association of bituminous-coal-mine owners and operators of the United States and has in its membership coal producers in every major coal-producing State in the Nation, and represents approximately 75 percent of the total commercial production of bituminous coal of the Nation.

My principal purpose in appearing before the committee today is to urge you to recommend that the Senate concur in the House action in raising the gross depletion for coal from 5 percent to 10 percent. I also deal with the necessity for clarifying the Internal Revenue Code with respect to what constitutes gross income from the property for purposes of interpreting the depletion allowance and also with respect to corporate earnings and profits accumulated prior to March 1913.

A. WHY COAL SHOULD GET 10 PERCENT DEPLETION

For the four war years, 1942 through 1945, the bituminous coal industry supplied the country with 49.3 percent of its total fuel and energy requirements. For this period the bituminous coal mining industry was allowed depletion at an average rate of only 6.6 cents per ton, to replace the only thing the industry has to work with—the coal itself. During this same 4-year period, 1942 through 1945, the oil and gas industry supplied only 41.6 percent of total fuel and energy requirements of the country, but was allowed an average depletion allowance equivalent to approximately 19.7 cents per ton on a coal equivalent basis.

Under the Internal Revenue Code as presently drawn, coal receives only 5 percent depletion. Its principal competitors, oil and natural gas, receive 27½ percent. Under the present Internal Revenue Code, coal is the only natural resource with a rate of less than 15 percent. H. R. 8920, the House bill, tends to correct this long standing inequality by raising the gross percentage depletion rate on coal from 5 to 10 percent.

The action of the House in raising the depletion for coal from 5 to 10 percent is a sound move from the standpoint of coal producers, coal consumers, and the Nation generally. Certainly the coal industry should have at least 10 percent depletion when oil and gas receive 27½ percent. Coal, oil, and gas are highly competitive, and the House action merely reflects a tendency in the direction of equitable treatment among competing taxpayers.

It should be understood that the bituminous coal mining industry is making no allegation that the 27½ percent gross depletion rate allowed to oil and gas is excessive, in view of the necessity for increased oil and gas reserves in times of peace for use in case of war. It is my opinion, and I believe the opinion of many others in and out of the coal industry, that the United States was very fortunate during the last war in that the Congress had shown the wisdom and the foresight to develop a tax structure which permitted this country to produce a supply of petroleum without which the war could not have been won.

Your attention is invited to tables I and II attached to my statement. As shown on table I, reflecting information from official United States Bureau of Internal Revenue sources, in 1946, the latest year for which the information is available, the depletion allowance for the bituminous coal industry was only 3 percent of gross sales, whereas for the petroleum and natural gas industry the percentage was 18.2. Table II, also taken from official Treasury sources, shows that the petroleum-natural gas industry for 1946 was permitted a depletion allowance of $124,056,000, while the bituminous coal industry was permitted a depletion deduction of only $40,508,000.

Table III shows production of bituminous coal and bituminous coal equivalent of crude petroleum-natural gas, and depletion per ton and per ton equivalent, 1938 through 1946.

Raising the depletion on coal from 5 to 10 percent will be beneficial to the coal producing industry in that it will afford to the industry an opportunity to acquire some reserve with which to maintain its physical properties. Certainly the value of coal, like the value of everything else, has increased in the last 10 years. Moreover, the acquisition and mining of desirable coal properties has become in recent years increasingly difficult and expensive. Also increased depletion for coal will help labor in that it will mean more running time, more work and more wages.

Raising the depletion on coal from 5 to 10 percent will be beneficial to coal consumers. In the long run it will enable the coal operators to offer coal to coal consumers at a relatively lower price. Due to the highly competitive nature of the coal mining industry, this is certain to be the case.

From the standpoint of the national welfare, raising the depletion rate on coal from 5 to 10 percent will be highly beneficial for the reason that it will afford

much needed encouragement to the coal mining industry to install and maintain the plant and equipment necessary to meet the needs of the Nation, not only in peacetime but particularly in times of national emergency. It will be remembered that during the last war the principal burden of fueling America fell upon the bituminous coal mining industry.

It should always be remembered in the case of percentage depletion that the taxpayer never gets tax exemption or a subsidy free of taxation, because such depletion allowances are under the law limited to 50 percent of the net income from the property. It should also be remembered that the definition of property contained in the statute is limited to each separate tract or lease, and usually a mine operator has many such separate tracts or leases, with the result that percentage depletion may not result in any benefit except in the case of a few of such leases. Finally, the law further restricts the benefit of percentage depletion by excluding such deductions in computing an operating net loss to be carried forward to another year. In the case of depreciation, such deductions are taken into account. It should also be kept in mind that unless the taxpayer has net income, no percentage depletion whatever is available to him.

According to official Treasury reports, the bituminous coal mining industry as a whole operated at a loss from the years 1925 through 1939, a period of 15 years. During the 8-year period, according to the same report, 1940 through 1947, during which time the industry was called on to furnish fuel and power for the United States as well as our allies, there was a small profit amounting to about 10 cents per ton. In this connection, it should also be remembered that even during the war years about 40 percent of the coal companies in America operated at a loss, or at least without any profit. In the 20-year period, 1928 through 1947, after paying Federal income taxes of $343,000,000, the entire bituminous coal mining industry showed a profit of only $96,000,000, about 1 cent per ton.

The difficulties that the coal industry has encountered in recent years are a matter of common knowledge. The industry is highly competitive within itself as well as being competitive with other fuels and sources of energy. In addition, indirect taxes, such as the social security tax, are unduly and discriminatorily oppressive on the coal industry. The social security tax, predicated as it is on payroll, is many times as oppressive on the coal industry as it is on practically all large industries in the United States, due to the fact that approximately 60 percent of the total cost of producing coal goes for the payment of wages. Your attention is invited to table IV for a showing of how the coal industry has suffered competitively in recent years.

The Ways and Means Committee carefully considered the subject of percentage depletion for the natural-resource industries. Your particular attention is invited to the fact that in its report the Ways and Means Committee stated:

"* * * The testimony received by your committee indicated also that the 5-percent rate allowed in the case of coal is of little practical value, and that the coal-mining industry is peculiarly in need of more favorable tax treatment because of the inroads on its potential markets by alternative sources of energy, particularly oil and gas" (p. 65).

B. TRANSPORTATION COSTS AND PERCENTAGE DEPLETION

The House bill, H. R. 8920, page 52, line 13 through line 18, provides the following so-called technical amendment:

"(c) GROSS INCOME FROM MINING.—The second sentence of section 114 (b) (4) (b) (relating to definition of gross income from property) is hereby amended by inserting before the period at the end thereof the following: ', but such term shall in no case include transportation beyond the property'."

The report of the Ways and Means Committee, page 65, states in connection with the above quoted proposed amendment:

"The rates used under the percentage depletion option are, of course, applied to the gross income from the property. In order to restrict depletion to the actual product of mineral extraction, it is stipulated in your committee's bill that the gross income to which the percentage depletion rate is to be applied shall not include income resulting from the transportation of the product beyond the property."

And, page 84 of the report, last paragraph:

"Section 114 (b) (4) (B) of the code (relating to the definition of gross income from the property) is amended so as to provide, in effect, that, in computing gross income from the mineral property, the gross income shall not be augmented by value added as the result of transportation of the crude mineral product from the property. The amendment is merely declaratory of existing law."

Particular attention is called to the last sentence of the House report quoted above, reading: "The amendment is merely declaratory of existing law." We submit that this is not the case. The amendment in the House bill is substantive and not technical. Even a brief examination of the statute and the interpretations thereof will prove this.

The difficulty lies in the definition of "the property" which has been the subject of long and difficult controversy with the Bureau of Internal Revenue. There have been a number of court cases on the subject. It has been the subject of Law Review articles. Congress has been asked to clarify the situation on several occasions. But today the narrow interpretation applied to the meaning of "the property" by the Bureau of Internal Revenue continues to confuse taxpayers.

For several years the Bureau of Internal Revenue has been attempting to diminish the effect of percentage depletion by excluding certain costs involved in getting the coal from the mine to the tipple. The Bureau has diligently tried to exclude this and other items of cost from depletion computation in spite of the fact that the Internal Revenue Code as presently drawn contains the following language (in sec. 114 (b) (4) (B)):

"The term 'ordinary treatment processes,' as used herein, shall include the following: (i) In the case of coal—cleaning, breaking, sizing, and loading for shipment; * * *"

The effect of the amendment contained in the House bill stems from the very narrow definition of "the property" contained in the regulations of the Bureau of Internal Revenue, Regulations III, section 29.23 (m)–1(i) reading as follows:

" 'The property,' as used in section 114 (b) (2), (3), and (4) and sections 29.23(m)–1 to 29.23(m)–19, inclusive, means the interest owned by the taxpayer in any mineral property. The taxpayer's interest in each separate mineral property is a separate 'property'; but, where two or more mineral properties are included in a single tract or parcel of land, the taxpayer's interest in such mineral properties may be considered to be a single 'property,' provided such treatment is consistently followed."

The record of dealings with the Bureau of Internal Revenue in connection with this matter demonstrates the narrow interpretation given to the word "property." Each separate economic interest is considered a separate property. It is true that the Bureau has permitted the aggregating of properties where the ultimate tax liability would be unaffected thereby. But, unquestionably, if the amendment contained in the House bill is enacted into law, the Bureau will still further narrow the concept of the word "property" for purposes of computing the depletion deduction and will thereby substantially diminish the depletion allowance available to the coal industry.

It is suggested that this situation be corrected and clarified by the following amendment:

"Page 52, H. R. 8920, strike out lines 13 through 18 and insert in lieu thereof the following:

" '(*c*) GROSS INCOME FROM MINING.—Section 114 (b) (4) (B) (relating to definition of gross income from property) is hereby amended by inserting after the end of the third sentence a new sentence as follows:

" 'The term "mining" as used herein, shall also be considered to include the transportation of the ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plant or mill in which the ordinary treatment processes are first applied thereto.' "

C. CORPORATE EARNINGS AND PROFITS ACCUMULATED PRIOR TO MARCH 1913

Section 205 of H. R. 8920 proposes a series of amendments to the Internal Revenue Code, which would require corporate earnings and profits, accumulated before March 1, 1913, to be fully taxed in the hands of the stockholders when distribution of such earnings and profits is made to them.

This reverses the policy consistently followed by the Congress for 34 years. It is believed that this long-established policy is proper and equitable, and it is urged that section 205 be stricken from the House bill. The following reasons are given for such action, although others exist:

1. It was a basic principle of the Federal income tax from the beginning to exempt from such tax earnings and profits accrued before March 1, 1913, because prior to that date such earnings and profits could not be taxed under the Constitution.
2. Section 205 of the House bill affects stockholders only, and only stockholders of companies in existence before March 1, 1913.

3. The earnings and profits accumulated prior to March 1, 1913, of most of these long-established companies are not in cash but are in property and cannot be distributed except through liquidation.

4. Under existing law pre-March 1, 1913, earnings and profits cannot be distributed until all earnings and profits accumulated since that date have been distributed. All such later earnings are, of course, fully taxable in the hands of the stockholders when distributed.

5. Many stockholders over the last 34 years have received dividends declared out of pre-March 1, 1913, earnings and profits and paid no tax thereon. Section 205, therefore, discriminates against a relatively small group of stockholders whose companies are still in existence and happen to have earnings and profits accumulated prior to March 1, 1913, available for distribution.

6. The propriety of taxing these pre-March 1, 1913, earnings and profits has been considered carefully by the Congress on at least six occasions, and every time the Congress has refused to change its established policy.

7. Finally, the added annual revenue to be secured by section 205 is officially estimated at only $1,000,000. This amount becomes insignificant when we are considering a Federal tax burden of over $40,000,000,000.

TABLE I.—*Ratio (percent) of depletion to gross sales in the mining and quarrying industries, 1938–46*

Year	Bituminous coal	Anthracite	Crude petroleum and natural gas	Metal mining	Nonmetal mining and quarrying	Total mining and quarrying
1938	1.9	2.8	18.4	9.7	3.2	9.0
1939	2.2	3.6	19.5	9.6	3.6	8.6
1940	2.3	3.1	19.2	9.4	3.4	8.2
1941	2.5	2.9	18.9	9.0	3.1	7.9
1942	2.9	3.0	19.1	7.7	3.0	6.8
1943	3.0	2.6	19.6	8.8	3.3	6.9
1944	3.1	2.5	18.6	8.2	3.8	6.7
1945	2.9	2.3	18.0	7.2	4.0	6.5
1946	3.0	2.7	18.2	7.6	3.8	6.9

Source: Pt. II, Statistics of Income, Bureau of Internal Revenue

TABLE II.—*Depletion in the mining and quarrying industries, 1938–46*

[Thousands of dollars]

Year	Bituminous coal	Anthracite	Crude petroleum and natural gas	Metal mining	Nonmetal mining and quarrying	Total mining and quarrying
1938	$11,834	$5,243	$125,459	$56,242	$6,266	$205,338
1939	15,689	6,615	105,440	74,192	7,907	210,134
1940	20,012	6,758	111,035	89,930	8,752	237,014
1941	27,321	7,050	129,871	96,340	10,182	271,207
1942	32,620	8,347	92,329	94,105	10,878	238,926
1943	40,038	7,941	94,480	70,123	11,313	224,321
1944	44,566	8,620	104,616	59,705	12,726	230,805
1945	39,206	7,389	102,746	48,988	12,693	211,433
1946	40,508	10,519	124,056	46,138	15,781	237,252

Source: Pt. II, Statistics of Income, Bureau of Internal Revenue.

TABLE III.—*Production of bituminous coal, and bituminous coal equivalent of crude petroleum and natural gas, and depletion per ton, and per ton equivalent, 1938–46*

Year	Bituminous coal		Bituminous coal equivalent of crude petroleum and natural gas [1]	
	Production (thousands net tons)	Depletion per ton	Production (thousands net tons)	Depletion per ton
1938	348, 545	$0 034	368, 855	$0 340
1939	394, 855	.040	389, 008	.271
1940	460, 771	.043	418, 163	.266
1941	514, 149	.053	437, 061	.297
1942	582, 693	.056	434, 962	.212
1943	590, 177	.068	476, 489	198
1944	619, 576	072	533, 626	196
1945	577, 617	.068	556, 527	.185
1946	533, 922	.076	568, 969	.218

[1] Conversion factors. Petroleum 5,800,000 B. t u.'s per barrel, natural gas 1,075 B. t. u.'s per cubic foot bituminous coal 13,100 B. t. u.'s per pound.

Source: Bureau of Mines for production, and Bureau of Internal Revenue for depletion.

TABLE IV.—*Percent of total energy in the United States contributed by coal and petroleum-natural gas, 1938–49*

Year	Bituminous coal	Anthracite	Total coal	Total crude petroleum and natural gas	Year	Bituminous coal	Anthracite	Total coal	Total crude petroleum and natural gas
1938	43.8	5.6	49 4	46 4	1944	48 9	4 9	53.8	42 1
1939	45 6	5 8	51 4	44 9	1945	46 5	4 3	50 8	44 8
1940	47 9	5 2	53 1	43 4	1946	44 0	4 8	48 8	46 8
1941	49 4	5 2	54.6	42 0	1947	46 3	4 1	50 4	45 6
1942	52 1	5 2	57.3	38 8	1948	42 9	4 0	46 9	49.1
1943	50.2	5.0	55.2	40 6	1949	35 9	3 4	39 3	55.8

Source U. S. Bureau of Mines.

The CHAIRMAN. Mr. Henry B. Fernald.

STATEMENT OF HENRY B. FERNALD, MONTCLAIR, N. J., CHAIRMAN, TAX COMMITTEE, AMERICAN MINING CONGRESS

Mr. FERNALD. Mr. Chairman and members of the committee, I am Henry B. Fernald, of Montclair, N. J., chairman of the tax committee of the American Mining Congress.

Certain provisions of the pending bill are of particular concern to the mining industry, including some which are of general application but are of especially serious import to mining.

Present tax provisions, those substantive in their nature, together with the high cumulative tax rates of corporate and individual taxes, leave little incentive for the search for, development of, and investment in new mining ventures. Existing mines are being exhausted without adequate replacement. Plants and equipment are being used up or becoming obsolete. New plants or replacements cost far more than existing installations. Depreciation allowances often fail to recover initial costs; are quite inadequate top provide for replacements. Allowances for operating and capital losses are denied or abridged. What is needed is an improvement, not a worsening, of the existing tax situation.

Recommendations of certain major improvements which should be made in the tax system are set forth in the Report of the National Minerals Advisory Council to the Secretary of the Interior, which is in the record of hearings on this bill before the Committee on Ways and Means, February 1950, page 362. These are the lines which should be followed to provide needed minerals for defense and for peacetime use and to provide the sources from which Government revenues may flow.

I shall speak primarily of this bill as peacetime legislation; hoping, as you do, that we can maintain that viewpoint. Yet, if change is necessary and additional revenues must be raised to meet an emergency, we should not start with erroneous and unfair computations of taxable income such as we believe some of the proposals of the House bill would require.

Provisions are not necessarily wise because they are intended to close so-called loopholes. To prevent a few abuses does not warrant broad provisions which will do injustice to many in order to reach a few, and which, by killing incentives for desirable activities, will sacrifice rather than gain revenues.

Matters of greatest concern to us, which we ask receive your attention, are the following:

(I) Section 209 of the bill, amending section 117 with respect to capital gains or losses and changing the rules with respect to property used in the trade or business, is very bad, particularly in the change it would make in section 117 (j) of the code and in its new provision which would consider abandonment as a sale or exchange.

It is stated by the House committee report that present treatment is "inconsistent." The real inconsistency of the law is that it treats a capital gain as taxable income regardless of whether or not there are capital losses to be deducted, but permits deduction of capital losses only if there are capital gains from which they are deductible. It is this inconsistency that the present provisions of section 117 (j) were intended in some degree to mitigate, but which the proposed amendments would intensify.

We cannot wisely look only at formalities of wording regardless of application and practical effect.

There is a material difference between the gains and the losses generally sustained with respect to property used in the trade or business. Losses sustained on sale or abandonment of depreciable property or real estate used in the trade or business commonly represent nothing more than operating losses not adequately provided for by depreciation or other deductions. They are in their nature operating costs or losses and should be so allowed. Gains are not realized by abandonment. They are generally realized only through a capital transaction when the property is disposed of to realize a gain from its sale, and should be taxed as capital gains.

(The statement referred to follows:)

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(I) Section 209 of the bill, amending section 117 with respect to capital gains or losses and changing the rules with respect to property used in the trade or business, is very bad, particularly in the change it would make in section 117 (j) of the code and in its new provision which would consider abandonment as a sale or exchange.

It is stated by the House committee report that present treatment is "inconsistent." The real inconsistency of the law is that it treats a capital gain as taxable income regardless of whether or not there are capital losses to be deducted, but permits deduction of capital losses only if there are capital gains from which they are deductible. It is this inconsistency that the present provisions of section 117 (j) were intended in some degree to mitigate, but which the proposed amendments would intensify.

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This question of the nature of a loss sustained on sale or abandonment of depreciable property was carefully considered by the Congress in the 1938 bill, when depreciable property was excluded from the definition of capital assets in order that loss due to sale or abandonment of obsolete plant or equipment should not be treated as a capital loss deductible only from capital gains but should be treated as an operating loss deductible from ordinary income.

The reasons for the change in 1938 are well set forth in report of the Committee on Finance (S. Rept. 1567, 75th Cong., 3d sess., Calendar No. 1636, p. 7), as follows:

"The definition of capital assets has been changed so that depreciable assets are no longer included in the category of capital assets. This change made in the House bill allows a corporation to receive the full benefit of a deduction for losses on the sale of depreciable assets from its ordinary income. The change does not, of course, affect the deduction for obsolescence allowed by section 23 (l) of the bill and corresponding provisions of prior acts."

Of this and the other changes in treatment of capital gains and losses, the report then states:

"The committee believes that this treatment of capital gains and losses will stimulate transactions, facilitate the flow of capital into new enterprises, release frozen capital, and increase the revenues of the Government."

In the 1938 act the general corporate tax rate was some 17 to 18 percent. For taxpayers other than corporations the tax on long-term capital gains was limited to 15 percent for assets held 24 months, 20 percent for those held 18 to 24 months; deduction for long-term capital losses was allowable but not to reduce the tax on other income by more than the 15 or 20 percent rates specified. Because the corporate rates were substantially in accord with these limitations, no special limiting rates were made applicable to corporate capital gains or losses.

For corporations, losses on sales or exchange of capital assets were deductible only in the amount of capital gains plus $2,000. For other taxpayers, long-term losses were allowable as above indicated, but short-term capital losses were allowed only to the extent of short-term capital gains, with a 1-year carry-over.

What was done by amendment to the definition of capital assets in the 1938 act was to exclude depreciable property from the capital-gains provision. This made loss on sale or exchange of such property deductible from ordinary income. Loss on property abandonments continued as theretofore to be an ordinary income deduction. Gains on sale of such property used in the trade or business were likewise made taxable as ordinary income. For corporations there was, as noted above, no occasion for prescribing any special rate for gains on such property, since it was the flat corporate tax rate which applied to capital gains. The question of status of any gains from sale or exchange of depreciable property by individuals or partnerships seems not to have received any special consideration at that time, probably because it did not seem a major problem.

By 1942, however, a major change in situation had arisen. The corporate tax rate was far in excess of the capital-gain rate. Special provision was made to limit corporate taxation on capital gains to 25 percent; and this same rate was, by section 117 (j) made applicable to net gains from sale or exchange of property used in the trade or business. Because of the frequent difficulty in distinguishing between depreciable property and real estate, and because it was felt that real estate used in the trade or business might well have the same status as depreciable property so used, both were jointly excluded from the definition of capital assets and brought into the new classification of "property used in the trade or business" under section 117 (j).

This new provision also made another important change. Under the prior law, loss on sale or exchange of depreciable property had been fully deductible from ordinary income regardless of whether or not the taxpayer might at the same time have capital gains (which, as noted above, made no difference for corporations, since the same tax rate was then applied to capital gains as to ordinary income). When the reduced rate on capital gains was allowed to corporations in the 1942 act, it was then provided by section 117 (j) that, for corporations and for other taxpayers, any losses on sale or exchange of depreciable property or real estate used in the trade or business should first be deductible from capital gains, if any, and only the excess over net capital gains should be deductible as ordinary income. Losses on abandonments were in any event recognized as deductions from ordinary income. Loss due to abandonment is not at all in the nature of a capital transaction such as would give rise to a capital gain.

Most of the loss due to abandonment of property used in the trade or business or its sale as used equipment or scrap would never be shown if depreciation deductions more fully allowed for loss of useful value. We believe a more liberal policy on depreciation should be adopted. At best, however, there will be occasions when it is wise business policy to scrap or dispose of depreciable property before its full depreciation has been allowed. Denial of full deduction for loss, as now proposed in section 209 (d) of the pending bill, will discourage replacement of plant and equipment even though replacement would be wise business policy. Original investment likewise will be discouraged if the taxpayer, looking ahead, sees the probability that ultimate loss will be denied as a deduction except against capital gains. The change proposed in section 209 (d) will thus discourage both original investments and replacements which would directly create the incomes from which the Government would draw revenues. This will discourage employment and will limit the market for machinery. All of this will mean loss rather than gain in Government revenues. It will curtail production and employment and impair the welfare of the people.

The change proposed will not merely be as to losses sustained on sale or disposition of the property, but abandonment will be considered as a sale or exchange and losses denied except when they can be deducted from capital gains.

All industry may be affected in greater or less degree, but the change is particularly serious for the mining industry because its changes in plant and equipment are frequent to meet its operating and metallurgical needs.

But, more than that, the proposed change seems to require the treating of unsuccessful exploration and development of mining ventures as capital losses, with little or no opportunity of charging them off against capital gains. Such a tax policy would make it impossible for any individual, any small corporation, or any large corporation to justify economically any search for new deposits within the United States. Furthermore, it would virtually kill any incentive for endeavoring to develop a mining prospect. The amendments proposed by section 209 in this regard are so incredibly bad that they should be entirely rejected.

As to inconsistency, we can hardly see any more inconsistent or worse tax policy than to say, as these amendments would in effect say, "If you have gains, we will tax them. If you have losses, we will deny them unless you happen to have capital gains from which they may be deducted."

(II) Section 204, percentage depletion: (1) We urge that you reject the Treasury recommendation regarding percentage depletion, as the House has done after extended hearings. We believe it is unnecessary to repeat what was there presented to evidence that percentage depletion is no more than a proper allowance to the mining industry for capital exhaustion.

(2) The percentage for coal is rightly increased to 10 percent by the House bill. The allowance to metal mines should be increased to more than the 15 percent now allowed.

(3) Section 204 (c) of the bill proposes to add the words "but such term shall in no case include transportation beyond the property" at the end of the second sentence of section 114 (b) (4) (B), which, for determining gross income for percentage depletion purposes, defines the term "mining" to include both extraction from the ground and also "the ordinary treatment processes normally applied." The House committee report (p. 84) states that the proposed amendment "is merely declaratory of existing law." This statement is erroneous.

Section 114 (b) (4) (B) of the code was written into the law in 1943, as stated in the report of the Committee on Finance (S. Rept. 627 78th Cong., 1st sess., p. 23):

"The purpose of the provision is to make certain that the ordinary treatment processes which a mine operator would normally apply to obtain a marketable product should be considered as a part of the mining operation, and to give reasonable specification of what are to be considered such processes for various kinds or classes of mines.

"The law has never contained such a definition, and its absence has given rise to numerous disputes. The definition here prescribed expresses the congressional intent of these provisions as first included in the law, and is in accord with the original regulations and the Bureau practices and procedures thereunder. It is therefore made retroactive to the date of such original provisions."

The first sentence of the definition in section 114 (b) (4) (B) states that gross income from the property means the gross income from mining. The second sentence states that mining shall include not merely extraction of the ores but also the ordinary treatment processes normally applied. The third sentence specifies the ordinary treatment processes to be included for each of the several classifications there set forth as (i), (ii), (iii), and (iv). The processes are stated in considerable detail, following the lines of the Treasury regulations prescribed under the 1932 act and continued for many years thereafter. Such regulations (for example, art. 23 (m)-1 (g), Regulations 101) were definite in stating that the gross income determination should be "before transportation from the place where the last of the processes listed below was applied." Transportation necessary to move the minerals to the plants where the ordinary treatment processes were performed was, like the processes themselves, to be considered as part of mining. Transportation from the place where the last of the specified processes was applied was not to be considered as part of mining; nor were any further processes beyond those specified. The processes specified gave the cut-off point between what was and what was not to be considered mining in each case.

We are confident that Congress, in adopting the 1943 amendment to express the intent of the prior law, intended that the definition of "gross income" written into the law should carry the same meaning and the same cut-off point with regard to transportation as had been set forth in the early regulations and had been followed in Bureau procedure.

Sometimes plants for concentrating or other processes specified can be located directly on the mining property. At other times terrain, necessary water supply,

or other factors may make that impossible, and a plant will be located at the nearest practical point at which the processes can be efficiently performed. This is normal mining procedure.

Lately there has been some disposition in the Bureau to raise questions in this regard which were not raised and would not have been admissible under the earlier regulations and procedures. For this reason, and because of the statement erroneously made in the House committee's report, we believe the intent of the law should be made clear by the following amendment in lieu of that proposed by section 204 (c) of the bill:

(1) That the second sentence of section 114 (b) (4) (B) should be amended to read as follows:

"The term 'mining' as used herein shall be considered to include not merely the extraction of the ores or minerals from the ground, but also (a) the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products and (b) the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plant or mill in which the ordinary treatment processes are applied thereto."

It is understood that the amendment now proposed in section 204 (c) of the bill was intended primarily to apply to sand, gravel, etc., for which percentage depletion is proposed to be newly allowed by section 114 (b) (4) (A) (i). If none of the existing classifications (i) to (iv) in section 114 (b) (4) (B) is deemed to give the satisfactory cut-off point for these newly included minerals, the appropriate method to make clear the basis for them would be by inserting in the third sentence of section 114 (b) (4) (B) a new subdivision (v) which would specify the processes, if any, which should be considered as the "ordinary treatment processes" with respect to such minerals.

In this way the present meaning of the law will be maintained and clarified at the same time that the appropriate specifications are set forth for the newly added minerals, in harmony with the structure of the section and with its specifications for other classes of minerals.

(4) Another point with respect to section 204 of the bill is that it makes changes in certain language, particularly in omitting the words "mines" or "mines or deposits" in conjunction with the names of particular minerals, and substitutes a new title and introductory clause providing for percentage depletion "in the case of the following mines and other natural deposits * * *." We are certain that these changes are not intended to alter the meaning of the paragraph and are such as the committee report refers to as "technical amendments * * * which do not alter its substance." But the report does not specifically mention the changes referred to. This leaves the danger that a change in terminology may be made a basis for contending that the law after the change means something different. It is recommended that this committee in its report refer specifically to these changes and state that they are purely clerical and do not change the meaning of the paragraph.

(III) Section 205. Corporate Earnings and Profits Accumulated Prior to March 1, 1913: This amendment proposes to do away with the long-established rule that earnings and profits accumulated or increase in value of property accrued before March 1, 1913, should not be a source from which taxable dividends are paid. For over a generation the law has so provided, but with specification that tax-free distributions from such source may not be made until after all subsequent earnings have first been distributed. It is not keeping faith with taxpayers now to change the rule and to deny the tax-free status of these distributions which for years corporations and their stockholders have had assured to them.

It will not simplify the law nor the computations to do this. Companies concerned already have their dividend accountability well established under present rules. For them and for the Treasury it will mean recomputation over many years to determine what would be their status under the proposed new rule.

Perhaps it is true that a great majority of corporations today have no March 1, 1913, problem in their dividend accounting. Yet that does not warrant the change as to the many corporations who have rested on the congressional assurance that their March 1, 1913, accumulated earnings and March 1, 1913, increase in value of property, when realized, would be distributable tax-free to their stockholders after they had first distributed all their subsequent earnings.

(IV) Section 214, net operating loss deductions: (*a*) The bill would authorize a 5-year carry-forward, which we believe is very desirable. We urge, however, that the 2-year carry-back should still be retained. It is particularly important for the mining industry. In many cases the mine may become worked out or the

operation become unprofitable before full allowances have been made for depreciation of plant and equipment, writing off of deferred charges, etc. Or the mine may have to be shut down because of low metal prices or other conditions which make it impossible to continue operations. When it is shut down, there is no certainty that operations can ever be profitably resumed. Sometimes operations may be continued at a loss hoping for better conditions which, however, do not come. In any of these cases the only way to avoid taxing more than the net earnings of the mine is to allow the operating losses to be written off against the income of prior years.

It must be recognized that incentives for investment come from expected net profits of the business, taking into account good years and poor. If the miner must contemplate that the income of good years will be taxed without offset for years of loss, it is a very discouraging prospect which he faces. Certainly, from the standpoint of the mining industry, the 2-year carry-back should not be abridged.

(*b*) We further urge that the present arbitrary rules for computing the amount of net operating loss, and the net operating loss deduction allowable, should be revised so that the statutory concepts for determining these should be the same as for determining taxable net income. The taxpayer having a loss in one year and a profit in another should not be taxed more heavily than the taxpayer who receives the same amount of net income uniformly distributed over the 2 years.

From the standpoint of the mining industry, the particular discrimination against loss years is that section 122 (d) (1) lists percentage and discovery depletion among the adjustments required and, by reference thereto in section 122 (a), (b), and (c), such deductions are denied in computing the net operating loss deduction. We particularly urge that the adjustment required by section 122 (d) (1) should be eliminated.

(V) Section 218, increase in rates of corporation income taxes: We urge that the corporation income tax rate should not be increased. The corporation tax rate, together with the tax rates imposed on dividends to stockholders, is very high. As these rates now stand, they are obstructing the obtaining of equity capital for new ventures. The rates should not be further increased.

We also urge that the 2 percent penalty tax imposed on consolidated returns should be eliminated.

(VI) Section 602. Rate of Interest on Overpayments: The interest rate to be paid by the Government on refund of overpayments should be the same as the rate of interest which the Government collects on deficiencies. Our tax laws are so complicated, difficult, and uncertain that the Treasury cannot be confident of the correctness of its regulations, rulings, decisions, and instructions, and taxpayers cannot know definitely the amounts they should pay. Even our courts have difficulty in deciding tax questions. Under such circumstances, overpayments and underpayments of tax are inevitable.

The present 6 percent interest rate may be more than should be paid or charged under the monetary conditions of today. If so, the rate should be decreased both as to interest collected and as to interest paid. In any event, the rate receivable and the rate payable should be the same.

To do otherwise is gross injustice in the frequent situation in which it may be held that income has been included or deductions taken in the wrong year. The taxpayer, for example, may have taken an amount into account in 1948. The Commissioner may determine it should have been taken into account in 1949. This may show an underpayment in one year and an overpayment in the other, with no aggregate tax difference for the 2 years. Yet if the rate to be paid on refund of the overpayment is less than the rate charged on the underpayment, there will be a continuing incentive for the Government to find excuse for changing the year of inclusion or deduction in order to obtain the rate differential involved, with corresponding hardship and injustice to the taxpayer. Moreover, the longer the period of delay in making final determination, the greater will be the benefit of the interest differential to the Government, and the greater the injustice to the taxpayer. This is very bad tax policy.

(VII) Section 603. Payment of Income Tax by Installments: The proposed change in dates for payment of corporation income tax should not be made. It would overturn the established custom and would yield no additional revenue to the Government. Well-financed successful corporations might be able to accelerate their tax payments without great difficulty. But there are many corporations, including many of those engaged in mining, who will find it bitterly difficult. The fact that industry in general may have adequate funds to meet the proposed new demands does not make available to the struggling corporation the funds for

accelerated payments of its liabilities. The long-established practice of quarterly payments should not be changed. We discount the alleged necessity for the change and we see no real benefits to the Treasury.

(VIII) Taxation of Foreign Income: The Secretary of the Treasury has urged that certain amendments be made with respect to taxation on foreign income. These are referred to as part of the point 4 program. We urge particularly the enactment of the following items:

(*a*) Amendment of section 131 (f) to eliminate the present requirement for majority ownership of a foreign subsidiary in order to obtain the foreign tax credit involved.

(*b*) Amendment of section 116 (a) to modify its present technical requirements and permit Americans residing abroad to have the present exemption of their earnings applicable to the entire period they reside abroad once they have established a bona fide foreign residence.

A further amendment to section 116 (a) should also be made to clarify meaning of the term "residence." There seems some tendency to construe this as tantamount to "domicile." We believe the section was intended to apply to those who are employed and live abroad for the specified term, whether or not they have their families with them and whether or not they expect to return later to this country. It should be made clear that "residence" includes physical residence by the taxpayer in some foreign country for the specified period of time.

(c) Amendment to section 131 (b) to eliminate one of the present twofold limitations on the foreign tax credits.

(d) Extension of the foreign tax credit to the estate tax.

We believe there is no occasion to anticipate a loss of revenues from any of these amendments. Rather, we believe the resulting encouragement of our foreign trade will give rise to increased revenues.

(IX) Section 206. Liquidation of Foreign Subsidiaries: Section 206 of the bill proposes to add to the code a new paragraph, section 115 (c) (2). The purpose of the provision is to tax as ordinary income to each domestic corporate stockholder its share of a foreign subsidiary's accumulated earnings, upon liquidation of the subsidiary or its merger or consolidation into the domestic corporation. Under existing law, gain from the liquidation would be taxed as a capital gain under section 115 (c) of the code, or, in approved cases, the tax would be postponed, with a carry-over basis.

The proposed provisions are unsound in policy; are directly contrary to the Treasury's policies with respect to encouraging foreign trade; are in direct conflict with the proclaimed policies of our Government; and cannot be justified.

(X) Certain of the So-called Loopholes: There are several provisions of the bill which are intended to prevent certain abuses which are asserted now to exist. Some of these proposed provisions as now drawn we believe will curb or hamper proper and desirable activities in the ordinary course of business which in no way represent tax abuses. It is difficult to speak definitely and in detail of each of these provisions because it is not easy to determine just how some of them should be interpreted and how far they might go.

We urge your special consideration of the following:

(*a*) Section 203. Dividends Received Credit With Respect to Dividends Received in Property: This proposes that in case of a dividend in property received by one corporation from another which is subject to tax under this chapter, the receiving corporation will be subject to tax on the market value of the property received but shall be limited as to its dividend received credit to a credit computed on the basis of such property in the hands of the distributing corporation.

If the basis of property to the distributing corporation is to be considered as attaching in any way to the recipient or is to be applied in his tax computations, the simpler and fairer rule would be that the distribution should simply be considered as a transfer from the one corporation to the other, with no taxable gain to be recognized to either corporation until a gain is realized through sale or exchange of the property. This would prevent the recipient having a stepped-up basis which seems to be the particular point against which this proposed provision is directed.

(*b*) Section 207. Treatment of Certain Acquisitions of Stock as if They Were Taxable Dividends: This amendment proposes a very unrealistic treatment for certain stock acquisitions, particularly as it involves the acquisition of stock of one member of an affiliated group by another.

(c) Section 211. Collapsible Corporations: The new definition of a "collapsible corporation" is very difficult. It seems so broad that it would apparently include

many cases of corporations engaged in quite normal business pursuits. For example, it is quite common for a new corporation to undertake exploration and preliminary development of a mining prospect. Perhaps it is known at the outset that such a corporation will not be able to carry through the prospect, if successful, to make it an operating mine, or this may later be determined. In any event, it may be a one-purpose venture, which would be liquidated when that purpose of preliminary development of the prospective mine has been completed. It should not be brought into this definition of "collapsible corporations" to be treated as if it were formed or availed of for some improper purpose.

(XI) Sec. 172. Excise Tax on Transportation of Property: The excise tax on transportation of property, at the rate of 4 cents per ton on coal and at the rate of 3 percent on all other property, bears with particular severity on the mining industry. Products of the mines make up a major portion of the total tonnage transported by our common carriers. The prices of minerals are determined by world markets, and the tax cannot be passed on. In view of the small margin of profit generally prevalent in the mining industries today, the additional cost imposed by the transportation tax is an expecially heavy burden, and one which in an increasing number of cases means the difference between being able to continue to operate and being forced to shut down. We urge complete elimination of this tax.

(XII) Repeal of Silver Bullion Transfer Tax: Section 1805 of the Internal Revenue Code levies a tax of 50 percent of the proceeds from transfers of an interest in silver bullion. This tax originated as a part of the Silver Purchase Act of 1934 The tax was imposed to prevent speculation in silver arising out of the adoption of the silver program. It was not intended to produce revenues and, with sporadic exceptions, has never raised enough to pay the cost of administration.

The present effects of the tax are to prevent the operation in this country of a normal nonspeculative commercial market for silver and arbitrarily to penalize from time to time commercial users of that commodity.

The tax serves no useful purpose at the present time. It should be repealed.

We respectfully urge your careful consideration of the various points which we have here presented. We thank you for the opportunity given us to appear before you.

Mr. FERNALD. This question of the nature of a loss sustained on sale or abandonment of depreciable property was carefully considered by the Congress in the 1938 bill. The reasons for the change then made are set forth in the report of this Committee on Finance.

The definition of capital assets has been changed, so that depreciable assets are no longer included in the category of capital assets. This change made in the House bill allows a corporation to receive the full benefit of a deduction for losses on the sale of depreciable assets from its ordinary income. The change does not, of course, affect the deduction for obsolescence allowed by section 23 (l) of the bill and corresponding provisions of prior acts.

Of this and the other changes in that bill the committee stated:

The committee believes that this treatment of capital gains and losses will stimulate transactions, facilitate the flow of capital into new enterprises, release frozen capital, and increase the revenues of the Government.

I then follow through in some detail the changes made in the treatment of this from 1938 until in 1942 when a major change in the situation arose and section 117 (j) was introduced. By that time the corporate rate had gotten much higher than the ordinary rate on capital gains, which had not been the case in 1938, so that a change was made in 117 (j) which gave to corporations the 25 percent rate on capital gains. In that connection there was a distinction made in 117 (j).

Section 117 (j) did another thing. It said losses on property used in the trade or business should first be charged against capital gains but if in excess thereof, would be allowed as ordinary deductions, but

it did not change this matter of loss due to an abandonment of property, as the present bill would.

Most of the loss due to abandonment of property used in the trade or business, or its sale as used equipment or scrap would never be shown if depreciation deductions more fully allowed for loss of useful value. We believe a more liberal policy on depreciation should be adopted. At best, however, there will be occasions when it is wise business policy to scrap or dispose of depreciable property before its full depreciation has been allowed. If that is denied, it is going to discourage replacement of plant and equipment. It is going to discourage original investment because the investor will have to look ahead and see the possibility that he may have a loss denied to him since he will not have capital gains against which to charge it. It will discourage investments and replacements, it will discourage employment and limit the market for machinery. All of this will mean loss rather than gain in revenues.

Senator MILLIKIN. Mr. Fernald, that is especially true, is it not, as to small companies which operate on a sort of single-shot basis? They have no capital gains. The chances are 8 or 9 out of 10 that they will fail.

Mr. FERNALD. Most industrial companies do not have capital gains frequently. It will only be rarely that they will have capital gains.

Senator MILLIKIN. Is that not particularly true in the mining field?

Mr. FERNALD. Yes; it is particularly true in the mining field.

Senator MILLIKIN. The smaller segment of the mining business is out of business, it is not making any money at all, it is closed down.

Mr. FERNALD. That is correct, sir.

Senator MILLIKIN. When you are talking about capital gains, there is no gain of any kind; the business is on its back.

Mr. FERNALD. That is true. I touch on that subject a little later.

Now all industry may be affected in greater or less degree, but the change is particularly serious for the mining industry because its changes in plant and equipment are frequent to meet its operating and metallurgical needs.

But more than that, the proposed change, that is this treating of abandonment as if it were a sale or exchange, would require the treating of unsuccessful exploration and development of mining ventures as capital losses, with little or no opportunity of charging them off against capital gains. Such a tax policy would make it impossible for any individual, any small corporation or any large corporation, to justify economically any search for new deposits within the United States. Furthermore, it would virtually kill any incentive for endeavoring to develop a mining prospect. The amendments proposed by section 209 in this regard are so incredibly bad that they should be entirely rejected.

As to inconsistency, we can hardly see any more inconsistent or worse tax policy than to say, as these amendments would in effect say, "If you have gains, we will tax them. If you have losses, we will deny them unless you happen to have capital gains from which they may be deducted."

As to percentage depletion, we urge that you reject the Treasury's recommendation regarding percentage depletion, as the House has done after extended hearings. We believe it is unnecessary to repeat

here what was there presented to evidence that percentage depletion is no more than a proper allowance to the mining industry for capital exhaustion.

The percentage for coal is rightly increased to 10 percent by the House bill. The allowance to metal lines should be increased to more than the 15 percent now allowed.

Section 204 (c) of the bill proposes to add the words "but such term shall in no case include transportation beyond the property" at the end of the second sentence of section 114 (b) (4) (B)—which, for determining gross income for percentage depletion purposes, defines the term "mining" to include both extraction from the ground and also "the ordinary treatment processes normally applied." The House committee report on page 84 states that the proposed amendment "is merely declaratory of existing law." This statement is erroneous.

Section 114 (b) (4) (B) of the code was written into the law in 1943, as stated in the report of the Committee on Finance:

> The purpose of the provision is to make certain that the ordinary treatment processes which a mine operator would normally apply to obtain a marketable product should be considered as a part of the mining operation, and to give reasonable specification of what are to be considered such processes for various kinds or classes of mines.
>
> The law has never contained such a definition, and its absence has given rise to numerous disputes. The definition here prescribed expresses the congressional intent of these provisions as first included in the law, and is in accord with the original regulations and the Bureau practices and procedures thereunder. It is therefore made retroactive to the date of such original provisions.

In that section the first sentence of the definition states that their gross income from the property means the gross income from mining. The second sentence states that mining shall include not merely extraction of the ores but also the ordinary treatment processes normally applied. The third sentence specifies the ordinary treatment processes to be included for each of the several classifications there set forth as (i), (ii), (iii), and (iv). The processes are stated in considerable detail, following the lines of the Treasury regulations prescribed under the 1932 act and continued for many years thereafter.

Such regulations were definite in stating that the gross income determination should be "before transportation from the place where the last of the processes listed below was applied." Transportation necessary to move the minerals to the plants where the ordinary treatment processes were performed was, like the processes themselves, to be considered as part of mining. Transportation from the place where the last of the specified processes was applied was not to be considered as part of mining; nor were any further processes beyond those specified. The processes specified gave the cut-off point between what was, and what was not, to be considered mining in each case.

We are confident that the Congress, in adopting the 1943 amendment to express the intent of the prior law, intended that the definition of "gross income" written into the law should carry the same meaning and the same cut-off point with regard to transportation as had been set forth in the early regulations and had been followed in Bureau procedure.

Sometimes plants for concentrating or other processes specified can be located directly on the mining property. At other times terrain, necessary water supply or other factors may make that

impossible, and a plant will be located at the nearest practical point at which the processes can be efficiently performed. This is normal mining procedure.

Lately there has been some disposition in the Bureau to raise questions in this regard which were not raised and would not have been admissible under the earlier regulations and procedures. For this reason, and because of the statement erroneously made in the House committee's report, we believe the intent of the law should be made clear by the following amendment in lieu of that proposed by section 204 (c) of the bill:

(1) That the second sentence of section 114 (b) (4) (B) should be amended to read as follows:

> The term "mining" as used herein shall be considered to include not merely the extraction of the ores or minerals from the ground, but also (a) the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products, and (b) the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plant or mill in which the ordinary treatment processes are applied thereto.

Senator MILLIKIN. Will you give us some examples of the processing going on in normal operation when the ore comes out of the ground?

Mr. FERNALD. I will furnish that to you later if I may.

Senator KERR. With reference to the transportation, does this contemplate the reasonable ordinary cost of transportation from the mine to a mill located nearby or to what extent might that be expanded?

Mr. FERNALD. The kind of rule that we are asking for, sir, is to have it where the mill or processing plant is located at the nearest reasonable point for the efficient application of the processes, the transportation from the mine to that point.

Senator KERR. What might that involve?

Mr. FERNALD. That would depend a great deal on the question of terrain, on the location of the plant. For instance, if we take a concentrating plant, it must have adequate water supply, it must have space where tailings can be floated out from the plant. As to how closely we can place that to the mine, you can be sure that we will place it just as close to the mine as we can.

Senator KERR. Within 10 miles, 5 miles, 100 miles, or 1,000 miles?

Mr. FERNALD. Well, 10 miles, 20 miles, perhaps in very rare cases it might run up to 30 miles.

Senator KERR. Up to 30 miles?

Mr. FERNALD. Yes. There is no intention to have this run to a thousand miles. I do not think you will ever find a case where a thousand miles was the nearest place.

Senator KERR. It would not apply then to minerals obtained from some other country and shipped to a mill in the country?

Mr. FERNALD. No. I think that would not be normal processing. It is what the normal operators do under those conditions as a normal treatment process. But this proposed amendment would say if you move it off the edge of the property, bing, that is out.

Senator KERR. I want to say that your position is well taken, if I understand it, and I wanted to be sure than I did understand it.

Mr. FERNALD. Thank you.

We understand that the amendment now proposed in section 204 (c) of the bill was intended primarily to apply to sand, gravel, and so

forth for which percentage depletion is proposed to be newly allowed by section 114 (b) (4) (A) (i). If none of the existing classifications in that part of the section where we are specifying processes give a satisfactory cut-off for these newly added minerals, the proper way to do it would be to add a new classification and specify what is the rule which should be applied to sand, gravel, and so forth.

In this way we can maintain the present intent of the law and we can care for newly added materials in a harmonious manner.

There is another little point in regard to the language of section 204 that I note in my paper. I think I need not bring it in this presentation.

Next we speak of the matter of distribution of corporate earnings and profits accumulated prior to March 1, 1913.

This amendment proposes to do away with the long-established rule that earnings and profits accumulated or increased in value of property accrued before March 1, 1913, should not be a source from which taxable dividends are paid. For over a generation the law has so provided, but with specification that tax-free distributions from such source may not be made until after all subsequent earnings have first been distributed. It is not keeping faith with taxpayers now to change the rule and to deny the tax-free status of these distributions which for years corporations and their stockholders have had assured to them.

As to net operating loss deductions, the bill proposes a 5-year carry-forward which we believe is very desirable. We urge, however, that the 2-year carry-back should still be retained. It is particularly important for the mining industry. In many cases the mine may become worked out or the operation become unprofitable before full allowances have been made for depreciation of plant and equipment, writing off of deferred charges, and so forth, or the mine may have to be shut down because of low metal prices or other conditions which make it impossible to continue operations. When it is shut down there is no certainty that operations can ever be profitably resumed. Sometimes operations may be continued at a loss hoping for better conditions which, however, do not come.

In any of these cases the only way to avoid taxing more than the net earnings of the mine is to allow the operating losses to be written off against the income of prior years.

It must be recognized that incentives for investment come from expected net profits of the business, taking into account good years and poor. If the miner must contemplate that the income of good years will be taxed without offset for years of loss, it is a very discouraging prospect which he faces. Certainly from the standpoint of the mining industry, the 2-year carry-back should not be abridged.

We further urge that the present arbitrary rules for computing the amount of net operating loss, and the net operating loss deduction allowable, should be revised so that the statutory concepts for determining these should be the same as for determining taxable net income. The taxpayer having a loss in 1 year and a profit in another, should not be taxed more heavily that the taxpayer who receives the same amount of net income uniformly distributed over the 2 years.

From the standpoint of the mining industry, the particular discrimination against loss years is that section 122 (d) (1) lists percentage and discovery depletion among the adjustments required, and, by

reference thereto in section 122 (a), (b), and (c), such deductions are denied in computing the net operating loss deduction. We particularly urge that the adjustment required by section 122 (d) (1) should be eliminated.

With respect to the increase in rates of corporation income taxes, we urge that the corporation income tax rate should not be increased. The corporation tax rate, together with the tax rates imposed on dividends to stockholders, are very high. As these rates now stand, they are obstructing the obtaining of equity capital for new ventures. The rates should not be further increased.

We also urge that the 2-percent penalty tax imposed on consolidated returns should be eliminated.

With respect to the rate of interest on overpayments, the interest rate to be paid by the Government on refund of overpayments should be the same as the rate of interest which the Government collects on deficiencies. To do otherwise is gross injustice in the frequent situation in which it may be held that income has been included or deductions taken in the wrong year.

Section 603 proposes a change in dates for payment of corporation income-tax installments. It would overturn the established custom and would yield no additional revenue to the Government. Well-financed successful corporations might be able to accelerate their tax payments without great difficulty. But there are many corporations, including many of those engaged in mining, who will find it bitterly difficult. It is a change which we feel is not warranted and should not be made.

As to the taxation of foreign income, the Secretary of the Treasury has urged that certain amendments be made with respect to taxation on foreign income. These are referred to as part of the point 4 program. We urge particularly the enactment of certain of those measures that we point to in our statement. I will omit those and leave them in the record, if I may.

We believe there is no occasion to anticipate a loss of revenues from any of these amendments proposed as to the foreign income tax. Rather, we believe the resulting encouragement of our foreign trade will give rise to increased revenues.

Senator MILLIKIN. In brief, What do you want to do about that? Just give me the gist of it.

Mr. FERNALD. Very briefly, an amendment of section 131 (f) to eliminate the present requirement for majority ownership of a foreign subsidiary in order to obtain the foreign tax credit.

The present law, section 131 (f), requires majority ownership. As the changed conditions exist with greater insistence on not having a foreign majority interest, it presents a very difficult question. Also, it is becoming difficult when you have two or more corporations interested in some foreign corporation for expansion of trade and so forth where neither company will have a majority interest. This is one of the Treasury recommendations we think should be accepted.

Section 116 (a) should have modified its present technical requirements and permit Americans residing abroad to have the present exemption of their earnings applicable to the entire period they reside abroad once they have established a bona fide foreign residence. The Treasury so recommends and we so urge.

There is also a change in the definition of "residence" which we think it would be desirable to have made.

The amendment to section 131 (b) to eliminate one of the present twofold limitations on the foreign tax credits.

Then the extension of the foreign tax credit to the estate tax.

Those, as I say, are all recommended by the Treasury and we believe they should be made.

On the other hand, the bill proposes a change with respect to liquidation of foreign subsidiaries in section 206, which we believe is unsound in policy, contrary to the Treasury policy with respect to encouraging foreign trade, in conflict with the proclaimed policies of the Government, and cannot be justified.

We mention then in connection with certain of the loopholes that there are several provisions of the bill which are intended to prevent certain abuses which are now asserted to exist. Some of these proposed provisions as now drawn we believe will curb or hamper proper and desirable activities in the ordinary course of business which in no way represent tax abuses.

We note especially the provisions as to the dividend credit with respect to dividends received in property; the question of treatment of certain acquisitions of stock as if they were taxable dividends; and the question of collapsible corporations.

There may be occasion perhaps to stop some abuses there but we believe as the provisions are drawn they are so broad that they will hamper perfectly allowable matters. It gets very complicated and we just mention those briefly.

We then pass to the excise tax on transportation of property which bears with particular severity on the mining industry. Products of the mines make up the major portion of the total tonnage transported by our common carriers. The prices of minerals are determined by world markets, and the tax cannot be passed on. In view of the small margin of profit generally prevalent in the mining industries today, the additional cost imposed by the transportation tax is an especially heavy burden, and one which in an increasing number of cases means the difference between being able to continue to operate and being forced to shut down. We urge complete elimination of this tax.

In conclusion, I would like to say there is one tax here, that on silver bullion, which was established in 1934, which has outlived its usefulness and which yields no material revenue. The conditions which caused its original imposition have passed and we believe it should be repealed.

We urge consideration of these various points which we have presented. We thank you for the opportunity to appear before you.

I ask that the complete statement be included in the record.

Senator MILLIKIN. Mr. Fernald, you were going to give us illustrations of the processing which occurs after you get the ore out of the ground, which is involved in this question of transportation. Would you mind doing that? Give us a couple of illustrations.

Mr. FERNALD. We have the mining property here. Perhaps it may be at the top of a hill. There is no place there to locate a mill for handling that product. It is brought down the hill.

Senator MILLIKIN. What I am trying to develop is, what is actually done with the ore to process it? I think you have made that part

of it very clear, but what are these processing things so that the members of the committee may understand it?

Mr. FERNALD. I see.

For instance, for our ordinary metal mines there is the concentrating of the ore by gravity or by flotation. That is, the ore as it comes out of the ground is too low grade to be profitably shipped any distance.

Senator MILLIKIN. There is a lot of dead rock in it?

Mr. FERNALD. It has rock in it. Of course, with some mines they will have an actual selection underground so that a lot of the waste will be left in the mine whereas the vein itself and the good ore will be hoisted to the surface. In other places, instead of trying to do any sorting underground the whole thing is sent to the mill and there, either by flotation or other concentrating processes, mechanically you eliminate a large amount of the waste rock and get the concentrates which carry the bulk of the mineral which can then be profitably shipped.

Senator MILLIKIN. You are preparing your ores so that you have something to sell; that is the point, is it not?

Mr. FERNALD. That is it exactly.

Senator MILLIKIN. If you do not prepare them, you have nothing to sell and you do not have any income?

Mr. FERNALD. That is the ordinary mining process.

Senator MILLIKIN. Do you intend to carry it on to the smelting point?

Mr. FERNALD. When the amendment was originally presented in 1932 that matter was considered at some length and the Treasury felt strongly it should not include smelting as an ordinary treatment process applicable to percentage depletion. So the smelting of that ore was not originally treated as includible in the percentage depletion in gross income from mining.

Senator MILLIKIN. Smelting is another step?

Mr. FERNALD. Smelting is another step. Even if you have a smelter right at the mine, that still has been held by the Treasury in a ruling which has stood ever since 1932 as not one of the ordinary treatment processes to be considered as mining.

Senator MILLIKIN. So that all you are asking for is that transportation be included to that point where you can render your ore marketable?

Mr. FERNALD. That is it.

Senator MILLIKIN. That is the point?

Mr. FERNALD. Yes.

For coal, as they spoke this morning, they have this proposition of washing and classifying as part of their process.

Senator MILLIKIN. Thank you.

The CHAIRMAN. Thank you very much, sir, for your appearance.

Mr. FERNALD. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Sam Williston.

STATEMENT OF SAM H. WILLISTON, LOS ALTOS, CALIF., CHAIRMAN OF THE TAX COMMITTEE, MINING AND METALLURGICAL SOCIETY OF AMERICA

Mr. WILLISTON. Mr. Chairman and members of the committee, my name is S. H. Williston from Los Altos, Calif., and I am speaking as chairman of the tax committee of the Mining and Metallurgical Society of America.

Senator CONNALLY. Your testimony covers pretty much the same ground as the testimony of the witness who has just concluded?

Mr. WILLISTON. In a little different way, in this respect, Senator. The society is purely a technical society. They have no member corporations or anything like that in it and it is an endeavor to bring some concrete factual evidence before the committee to cover the particular problem of exploration and development in the mining industry.

The Mining and Metallurgical Society of America is one of the oldest professional societies solely concerned with mining. It is made up of mining and metallurgical engineers of recognized professional standing and with years of experience in the mining industry. It contains within its ranks most, if not all, of those technicians in the mining industry who make the decisions as to whether exploration or development of new metal deposits within the United States is economically justifiable.

The society feels that a recent study contributed to by most of the mining engineers of the society might well be of value to the Senate Finance Committee in the consideration of the present tax legislation. The study was conducted to determine the relative extent of exploration and development of new deposits being carried on at present and proposed for the immediate future, the relative health of various branches of the industry in comparison with 1940, and the suggested corrective measures if these conditions were not satisfactory. The results for each branch of the industry are as follows:

In regard to the coal industry, exploration and development has not changed materially but the industry is in a considerably worse condition than it was in 1940, insofar as ability to produce is concerned.

Senator MARTIN. May I ask a question there?

Is that because machinery has not been replaced? I do not understand that because in my part of the country we have more coal than we can possibly consume.

Mr. WILLISTON. These are not my opinions; these are the opinions of engineers in various districts and concerned with various types of material. They were asked how is the exploration and development program going on? That largely will be the result of the health of the industry. If it is not feasible to spend money and make a profit, they will not conduct exploration and development.

In regard to the iron mining industry, exploration and development of new reserves has increased since 1940 by an average of 50 percent, but in the event of war, all of the industry would be in a worse condition than it was in 1940, and an appreciable part of it would be in a very much worse condition.

In regard to the nonmetallic mines of the country, while different portions show varying degrees of health, the over-all picture would indicate that the industry is better off than it was in 1940 and could better stand any demands upon it.

In connection with the metal mines other than iron, exploration and development have declined drastically. Specific figures indicate a decline in exploration of 74 percent. In the event of war, 98 percent of the industry would be in worse condition than it was in 1940 and 30 percent of it would be in very much worse condition. Only a few of the open-pit coppers would be as well off as in prewar years.

Senator MILLIKIN. That has a very serious impact on our ability to wage war, has it not?

Mr. WILLISTON. Very much so, and that is principally the reason I am here today.

Senator MILLIKIN. It puts us in the hands of foreign producers, does it not?

Mr. WILLISTON. Absolutely.

Senator MILLIKIN. Should not our whole national policy be built up as far as strategic minerals are concerned so that we can get the maximum possible production?

Mr. WILLISTON. I certainly believe so.

A subdivision of this group is even more interesting. Exploration for strategic metals has declined by 96 percent; exploration for precious metals has declined by 90 percent; exploration for the critical metals—copper, lead, and zinc—has declined by 57 percent; while the average of all of these has declined by 74 percent.

Why, if the exploration and development picture is so bad, is metal production so high and why are the profits of some of our larger corporations so considerable? The answer is not difficult. Large known metal deposits developed under prewar costs are now being turned into dollars, but into 1950 depreciated dollars. If endeavor is made to replace those reserves under present costs and subject to present taxes, it would be almost impossible to show any profit commensurate with the risk.

Senator MILLIKIN. Is it not true that we are working on known reserves, that, roughly speaking, we have not opened new reserves commensurate with the use that we are making of our existing products?

Mr. WILLISTON. As far as new mines are concerned, we have opened almost none in the last 5 years. There are few exceptions to that.

Senator MILLIKIN. The older mines are working on their known reserves and are exploring their present diggings to find some more?

Mr. WILLISTON. The immediate area right around where they are.

Senator MILLIKIN. In other words, they are eating up their own fat.

Mr. WILLISTON. That is right.

Additional information from our western mining States is available. In the State of California, according to Mr. Averill of the California Division of Mines, the number of operating underground metal mines declined by 76 percent in the period from 1940 to 1949.

According to the California Division of Labor Statistics, the number of miners employed in metal mining in California between 1940 and March of 1950 has declined by 72.3 percent.

In Utah, one of our largest mining States, according to James K. Richardson, secretary of the Utah Mining Association, the number

of shipping mines in Utah declined 89 percent in the period 1940 to February 1950.

Senator CONNALLY. What do you mean by shipping mines?

Mr. WILLISTON. Those are mines producing ore and shipping to a smelter.

In Oregon, according to Fay W. Libby, director of the State department of geology and mineral industries, the number of underground producing lode mines declined by 95 percent from 1940 to May 1950.

In Nevada, according to A. E. Bernard, inspector of mines, the number of underground lode-mining operations declined by 62⅔ percent between 1940 and early 1950. It is believed that these States are representative and that other mining States would show similar declines.

Of the mining engineers consulted, not a single one could recommend investment either to their company or to their clients in a new property under present conditions unless that property was most exceptional. If our leading engineers cannot recommend exploration and development, little exploration and development will be carried on.

The primary cause of this lack of exploration and development activity within the United States is almost universally attributed to a Federal tax structure which permits insufficient return to the investor to justify the risk involved. The second cause is a tariff structure which prevents American mines with high-cost labor from competing with foreign imports. While dollar revaluation was most important to the precious metal mining group, it is interesting to note that only 7 percent of the engineers contributing to the study felt that differential premium prices would be of value to the mining industry.

In comparing the Federal tax structure with that of Canada, the following is of value. In the United States, annual depreciation rates range from 5 to 14 percent; in Canada up to 30 percent, with no requirement to charge off depreciation in excess of profits. In the United States, the corporate tax rate is 38 percent; in Canada 33 percent. Percentage depletion to the shareholder in the United States, none; in Canada 20 percent. Credit for corporate taxes to the shareholder in the United States, none; in Canada 10 percent. Exemption from taxation of new mines in the United States, none; in Canada, 3½ years. Capital-gains tax in the United States, 25 percent; in Canada, none. Mine labor costs in the United States, high; in Canada, appreciably less. Preproduction costs in the United States, capitalized; in Canada, expensed.

Senator MILLIKIN. Does that not have the effect and is that not deliberately desitned to have the effect, as far as gold is concerned, to increase the price of gold in Canada?

Mr. WILLISTON. I did not mention gold. There is an extra $4 premium for gold in Canada.

Senator MILLIKIN. So, they are using the tax structure to give them a distinct advantage on gold.

Mr. WILLISTON. The study of these facts leads to the almost inescapable conclusion that, unless Federal taxes as applied to mining are revised and unless tariff policies are changed, we can expect a continued decline in domestic mining, a decrease in Federal tax receipts from the metal mining industry, and eventually dependence

upon foreign sources for many, if not all, of the metals used in American industry.

The Mining and Metallurgical Society therefore urges that the recommendations of the National Minerals Advisory Council of the Department of the Interior be adopted and included in the present tax bill.

I would like to add one more point. The recommendations of the Advisory Council had to do with the encouragement of exploration and development.

In the present tax bill, section 209, having to do with capital gains and capital losses, would, in effect, increase the cost of unsuccessful exploration by approximately 80 percent. At the present time, as you know, individuals are not engaging in exploration and development in mining. Small corporations find it most difficult to charge off losses against gains. And what little exploration is being carried on is being carried on by the larger corporations.

In the event section 209 is included, that will stop exploration by the larger corporations.

I have one example, from Idaho, where one of the larger companies is contemplating a million-dollar expenditure for exploration and development of primarily zinc and lead, which we need, and in the event section 209 remains in the tax bill, I gather that they will not go ahead.

Senator MILLIKIN. Mr. Chairman, I would like to congratulate the witness on as cogent a summarization of the plight of the mining industry as I have heard.

Many people outside of the Western States have thought we were seeing devils under the bed when we were talking about these misfortunes that have befallen the industry. It emphasizes that we are talking about something that has happened, and not something that is going to happen in the future.

Senator MARTIN. Mr. Chairman, might I ask a question?

The CHAIRMAN. Yes, Senator.

Senator MARTIN. On the first page, in the next to the last paragraph where you are discussing the iron mining industry, Mr. Williston, you state that the increase since 1940 is an average of 50 percent. Is that all within the United States, or does that include some exploration outside of the country?

Mr. WILLISTON. No; I believe that 50 percent, since it was for men within the country, and we distinctly asked them not to take into account operations in Canada or Brazil, largely has to do with the taconite explorations on the Mesabi.

The CHAIRMAN. We thank you very much, sir.

Senator MARTIN. I would like to also add my complimentary remark. I think this is a very wonderful document.

Mr. WILLISTON. Thank you.

I wonder if I might be permitted to add a little more detail on some of these figures, which I left out because I wanted to keep it down to less than the 10 minutes you allowed me.

The CHAIRMAN. Yes, sir. You may do so.

Thank you for your appearance, sir.

Mr. WILLISTON. Thank you, Mr. Chairman.

(The following material was submitted for the record:)

COMPILATION OF REPORTS OF MINING ENGINEERS OF THE MINING AND METALLURGICAL SOCIETY OF AMERICA ON EXPLORATION AND DEVELOPMENT OF NONFERROUS METALS IN THE UNITED STATES

The mining engineers who participated reported an average decrease of 95 percent in exploration and development for nonferrous metals. Twelve percent reported almost complete cessation, while 5 percent reported exploration has slightly increased or the same as before the war. For the base-metal industry (copper, lead, and zinc) these figures were 93 percent decline, a 7 percent increase and only a 2 percent report of almost complete cessation. It was interesting to note that the increase of 5 percent was confined entirely to open-pit copper developments.

For the precious metals (gold and silver), 100 percent of the reporting engineers reported a decline and 36 percent an almost complete cessation in their own particular districts.

For the strategic metals, 100 percent reported a decrease, while 50 percent reported complete cessation.

The average decline for the whole nonferrous metal mining industry where figures were given indicated a decline of 74 percent. For the base metals (copper, lead, and zinc) the decline was 57 percent; for the precious metals (gold and silver) 90 percent; for the strategic metals, 96 percent.

The cause of this decline, as reported by the various engineers, indicated as an average for the industry: taxes, 75 percent; labor troubles, 44 percent; increased costs, 42 percent; lowered prices, 32 percent; tariffs, 25 percent. For the base-metal industry, taxes were again high with 81 percent, labor second with 45 percent; lowered prices, 38 percent; increased costs, 36 percent; and lowered tariffs, 29 percent. For the precious-metal industry, increased costs, 82 percent; taxes, 73 percent; labor, 45 percent; and inflation, 36 percent. For the strategic metals, reduced tariffs, 50 percent; lowered prices, 50 percent; currency depreciation abroad, 50 percent; and taxes and labor each 25 percent. Not a single reporting engineer could recommend to his clients or to his company investment in exploration or development at the present time unless the prospect was most exceptional.

In comparison with the prewar years and the general health of the industry, 98.3 percent of the reporting engineers reported the nonferrous metal industry in worse shape than it was in 1940, as far as ability to produce was concerned. Thirty percent felt it was in a much worse condition, while only 1.7 percent felt that the area in which they were best informed was in better shape to produce than in 1940.

These figures as applied to the base-metal industry indicated that 98 percent felt it was in worse condition, 29 percent felt it was in much worse condition, and only 2 percent felt it was in better condition. It is interesting to note that in this case all reporting engineers were speaking of open-pit copper.

In the precious-metal group, all engineers reported that the industry was in worse shape, and 50 percent felt it was in much worse shape.

In connection with the strategic metals, the report was identical with the report for the precious metals.

In asking the reporting members what they felt was necessary to put exploration and development in the nonferrous industry back on a sound basis, 97 percent of all engineers reported tax revision as the most important; 62 percent mentioned relief from labor difficulties; 53 percent thought increased tariffs or quotas were necessary; 18 percent were in favor of letting it alone; 14 percent suggested dollar revaluation; and only 7 percent were in favor of differential subsidies.

For the base-metal industry 98 percent thought tax revision necessary; 72 percent relief from labor difficulties; 62 percent an increase in tariffs or quotas; 19 percent wished to be left alone; and 5 percent felt that dollar revaluation or differential subsidies would be helpful.

For the precious metals, 91 percent thought tax revision necessary; 55 percent desired dollar revaluation; 45 percent relief from labor difficulties; while 18 percent thought the industry should be let alone.

For the strategic metals, all reporting engineers favored tax revision and an increase in tariffs or quotas, while half thought differential subsidies advisable to maintain the industry.

Members of the Mining and Metallurgical Society participating in this survey included a great number of our leading mining engineers. Unfortunately, however, more than half requested that their names not be used. In some cases and

possibly in many, it may have been because of the policies of the companies by which they were employed. For this reason, the names of the members contributing to the report are not included.

The information contained in the above compilation was accumulated during March and April 1950.

S. H. WILLISTON,
Chairman, Tax Committee, Mining and Metallurgical Society of America.

HECLA MINING CO.,
Wallace, Idaho, July 5, 1950.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee, Washington, D. C.

DEAR SENATOR GEORGE: We have made an examination of the revenue bill of 1950, H. R. 8920, and must call your attention to section 209 (b), which would amend code section 117 (j) by providing that losses as well as gains from the sale or exchange of property used in the trade or business shall be considered as gains and losses from the sale or exchange of capital assets.

The bill also proposes a new subsection under section 209 (b) which would provide that the abandonment of a capital asset or of property used in the trade or business (as defined in subsection (j) without regard to the last sentence in paragraph (1) thereof) shall be considered as a sale or exchange of such asset or property.

The effect of these proposed amendments on the mining industry, if enacted, would be that neither a mining corporation nor an individual could deduct losses on expenditures for exploration and development of unsuccessful mining properties against ordinary income from mining operations, since such losses would be treated as capital losses and could be deducted only against capital gains.

Since a capital gain is quite unusual in a mining corporation, the taxpayer would, in the great majority of cases, derive no tax benefit whatosever from such a loss. In fact, we have checked the records of the Hecla Mining Co. and find that during the past 15 years this company has had no capital gains of any consequence against which a capital loss could have been taken.

During this period, we have expended nearly a half million dollars for exploration and development of mining claims which turned out to be failures. Had this proposed amendment been in effect during these years, the company would have realized no tax benefit from the losses suffered.

When we realize that probably not more than one out of 100 prospects ever develops into a profitable mining operation, it is obvious that the proposd amendment would practically kill any incentive toward the exploration and development of much needed new mineral deposits.

It is common knowledge that excessive tax rates have already greatly curtailed expenditures for exploration of much needed new mineral deposits, to replace presently known ore reserves as they become exhausted.

Certainly, it would not be wise to further hamper the mining industry with an amendment that proposes to disallow the many losses incurred by the taxpayer in his search for new mineral deposits on the one hand, and yet tax any profit he might realize from an occasional successful venture.

The Hecla Mining Co. is in the process of closing a deal whereby it is anticipated that about one million dollars will be expended in this area for the exploration and development of a group of mining claims. Certainly, we cannot go ahead with the negotiations until we are assured that this proposed amendment will not be approved.

We would appreciate hearing from you in regard to the above, and will be only too glad to furnish you additional information.

Yours very truly,

L. J. RANDALL, *Comptroller.*

The CHAIRMAN. Is Hon. Wesley Disney here? He is not present but his statements will be inserted in record of hearings at this point.

(The statements of Mr. Disney follow:)

STATEMENT OF WESLEY E. DISNEY, GENERAL COUNSEL, INDEPENDENT NATURAL GAS ASSOCIATION OF AMERICA

My name is Wesley E. Disney. I am general counsel for the Independent Natural Gas Association of America. The membership of the association is engaged in the oil and gas industry and in the natural-gas pipeline business.

The object of this appearance is to register the objection of the membership of the association to section 209 (d) of H. R. 8920, now under consideration by your committee.

If enacted into law, 209 (d) would have a most serious effect upon the oil and gas industry. It would in the long run result in a loss of revenue to the Government. Its adverse effect on the industry and on its ability to supply the Nation's needs for the fuels involved would shortly be demonstrated, if such a business impediment were placed in the path of the industry, thereby endangering our national security. Section 209 (d) would result in a tremendous loss of business to the industry by adversely affecting the consumers of oil and gas.

In other words, section 209 (d) would accomplish no good purposes, but its evil effects are apparent now to those experienced in the oil and gas industry and would soon become evident to everyone.

This section is nothing less than a legislative fiat, technically changing the "abandonment" of a "capital asset" to a "sale or exchange" of such an "asset or property"—an unnatural treatment of the subject and a distortion of the realities of the situation.

Under such a theory the taxpayer, notwithstanding the fact that he has a bona fide loss, would be compelled to make a profit on capital gains transactions in order to get credit for his losses, even though he were driven to the extent of unwillingly selling property that his business requires him to keep. Because, under no circumstance, with this provision as law, can he get credit for his bona fide losses except by balancing them against naturally acquired capital gains or capital gains artifically created.

The oil and gas industry expends huge amounts of capital for leases, geological and geophysical development, and other elements of this business. The tremendous proportions which this activity assumes is illustrated by the testimony of other witnesses in this hearing to the effect that hundreds of thousands of leases turn over annually and that millions of acres of land in the United States are now under lease for oil and gas development. The annual abandonment of oil and gas leases, determined for business reasons to be valueless, occurs on a large scale. This is the rule. It represents actual losses in the business, for after it has been determined by exploration and testing that a lease is valueless it is not sound business to retain it and to pay annual rentals on it. Consequently, these thousands of acres of leases are abandoned annually. These abandonments represent ordinary business losses of actual capital expended, not only for the leases but for geological and geophysical developments and the other costly incidents to the acquisition and maintenance of the leases.

As I have said, this is the rule, the ordinary conduct of the business.

Capital gains by the industry is the exception, only occasional and incidental to the general conduct of the business. This industry is not engaged, generally speaking, in making capital gains but is engaged in the production of oil and gas for sale to the public.

These lease abandonments are in fact ordinary business losses. They are not abandoned unless they are determined to be valueless. To our mind to make the "abandonment" of these leases "sales or exchanges," is a long stretch of the legislative imagination and will not bear the test of practical reality.

The effect of this section would permit these actual losses to be chargeable against ordinary income only by balancing them against capital gains.

Even the most cursory examination of the history of the sixteenth amendment proves that when the people adopted that amendment they gave the Congress the right to tax income from whatever source derived. Real income, not simulated income. The basic concept of the sixteenth amendment is net income. The people gave Congress no right to tax gross income nor by ingenious classification to make gross income appear as net income. In the ordinary course of business taxpayers must deduct business losses from business income in order to arrive at their net income. The abandonments of oil and gas leases constitutes the run-of-the-mine losses incident to business, deductible as ordinary losses from the business income. Classification of "abandonments" as "sales or exchanges" would be technically fictitious, an artifical imitation of net income, which under

the circumstances described, is actually an attempt to tax gross income. The result would be futility and discouragement rather than incentive on the part of the industry affected

We cannot believe that the Congress would knowingly intend to stray so far from the basic concept of net income as section 209 (d) would lead it.

STATEMENT OF WESLEY E. DISNEY ON BEHALF OF NATIONAL BUILDING GRANITE QUARRIES ASSOCIATION

Section 204 of H. R. 8920 provides a percentage depletion allowance of 5 percent for granite. This committee last year reported favorably the bill H. R. 5268 which provided an allowance of 15-percent percentage depletion for granite, but in conference it was agreed to eliminate the percentage depletion features of that bill in the interest of expediency. We are not informed as to why the Ways and Means Committee allowed 5 percent for granite rather than 15 percent which was recommended by this committee last year, but I rather think it was because of an error in classifying granite with the other types of materials and minerals which were accorded 5-percent depletion by H. R. 8920.

We do not wish to impose on your time by going into detail as to why the granite producers feel that they are entitled to a 15-percent allowance. A comprehensive statement was made before the Ways and Means Committee on this subject. Suffice it to say that the granite industry has been in great economic distress for some years and the materials which are competitive with granite are now receiving a 15-percent allowance.

I request that this committee give consideration to increasing from 5 percent to 15 percent the allowance recommended by the Ways and Means Committee and passed by the House.

STATEMENT OF WESLEY E. DISNEY REGARDING CLARIFYING AMENDMENTS TO SECTION 204 OF H. R. 8920

Mr. Chairman and members of the committee, I am appearing today in behalf of the producers of certain nonmetallic mineral products to suggest clarifying amendments respecting percentage depletion. I am not here asking an allowance for any new minerals. All of the minerals which I expect to mention now receive a percentage depletion allowance or are included in section 204 of H. R. 8920 passed by the House.

The first suggestion for your consideration concerns potash, trona, borax, and thenardite. I suggest that the parenthetical clause (lines 18–19, p. 51 of the bill), which reads: "(including thenardite from brines or mixtures of brine)" be changed to read: "(including potash, trona, borax, or thenardite from brines or mixtures of brine)."

This will require a rearrangement of the order in which the various items are listed so that the words "potash, trona, borax, thenardite" immediately precede the parenthetical clause.

The commercial producers of these minerals fear that under the language of H. R. 8920 there is danger of Bureau interpretation which will defeat the purposes of Congress in granting the allowances. In one case with which I am familiar, one company produces all four of these commercial mineral products from brines or mixtures of brine. Some of these minerals are also produced by conventional mining methods. I don't believe it was the intention to discriminate against the method of operation in granting the allowance originally, nor do I believe it is the committee's intention to encourage the Bureau to discriminate among the producers. This suggested amendment does not alter the substance, but is designed to remove any ambiguity in the wording so that potash, trona, borax, and thenardite are accorded the allowance regardless of whether produced from brines or mixtures of brine or by the conventional mining methods.

The second suggestion for your consideration concerns the commercial mineral, talc. The parenthetical phrase which follows the word "talc" should be eliminated and a comma placed after the word "talc" followed by the word "pyrophyllite." This error has caused considerable controversy with the Bureau since finding its way into the statute in 1947. Talc and pyrophyllite are two separate mineral products seldom found associated in nature. Talc is a mineral compound which varies widely in chemical and physical proportion but is predominately a magnesium silicate, while pyrophyllite is predominately an aluminum silicate.

Talc has many industrial uses but there is little or no market for it in its crude form. It must be crushed and ground before it can be sold. To eliminate any further controversy with the Bureau, I suggest that section 114 (b) (4) (B) of the Internal Revenue Code which defines ordinary treatment processes be amended by inserting "talc" after the word "potash" in subsection (iv) so that talc will be listed among those ores which are not customarily sold in the form of the crude mineral product. Just as in the case of copper, fluorspar, and other ores, talc has no market until after the ordinary crushing and grinding processes have been applied. While talc was obviously intended to be included in the phrase "and ores which are not customarily sold in the form of the crude mineral product," the Bureau has insisted that the failure to list talc by name in this subsection effectively eliminates the ordinary crushing and grinding in calculating a producer's gross income.

The last suggestion which I submit for your consideration deals with the so-called technical amendment made by the Ways and Means Committee to section 114 (b) (4) (B) of the Internal Revenue Code relating to the definition of gross income from the property (lines 17–18, p. 52). According to the committee report this amendment was designed to be "merely declaratory of existing law" with respect to transportation. Careful study indicates to me that this amendment not only is contrary to existing law and to existing Treasury regulations, but that it might be subject to Bureau interpretation which would severely affect the ordinary treatment processes of producers. It is my understanding that this matter has or will be discussed in detail by a representative of the American Mining Congress.

Senator CONNALLY. Mr. Chairman, I have a witness here, Mr. Byron Skelton, from Temple, Tex. He will be very brief, but he wants to testify with regard to the tax on hospitals and related subjects.

The CHAIRMAN. Come around, Mr. Skelton.

STATEMENT OF BYRON SKELTON, TEMPLE, TEX., REPRESENTING SCOTT AND WHITE HOSPITAL

Mr. SKELTON. Mr. Chairman and members of the committee, my name is Byron Skelton. I live at Temple, Tex., and represent Scott and White Hospital, which maintains a clinic and hospital at Temple.

I want to speak to you briefly about the so-called lease-back provisions of House Resolution 8920 insofar as they affect exempt hospitals, clinics, and medical institutions, such as research and scientific medical organizations.

Many exempt hospitals and medical institutions throughout the country lease some of their facilities to physicians, for diagnostic clinics, treatment centers, and research and educational purposes. This bringing together of the closely related elements of medical practice, medical research, and hospital care is salutary and greatly increases the ability of those institutions to serve the public.

In order to provide the necessary facilities, hospitals must frequently borrow money. As presently framed, the bill would tax rentals received for such facilities, to the extent of the money borrowed to provide them. The general objectives of title III, to eliminate unfair competitive advantages and prevent tax evasion through so-called lease-backs, are laudable. However, a lease by a medical institution to physicians is not in the undesirable category, and should not be so classified, whether or not the institution finds it necessary to borrow money to provide the facilities. The bill as it stands would prevent vitally needed expansion of hospitals and other medical facilities.

When exempt hospitals and other exempt medical institutions lease their facilities to physicians, the rental should be treated for tax purposes as what it is in fact, namely, related income.

The proposition simply is this: Exempt hospitals and medical institutions acquire their facilities usually, their buildings and other facilities, by borrowing money; and then they lease portions of these facilities, usually clinic facilities, to practicing physicians and doctors and surgeons for rent, and out of this rent they pay for these buildings which they have built with this borrowed money.

Under the bill as it is now written, that sort of an arrangement, whether they borrow the money from a loan company or whether they buy these properties from physicians and surgeons who may own it, and then pay them for it out of the money received from these doctors as rent, is made taxable. It will, in our opinion, prevent these great medical hospitals and clinics and institutions from expanding and building buildings and acquiring facilities adequate to further their charitable purposes.

We have suggested here, and we now suggest, a simple amendment of just six lines, to section 423 of the bill, which deals with the supplement U lease; in other words, the lease-back arrangement. This simple amendment says, in substance:

> * * * but such term—

that is, the supplement U lease—

> shall not include a lease by an organization the principal purposes or functions of which are medical education or research, or the providing of medical or hospital care, to any lessee whose trade or business is substantially related to the exercise or performance of the purposes or functions of the lessor.

In other words, in the case of the lease from an exempt medical institution of a part of its property to a group of practicing physicians and surgeons, the income as rent from such a lease would be treated as related income of the leasing institution, and would therefore be tax-exempt.

Senator CONNALLY. Mr. Chairman, in connection with this, I would like to hear from Mr. Stam very briefly. He has been investigating this phase.

Mr. STAM. (Colin F. Stam, chief of staff, Joint Committee on Internal Revenue Taxation.) We have looked into that matter, and I think we can prepare something that would take care of this problem.

The CHAIRMAN. It would not be exempt under rents and royalties, Mr. Stam?

Mr. STAM. No; because the property was acquired with borrowed funds, don't you see. I think, though, we can take care of that without interfering with the other provisions.

Mr. SKELTON. Thank you, sir.

Senator CONNALLY. You are the only one who represents that group?

Mr. SKELTON. Yes, sir.

Senator CONNALLY. It is not necessary, then, to have that other witness?

Mr. SKELTON. No, sir.

Senator CONNALLY. Is Mr. J. Rutledge Hill here?

Mr. Chairman, this is Mr. J. Rutledge Hill, of Dallas, Tex., who wants to talk about depletion of sand gravel and correct some statements that he says the Secretary of the Treasury made under a misapprehension of the facts.

The CHAIRMAN. You may come around, Mr. Hill.

STATEMENT OF J. RUTLEDGE HILL, DALLAS, TEX., APPEARING AS CHAIRMAN, COMMITTEE ON TAXATION, NATIONAL SAND AND GRAVEL ASSOCIATION

Mr. HILL. Thank you, sir.

Mr Chairman and gentlemen of the committee, I come before you as chairman of the Committee on Taxation of the National Sand and Gravel Association, who represents the big part of the production of sand and gravel in these United States.

There are people who probably don't recognize the importance of sand and gravel. Let me say to you that nothing is built without its use. The sand on the seashore is utterly worthless to this industry. All the gravel on the hillsides which might have been scooped up has long since been scooped up and used for something useful.

The rate of production of our industry at this time is far beyond the peak of the war years. The demand is growing stronger and bigger every day. Our costs of exploration are advancing, and they are tremendous.

I have in my hand two pictures of an exploratory rig we use.

We are in the position of the man who has had his throat cut and who is bleeding to death. We need a transfusion; not 5 percent, but 15 percent. Five percent is not enough, gentlemen, because in many instances cost depletion is far greater than 5 percent.

If the sand and gravel industry is to survive and to continue in business, we must explore and discover new deposits, acquire them and develop them, which will take substantial sums of money.

We believe that the sand and gravel industry is a most important industry, and it is worthy of your consideration. We pray you, gentlemen, that you will give us a depletion percentage allowance of 15 percent. We believe we are entitled to it. We believe we can qualify. And we want to impress upon you again our dire need and the importance of our industry.

Bear in mind, gentlemen, that you do not build anything that does not have a foundation; and when you put in a foundation you use sand and gravel.

Gentlemen, I thank you.

Senator CONNALLY. Just a minute. You were talking about processing sand and gravel. What do you do? Just go out and scoop it up and bring it in?

Mr. HILL. Senator Connally, will you let me start at the beginning?

Senator CONNALLY. Well, do not go back too far.

Mr. HILL. We take this rig I showed to you in the picture and find out where there is sand and gravel. That is an oil drilling rig, for your information.

Senator CONNALLY. You go out and bore for sand and gravel?

Mr. HILL. Yes, sir.

Senator CONNALLY. Now, explain that to them. They want to know why you want to have this depletion allowance. They want to see if you do anything to earn it.

Mr. HILL. Well, we go out with this oil drilling rig, and we bore holes all over an area, and we determine the presence of sand and gravel. At the same time we determine the characteristics, the size, the gradation, whether there is foreign material in it, the depth, and the quantity. Once we have determined that, we acquire the property.

Senator CONNALLY. First, though, before you get to acquiring it, you determine whether or not the deposits that you have found are sufficient to justify it, do you not?

Mr. HILL. Yes, sir.

Senator CONNALLY. Well, bring that out.

Mr. HILL. If we find that there is sufficient sand and gravel to justify the acquisition and the possible marketing of it, we acquire the property, and we erect a processing plant, which consists of crushing, washing, sizing, screening, grading, and recombining, to form the particular material that the architect or the engineer may specify for a given job. There are certain sizes, small to large, and they must be uniformly graded from small to large; and then the sand must be clean, sharp, well graded, from the 200 mesh sieve, which, by the way, is so small that water won't go through it, up to a quarter inch.

When all that preparation has been made, it is then loaded on to a vehicle for delivery to the user.

Now, in the extraction of the sand and gravel from the soil, we remove 5, 10, 20, or 50 feet of overburden, and then, by use of draglines, hydraulic dredge, or whatever is the best and most economical method, we remove that material from the ground, transport it to the plant, and process it, and it goes on to the user.

The CHAIRMAN. Is your plant generally connected with the gravel pits or the place where you mine it? Do you have to transport it any distance?

Mr. HILL. A relatively short distance, sir. The plant is always relatively close to the point of processing.

The CHAIRMAN. In the case of sand and gravel, you say that is true always?

Mr. HILL. In the case of sand and gravel; yes.

The CHAIRMAN. But there is some transportation cost there, is there?

Mr. HILL. In getting the raw material from the point of extraction to the processing plant.

The CHAIRMAN. It is necessary to get it to this processing plant and take this step in processing it in order to make it marketable?

Mr. HILL. That is correct, sir.

Senator MILLIKIN. You have to either bring the water to your deposit, or bring the deposit to the water, some place, to clean it; is that not right?

Mr. HILL. That is correct, Senator. Where you find a good gravel deposit, particularly in the section of the country I am connected with, it is always under water. In other words, you take the material up from under the water. And that water is usually available for washing; but, as explained by some gentleman before, you have the question of waste. You have to provide a place for the waste to go, and you may have to get off some little distance from the actual point of extraction.

Senator CONNALLY. Were you through, Senator?

Senator MILLIKIN. Yes, I am through.

Senator CONNALLY. When you drill down and find this sand and gravel, how do you get it out? Do you build a shaft down there to it?

Mr. HILL. Senator, we put down a casing, an oil well casing, and we have a hydraulic turntable, a rotary turntable, which has a hydraulic cylinder on it, and that hydraulic cylinder forces the casing

down. Then we put on the rig a bailer. You know what an oil well bailer is, a long tube with a flat valve in the bottom of it. You turn that baby up and down and pick up this sand and gravel, pull the bailer out, pour the water off the top, and then pour the gravel and sand out on the ground. Now, when you have gone to the bottom of that, you have re-created here on the ground an exact picture of what is under the ground. In other words, you can see what every foot of the deposit down here is and have a picture of it there before you. Do I make myself clear?

Senator CONNALLY. If you keep on doing that, do you get it out?

Mr. HILL. No; that is for the testing.

Senator BUTLER. That is just for survey.

Senator CONNALLY. But after you have tested and found out what you have down there, how do you bring it up? Do you build a shaft down to it?

Mr. HILL. No, Senator; we commonly use a big dragline. In other words, we perform the same operation as in the strip mine, in coal.

Senator CONNALLY. You said you may go down 50 feet?

Mr. HILL. That is right. We use a hydraulic dredge when we go down that deep.

Senator BUTLER. Do you have to remove the surface?

Mr. HILL. Yes; we have to remove the surface, usually by means of hauling it away, or by a big dragline, and casting it over out of the way, and following up with a hydraulic dredge.

Senator MILLIKIN. Am I not correct in this: that that is one particular type of mining sand and gravel, but that many sand and gravel deposits are old river beds, which in time were left high and dry, and in that sort of a case you have a dry operation, and they have to take that stuff and remove it to some place where there is water to clean it up?

Mr. HILL. That is correct, Senator, in some sections of the country.

The CHAIRMAN. Are there any other questions?

Senator CONNALLY. Do you have anything else, Mr. Hill?

Senator MARTIN. You do not have any places where you can go along a river bank or a small stream bank, where you can take out the gravel and sand and clean it without excavation, do you?

Mr. HILL. There were once places like that, but they are long since gone. That is, in marketable areas, there may be some small places where that exists today. But generally I would say that doesn't exist any more, because those have all been gone.

In other words, we are approaching the exhaustion of all known deposits, and we are frantically searching for new deposits. The search has become very intense. To show you, we are removing as much as 50 feet of overburden now, to recover sand and gravel.

Senator CONNALLY. Anything else, Mr. Hill?

Mr. HILL. I wish to thank the committee sincerely for having heard my story.

The CHAIRMAN. Well, sir, we thank you for appearing.

Senator BUTLER. Mr. Chairman, do you have any other witness?

The CHAIRMAN. I am going to ask now:

Is there any other witness who wishes to appear this afternoon?

Senator BUTLER. I have a five-page statement here from Mr. John E. Shea, which he wants to submit for the record on behalf of the

Southern Pacific Co., which has to do with the proposed amendment to provide equitable treatment for losses upon the sale or exchange or abandonment of business property, which I think has been covered by some of the witnesses.

The CHAIRMAN. Sections 209 and 117 (j) yes.

That will be received.

(The statement referred to follows:)

STATEMENT OF JOHN E. SHEA ON BEHALF OF SOUTHERN PACIFIC CO.

Section 117 (j) of the Internal Revenue Code applies to gains and losses from sales or exchanges of certain property used in the trade or business and capital assets held for more than 6 months. When such sales result in profit, the profit is taxed at rates applicable to long-term capital gains. When the sales result in a loss, the loss is allowed in full against ordinary income. Referring to the tax treatment of such sales and exchanges, the Secretary of the Treasury in his recent testimony before the Senate Finance Committee on the proposed Revenue Act of 1950, H. R. 8920, stated:

"This inconsistency and the resulting prejudice to the revenue can be eliminated either by treating both gains and losses as ordinary income and loss or by treating them both as capital transactions;"

H. R. 8920 as passed by the House of Representatives includes an amendment making gains and losses from sales or exchanges of business property—under section 117 (j) of the code—capital gains and capital losses. Furthermore, the House of Representatives in section 209 (d) of H. R. 8920 inserts a new provision (sec. 117 (1) of the code) providing that the abandonment of a capital asset or of property used in the trade or business (excepting timber) shall be considered as a sale or exchange of such asset or property and therefor losses on abandonment shall be subject to capital-loss restrictions.

This is particularly detrimental to railroads. Railroads are under the regulation of the Interstate Commerce Commission. The accounting regulations prescribed by the Commission are made mandatory by section 20 (5) of the Interstate Commerce Act. For tax purposes practically all class I railroads account for their roadway properties partly under the retirement method of accounting and partly under straight-line depreciation method. This is expressly authorized by the Commissioner of Internal Revenue. It is estimated that approximately 40 percent of railroad roadway properties are subject to retirement accounting. Under retirement accounting no depreciation charges are made against any asset so long as it remains in service but in the year of retirement the entire original cost (less salvage) is charged as an expense in the year of retirement.

It is submitted that in properly determining net income derived from the operation of a business, it is elemental that all operating costs and expenses must be determined and deducted from gross income in order to properly reflect actual net income. The consumption of business capital represented by exhaustion, wear and tear of properties used in business, commonly referred to as depreciation is universally recognized as an operating cost When an asset acquired for use in a business ceases to be useful in that business and is retired and abandoned, the loss occasioned thereby is properly attributable to the business and constitutes an operating cost directly chargeable against the profits of the business. The right of the taxpayer to a deduction for exhaustion, wear and tear of assets used in the business is expressly recognized by the Internal Revenue Code. The code, however, does not provide any terms for any particular method of accounting for the purpose of determining the amount of such deduction. The statute merely provides that a deduction will be allowed in the amount of a reasonable allowance for exhaustion, wear or tear of property used in the trade or business including a reasonable allowance for depreciation.

It has been uniformly held by the courts, the Board of Tax Appeals, and the Commissioner of Internal Revenue that by the use of the retirement method of accounting a company can reflect its loss from depreciation with adequate accuracy and that the use of such system is a proper means for determining the amount of the reasonable allowance authorized by section 23 (i) of the code and results in a clear reflection of income. Under the rulings of the Bureau of Internal Revenue net income of railroads is required to be computed in accordance

with "methods of accounting regularly employed," provided such method clearly reflects income and this requirement is satisfied by the retirement method of accounting. Under these circumstances, section 117 (1) would be discriminatory against railroads depriving them of allowance for exahustion on properties subject to retirement accounting which would be allowable to taxpayers solely on a straight-line depreciation basis.

If any change is to be made in the present section 117 (j) of the code covering losses on the sales or exchanges of property used in the trade or business, it is submitted that the section should be changed to provide that such gains or losses should be ordinary gains or losses. The Secretary of the Treasury indicated in his statement that this would result in savings to the revenue equivalent to that accomplished by the House amendment. This is consistent with one of the fundamental principles underlying Federal income taxation and is consistent with the recommendation of the Ways and Means Subcommittee made in 1938 after making an exhaustive study of the subject. This was agreed to by the Senate Finance Committee in 1938.

The new section 117 (1) of the code inserted by section 209 (d) of H. R. 8920 provides for the thoroughly unjust, unrealistic, and discriminatory provision that abandonments of property used in the trade or business should result in capital gains and losses. It is contended that abandonment of property used in trade or business should result in ordinary gains and losses and not in capital gains and losses. It is submitted that H. R. 8920 should be modified to accomplish this result.

There is another point which we believe may have been overlooked.

Whether a taxpayer is on a retirement basis, a depreciation basis, or a combination retirement and depreciation basis, the taxpayer is entitled, upon abandonment of an obsolete item, to a deduction for special obsolescence. It is believed that under section 209 (d), upon abandonment even of an item which is being depreciated, the taxpayer would not be entitled to special obsolescence. The loss to the taxpayer upon abandonment would be subject under section 209 (d) to capital-loss restrictions. This would stamp a fundamental defect on our Federal income-tax system which would be detrimental to our business economy.

It is urgently suggested that H. R. 8920 be amended to provide equitable treatment for losses upon the sale, exchange, or abandonment of business property. This may be done by making gains and losses from such transactions ordinary gains and losses. This will, as Secretary Snyder has stated, eliminate "prejudice to the revenue" and will present an unwarranted burden on operating businesses.

Senator BREWSTER. Mr. Chairman, I have one statement by Frank H. Daggett, vice president and general manager of the Bangor & Aroostook Railroad Co., dealing with this matter of transportation to Canada.

Have you received evidence on that?

The CHAIRMAN. We have had reference to it.

Senator BREWSTER. This covers it in some detail. Senator McGrath and I last year presented a bill dealing with that, and this would be, I think, an amendment in form. The House considered it but found it very difficult to draft something.

I do not know whether Mr. Stam has looked into it or not.

Mr. STAM. We had transportation of persons under study in the House, and we did have a draft, but they finally eliminated it. I think the Treasury felt it would create some administrative problems, and they did not want to go ahead with it.

Senator BREWSTER. And was there anything dealing with freight transportation?

Mr. STAM. There was nothing on freight, but the matter has come up in this committee.

Senator BREWSTER. This refers to the whole subject

The CHAIRMAN. The statement will be received.

(The statement referred to follows:)

BANGOR & AROOSTOOK RAILROAD CO.,
Bangor, Maine, July 5, 1950.

Hon. OWEN BREWSTER,
Senate Office Building, Washington, D. C.

MY DEAR SENATOR: We here (as well as elsewhere in Maine and the areas adjacent to Canada) are very much concerned by the failure of the House to repeal entirely the 3 percent excise tax on the transportation of property, or properly to amend the taxing statute; the House has voted to reduce the tax to 1½ percent of the freight charges on transportation of property generally, and from 4 cents a ton to 2 cents a ton on transportation of coal. This excise tax is unpopular, a considerable nuisance to shippers and carriers, was enacted as a wartime measure, and should not be used as a peacetime revenue or taxing measure.

Most important of all, however, the original taxing law (still unchanged) is so written that the tax is readily avoided in some sections of the country. The tax revenue received by the United States is not what was intended (as generally seems to be understood), and the result is inequitable to the United States and among many competing shippers and consignees. Am enclosing copy of a letter written by the Commissioner of Internal Revenue to the Northwest Fish Traffic Committee, and also copy of an article which recently appeared in The Traffic World; these tell the story of legal evasion of the tax and the inequities and embarrassments which arise.

In its measure reducing the amount of the tax the House made no change in the language of the excise-tax law which would tend to eliminate the loss of tax revenue to the United States and the inequities and embarrassments. The tax is on "the amount paid within the United States" for the transportation of property; it would seem as if it was intended to tax the amount paid for transportation of property within the United States. Our general counsel has suggested that all this can probably be cured if the words "within the United States," which follow the words "upon the amount paid" (in the first two lines of sec. 3475 (a) of the Internal Revenue Code) be stricken out, and then the words "for transportation," (in the second line) be changed to read "for transportation between points within the United States,"; he also suggests that a further phrase might be added to provide that "amounts paid for transportation between points within the United States shall be paid only at a point within the United States." Such changes apparently would secure to the United States the tax revenue intended, and would eliminate the inequities and many embarrassments which result from the present wording of the taxing statute as interpreted by the Commissioner of Internal Revenue.

I trust that you will give this matter your usual thoughtful consideration, will refer it to the chairman of the proper committee or subcommittee, and use your good efforts to have the taxing statute amended (as it probably cannot be repealed) along the lines herein suggested.

Yours very truly,

F. H. DAGGETT,
Vice President and General Manager.

UNITED STATES TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, April 11, 1950.

NORTHWEST FISH TRAFFIC COMMITTEE,
Seattle, Washington.

(Attention: Mr. Fred H. Tolan.)

GENTLEMEN: Further reference is made to your letter of December 22, 1949, relative to the tax on the transportation of property imposed by section 3475 of the Internal Revenue Code.

You state that Senator Magnuson has furnished you a copy of the Bureau letter addressed to him under date of November 28, 1949, regarding the question of whether the tax would apply under a proposed procedure whereby freight bills rendered in the United States would be transmitted by the Northwest Fish Traffic Committee to its Vancouver bank which would pay the freight bills to the Vancouver agent of the carrier involved from a fund established by the committee in Vancouver for that purpose. In the letter of November 28, 1949, Senator Magnuson was advised, in part, that, based upon the facts presented, it is the opinion of the Bureau that the acts to be performed within the United States by

the persons incurring the transportation charges will constitute the making of payments within the United States for the purpose of applying section 3475 of the Internal Revenue Code, and such payments will therefore be subject to the tax imposed by that section.

You now request advice whether this tax would apply if freight bills rendered in the United States were physically taken from Seattle, Wash., to Vancouver, B. C., and paid in person direct to a railroad at Vancouver.

On February 10, 1950, in response to a letter dated February 6, 1950, from this Bureau, you submitted additional information regarding the nature and activities of the Northwest Fish Traffic Committee. In your letter you point out that the committee is not a shipper of fish; that it does not make payment for any transportation charge; and that the committee acts merely as a source of transportation information for its members. You state that the committee is a voluntary, nonprofit association. You do not explicitly state the method by which it is proposed to make payment for transportation, i. e., whether a representative of the committee will receive within the United States payments for transportation from the various members of the committee or whether an employee of each member will personally go to Canada and there make payment.

It is the opinion of the Bureau, that, if a bona fide employee of the actual shipper of fish goes to Canada in person and there makes payment for the transportation of property, the tax will not be owing on account of such payment in Canada.

Yours very truly,

FRED S. MARTIN,
Commissioner.

[From the Traffic World, June 24, 1950]

NORTHWESTERN SHIPPERS PAY FREIGHT BILLS IN CANADA, SAVE TRANSPORT TAX LEGALLY

Under a ruling by the Collector of Internal Revenue, shippers in the northwestern section of the country are able legally to save the 3-percent tax on freight shipments between points in the United States by making payment of freight bills in Canada.

The ruling was obtained last April by Fred H. Tolan, an attorney and traffic consultant of Seattle, Wash. Interviewed in Washington, D. C., Mr. Tolan said that the importance of the matter was not in the saving of the tax payments, but rather as a demonstration that "the tax is a burden and should be repealed."

At the Internal Revenue Bureau in Washington it was observed that the language of the statute levying the tax makes the tax payable on amounts paid within the United States, and that it was in accordance with this language that the ruling was made. The ruling was dated April 11, in United States Treasury Department file MT-M-CTD.

It was also pointed out at the Internal Revenue Bureau that the same question was involved last September when it became known that passenger tickets were being bought in Canada to avoid the 15-percent tax on such transportation. At that time George J. Schoeneman, Commissioner of Internal Revenue, issued a statement that the tax was due even if the persons buying passenger transportation mailed or telegraphed or sent cash, checks, money orders, or other funds to ticket offices, travel agents, etc., in other countries for the tickets, or if persons arranged with travel or transportation offices in this country for the furnishing of such tickets from a foreign address.

RULING MADE

The ruling of April 11 with reference to the tax on freight shipments was that if charges on freight shipments between points in the United States, which did or did not touch Canada en route from origin to destination, whether carloads or less than carload, were paid in Canada by a bona fide employee of the shipper or receiver or truck line involved in Canada, within the time limit for payment of the freight bill according to the credit rules of the Commission, that would be a legal avoidance of the 3-percent transportation tax.

Mr. Tolan said that payment should be made in United States funds, since there must be a payment of one-half of 1 percent extra to the carriers if cash or a check on a Canadian bank was used to make the payment, in order that the carrier may take the funds out of Canada. He also asserted that railroads or truck lines that had no facilities in Canada for receiving payments could offer no method legally

to avoid the tax. He said that payment of freight bills in Canada had become routine in the Northwest, and estimated that one large miller would save $100,000 a year, a large produce distributor would save $150,000 a year, and that others would save from $10,000 to $50,000 a year by avoidance of the tax on freight shipments.

Senator BREWSTER. I understand there has been a memorandum filed on the flavoring extracts.

Has that been filed, and is that in the record?

The CHAIRMAN. That statement was inserted in the record of Saturday, July 8.

Senator BREWSTER. I may want to file a supplemental statement, if permissible, and I will get it down tonight.

The CHAIRMAN. Yes, sir.

(The following material was submitted by Senator Brewster:)

BOWEY'S, INC.,
Chicago 10, July 6, 1950.

Re Revised revenue bill. Part IV. Occupational Taxes; section 141. Distilled Spirits Used in the Manufacture of Certain Nonbeverage Products.

Hon. OWEN BREWSTER,
Senator from Maine, Senate Office Building,
Washington, D. C.

DEAR SENATOR BREWSTER: The House of Representatives passed a revised revenue bill granting partial relief on ethyl alcohol taxes where they are used in medicines and medical preparations by amending section 3250 (5), reading as follows:

"(5) DRAW-BACK.—A draw-back at the rate of $6 on each proof gallon shall be allowed on distilled spirits tax-paid and used as provided in this subsection and be due and payable quarterly upon filing of a proper claim with the Commissioner, except that in the case of distilled spirits used in the manufacture or production of medicines or medical preparations the draw-back shall be at the rate of $7. No claim under this subsection shall be allowed unless filed with the Commissioner within the 3 months next succeeding the quarter for which the draw-back is claimed.

"(c) EFFECTIVE DATES.—The amendment made by subsection (a) shall be applicable with respect to all periods after June 30, 1950, and the amendment made by subsection (b) shall be applicable with respect to distilled spirits used after June 30, 1950."

We think this is indeed very unfair, and we ask that in place of section 3250 (5) amendment by the House, the following be substituted therefor:

"(5) A draw-back at the rate of $7 on each proof gallon shall be allowed on distilled spirits tax-paid and used as provided on this subsection and be due and payable quarterly upon filing of a proper claim with the Commissioner. No claim under this subsection shall be allowed unless filed with the Commissioner within the 3 months next succeeding the quarter for which the draw-back is claimed."

We do not think it fair or reasonable that there should be a differentiation between alcohol used for medicines and medical preparations, and those used in flavoring extracts and foods. You would have this very unreasonable situation set up if the present amendment becomes a law.

Some manufacturers of medicines also make flavoring extracts. A large number of us use alcohol only in the making of flavoring extracts for foods. Those firms who make medicines and medical preparations under this proposed amendment would only have to pay a net of $2 a gallon then on the alcohol they use in medicines and medical preparations, but would be supposed to pay a net of $3 a gallon on their other nonbeverage products using alcohol.

We are not insinuating that any firm we know of legitimately in business would "make mistakes" and use $2 alcohol in making products directly in competition with those of us who only make flavoring extracts, but there is the possibility that firms might make mistakes to the detriment of all legitimate manufacturers of flavoring extracts.

Why not inquire of the Internal Revenue Department to see what they think of this differential?

We don't see how they can very well enforce such an unreasonable amendment, so we ask that in place of the amendment to section 3250 (5) now in your hands

for perusal, you substitute the following, which we have already referred to in this letter, namely:

"(5) A draw-back at the rate of $7 on each proof gallon shall be allowed on distilled spirits tax-paid and used as provided in this subsection and be due and payable quarterly upon filing of a proper claim with the Commissioner. No claim under this subsection shall be allowed unless filed with the Commissioner within the 3 months next succeeding the quarter for which the draw-back is claimed."

Then all users of alcohol not for beverage purposes, whether the alcohol is used in making medicines or ingredients of foods, shall be classed alike and pay the same tax to the Government. In other words, we are in favor of getting an additional $1 draw-back, but don't think the medicine manufacturers should be favored over those using alcohol in foods.

We would appreciate hearing from you as to your attitude in this matter.

Respectfully yours,

W. H. HOTTINGER, Jr.,
Assistant Secretary.

The CHAIRMAN. Senator Thomas of Utah submits for the record a telegram from Mr. Cecil Fitch, president, Chief Consolidated Mining Co., of Utah, relating to section 209 and also to section 117 (j) and that may go into the record.

(The material referred to follows:)

UNITED STATES SENATE,
COMMITTEE ON LABOR AND PUBLIC WELFARE,
July 11, 1950.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
United States Senate, Washington, D. C.

DEAR SENATOR GEORGE: I have just received the enclosed telegram which comes from one of the substantial mine owners of Utah with reference to section 117 (1) of H. R. 8920.

I would greatly appreciate your consideration of Mr. Fitch's telegram and the problem that it poses to the mining industry. I request that it be made a part of the record of the proceedings held in connection with H. R. 8920.

With kindest personal regards, I am,

Most sincerely yours,

ELBERT D. THOMAS.

SALT LAKE CITY, UTAH, *July 10, 1950.*

Senator ELBERT D. THOMAS,
Washington, D. C.:

Referring to the 1950 tax bill, H. R. 8920, the inclusion of new section 117 (1) lines 3 through 8, page 65, may prevent the charging off of abandoned mine exploration to current income, providing instead charge-offs only against capital gains. Since mining companies rarely have capital gains, effect would be to eliminate opportunity to charge off any abandoned exploration. This would choke future exploration, which is lifeblood of the industry, and would perpetrate fraud with respect to present exploration begun in belief it could be charged off against current income if unsuccessful and abandoned. We urge elimination of proposed section 117 (1).

Further proposed change in section 117 (J), page 64, lines 1 through 18, would make losses on depreciable property or real estate deductible only from capital gains, again making such losses effectively nondeductible.

Since mining companies rarely have capital gains, this would tend to reduce rate of scrapping of obsolescent machinery and slow progress in productivity in the industry. We understand this change is proposed only to provide consistent treatment, and that treasury would agree to providing such consistency through making losses and gains of this type both chargeable to current income. We urge either retention of present 117 (J) or acceptance of treasury proposal.

We most urgently ask that you attend hearings on this bill Wednesday, July 12, as it is imperative that no further burdens be put on the zinc lead mining industry which is already practically collapsed under the present ones.

CHIEF CONSOLIDATED MINING CO.
CECIL FITCH, *President.*

The CHAIRMAN. I also have a statement from Mr. W. R. Emery, tax attorney for Armour & Co., on loss on the sale or abandonment of depreciable assets and other features of the tax bill.

(The statement referred to follows:)

STATEMENT OF W. R. EMERY, TAX ATTORNEY FOR ARMOUR & CO., CHICAGO, ILL.

I appreciate the opportunity to present for your consideration the views of Armour & Co., with respect to certain provisions of H. R. 8920 as passed by the House of Representatives.

1. LOSS ON SALE OF DEPRECIABLE ASSETS

Section 209 of H. R. 8920 in effect provides that any gain or loss on the sale or abandonment of depreciable assets or land used in a taxpayer's trade or business shall be treated as a capital gain or loss. This represents a radical departure from existing law which taxes such gains as capital gain and allows a deduction in full from gross income for such losses. The Ways and Means Committee felt that the special treatment now accorded such gains and losses was no longer necessary to stimulate the sale of business properties, and redrafted section 117 of the Internal Revenue Code to treat both the losses and the gains as capital transactions.

Whether the favorable treatment now accorded gains and losses from the sale or abandonment of depreciable assets used in a taxpayer's trade or business should be continued is a question for the Congress to decide and will depend largely upon whether it feels this principle of incentive taxation is needed to stimulate the sale of business properties in much the same manner that percentage depletion is needed to stimulate the production of certain oils and minerals. We hope that the Congress decides that incentive taxation is still needed in this field and will make no change in the existing provisions of section 117 of the Internal Revenue Code.

However, if the Congress decides that incentive taxation is no longer desirable in this field, and that the tax treatment of such gains and losses should be equated, we ask that any gain or loss on the sale or abandonment of depreciable assets be treated as ordinary income or loss. Our experience has shown quite definitely that on the whole our losses on disposition of depreciable business assets greatly exceed the gains, and since capital losses can only be offset against capital gains, the provision of section 209 of H. R. 8920 in their present form would deny us a tax deduction for a substantial part of such losses. We do not believe that the Congress intends this inequitable result.

Furthermore, any gain or loss on disposition of depreciable business assets ordinarily is attributable to errors in calculating the depreciation and obsolescence on such assets in the past. In effect then, such gain or loss represents an adjustment of depreciation and obsolescence charges in prior years; therefore the gains and losses on disposition thereof should be accorded the same tax treatment as depreciation and obsolescence charges, namely, as items of gross income and deductions therefrom. As a matter of fact, we believe this was the reason underlying the amendment in 1938 of the definition of "capital assets" to exclude therefrom "property used in trade or business, of a character which is subject to the allowance of depreciation." In its report on the revenue bill of 1938 the Ways and Means Committee stated that "gains or losses realized upon the sale, exchange, or other disposition of such (i. e., depreciable business) property are business gains and losses" and should be so regarded for tax purposes. We submit that this statement is equally true today and merits the same consideration in H. R. 8920 as it received in the revenue bill of 1938.

Therefore, if the committee deems it necessary to change the provisions of section 117 of the Internal Revenue Code, we respectfully request that gains and losses on sales of depreciable business assets be treated as ordinary income and loss.

2. INTEREST ON OVERPAYMENTS

Section 602 of H. R. 8920 would reduce the rate of interest on overpayments to 3 percent per annum effective November 1, 1950, but would continue the existing 6-percent interest rate on deficiencies. Since the inception of the income-tax law, the interest rates applicable to deficiencies and overpayments have remained the same. Undoubtedly there were and are strong policy reasons for reciprocity in this field.

While there may be justifiable reasons for reducing the interest rate on both deficiencies and overassessments, we wish to protest any differentiation in rates. The argument that the 6-percent rate is far out of line with the price which the Government generally pays for the use of money erroneously assumes that taxpayers are voluntarily loaning their money to the Government. Nothing could be further from the truth. No taxpayer in his right mind would deliberately overpay his tax, for he knows that claims for refund are always investigated and that the tendency of revenue agents is to try to offset the refund.

The inequality of the provisions of section 602 of H. R. 8920 is highlighted by the fact that an overpayment of income tax cannot be credited against a deficiency in income tax of the same taxpayer until the date of the assessment of the latter amount. Suppose a taxpayer reported an income item in 1950 which he should have reported in 1951. Upon examination, the revenue agent would find an overpayment for 1950 and a deficiency of the same amount for 1951 (i. e., assuming the tax rates remain the same). In all fairness, the taxpayer should be entitled in the net to 1 year's interest on the overpayment. However, section 3771 of the Internal Revenue Code, as amended by section 602 of H. R. 8920, would allow interest on the overassessment at the rate of 3 percent from March 15, 1951, to the date the deficiency was assessed for 1951, and would assess interest at the rate of 6 percent on the deficiency from March 15, 1952, to the date of assessment thereof. Because the period elapsing from the date of filing the return to the date of assessment of the deficiency may be from 1 to 10 years, this inequity becomes patently discriminatory—for example, in our own case the revenue agent has just completed his examination report for our 1941 and 1942 tax years.

3. EXTENSION OF PERIOD FOR REFUND IN CASE OF WAIVER BY TRANSFEREE

Section 322 (b) (3) of the Internal Revenue Code, as amended by sections 169 (a) of the Revenue Act of 1942 and 509 (a) of the Revenue Act of 1943, gives the taxpayer a correlative right to file a claim for credit or refund during the period the Commissioner is permitted to assess a deficiency by virtue of the execution of a waiver agreement under section 276 (b) extending the period of limitations for assessment of a deficiency. The theory underlying this provision is that, if the Commissioner is authorized to assess a deficiency, the taxpayer should have a reciprocal right to file a claim for refund. However, a transferee signing a waiver agreement under section 311 (b) (4) of the Internal Revenue Code extending the period of limitations for assessment of a deficiency against a transferee of a taxpayer is accorded no extension whatsoever for filing a claim for credit or refund, although the same policy should apply to both situations.

In 1945, I pointed out this omission to Mr. Colin F. Stam and Mr. Robert W. Wales, then tax legislative counsel for the Treasury Department. Mr. Wales informed me that the Treasury had contemplated according an automatic extension of the limitations period for filing refund claims to transferees as well as taxpayers when section 169 (a) was written into the Revenue Act of 1942, but that the inclusion of transferees had been abandoned because of an apparent lack of taxpayer interest, the time element, and some technical difficulties which were not at all insurmountable.

After receiving the approval of the Treasury Department and both the majority and minority members of the Magill committee, legislation correcting this defect was incorporated into the revenue-revision bill of 1948 as section 148. This bill, of course, never became law.

Amour & Co., and undoubtedly many other taxpayers, have signed transferee waiver agreements under section 311 (b) (4) extending the period of limitations for assessment of deficiencies against it as transferee of other companies, and it is only fair that it and other transferees similarly situated be accorded the right to obtain refund of any overpayments the revenue agent may find to exist. We respectfully request, therefore, that section 148 of the revenue revision bill of 1948 be incorporated in toto by your committee in H. R. 8920.

4. TAX RATES APPLICABLE TO LARGE AND SMALL CORPORATIONS

In recent years, with the increasing need for revenue to finance the operations of the Government, many advocates of tax policy have urged Congress to increase the corporate tax rates, particularly the rates applicable to large corporations. Small corporations should receive preferential tax treatment, these advocates argue, for one reason or another and the large corporations penalized. Far too frequently, I fear, they overlook the realities of the situation.

First, a substantial part of the taxes assessed against corporations, both large and small, probably is passed on to the consumer in the form of higher prices. To the extent this is true, there should be a single tax rate applicable to all corporations, for the consumer pays it in any event. It makes no difference whether the "tax collector" is a large or a small corporation.

Secondly, the balance of the tax burden is passed on to stockholders through reduced dividend payments. In this aspect, presumably the argument is that, if there is any justification for progressive taxation of individual income, the same principles should apply to an indirect tax on such income—i. e., a tax on corporate profits. This brings us to the crux of the question. Who are the corporation's stockholders? Are they individuals of considerable means or not?

I submit that most of the stock of the large corporations is owned by individuals in the lower-income groups, and that a far larger proportion of the stock of the smaller corporations is owned by the upper middle- and higher-income groups. The small investor cannot afford to risk losing his savings by investing in a small enterprise which may or may not succeed. Instead, he selects the stocks of large, well-established companies which have been in business for many years and whose future appears secure. The safety, rather than the risk factor, appeals to the small investor, even though the expected profits are much lower. It is otherwise with the more affluent investor. He can afford to and does take risks in an effort to earn a larger return on his investments This is the class of investors who undoubtedly furnish the major share of the capital of the small corporations.

Let us examine the stockholders of Armour & Co., which certainly would be classed as a large corporation. We have approximately 39,000 stockholders. Eighty-four percent of our common stockholders own 100 shares or less. Our common stock is now selling at approximately $9 a share, so that 84 percent of our common stock is owned by individuals whose total investment is $900 or less on the basis of current market values. Forty-four percent of our preferred stockholders own 10 shares or less, and 95 percent own 100 shares or less. Our preferred stock is now selling at approximately $75 a share, so that here too the small investor predominates.

If the stockholders of the larger corporations are mainly individuals of less financial means than those of the smaller corporations, logically the tax rates applicable to the large corporations should, if different at all, be lower than those applicable to the small corporations. After all, the stockholders, not the corporations, bear the full burden of that portion of the tax which is not passed on to the consumer.

CONCLUSION

I have deliberately treated the subjects discussed herein briefly with the thought that it would conserve the committee's time. If the committee wishes, however, I shall be glad to amplify any portion of this statement either in writing or by personal appearance.

The CHAIRMAN. I also have a statement from Mr. Hall, representing the American Farm Bureau Federation, relating to taxation of cooperatives and other subjects in the bill.

(The statement referred to follows:)

STATEMENT OF AMERICAN FARM BUREAU FEDERATION, CONCERNING THE TAXATION OF FARMER COOPERATIVES

The membership of the American Farm Bureau Federation is composed of over 1,400,000 farm families in 45 States and Puerto Rico, who have associated themselves voluntarily into a free, independent farm organization.

Consistently over the years, the federation has encouraged farmers within their respective areas of production to organize, support, and patronize farmer cooperatives. According to the reports of the Department of Agriculture, there are now over 10,000 farmer cooperatives throughout the United States. These farmer cooperatives are rendering a much-needed service to farmers. From studies of the Treasury Department it appears that almost half of these farmer cooperatives operate as taxable associations under the provisions of the Internal Revenue Code and regulations issued thereunder.

Every administration of the Federal Government since 1920, and even before regardless of the party in control, has given encouragement to the organization of farmer cooperatives. The Capper-Volstead Act, the Capper-Tichner Act, the Packers and Stockyards Act, the Agricultural Marketing Act, the Farm Credit

Administration Act, the Rural Electrification Act, and other acts of Congress are outstanding evidences of the constructive interest of the Congress over the years. In the platforms of the major parties since 1920, party leaders have promised every reasonable encouragement to farmer cooperatives. General farm organizations over the years have supported farmer cooperatives. The Farm Bureau, at local, county, State, and national levels, has actively sponsored and aggressively supported farmer cooperatives.

At the last annual meeting of the federation in December of 1949, the voting delegates adopted resolutions on the subject of taxation. They are quoted in part as follows:

"The personal income tax should be the major source of revenue for the Federal Government. The personal income tax base should be kept as broad as practicable through the retention of low exemptions. All self-supporting persons should make a direct contribution to the support of government."

In dealing with the subject of taxation of corporations, it said, in part, as follows:

"All corporations should be exempted from Federal income taxes on the portion of their annual earnings that is distributed to the stockholders as dividends, where such dividends are taxed in the hands of stockholders."

On the subject of the taxation of farmer cooperatives, it said:

"Agricultural cooperatives are an integral part of the twentieth-century farming business and have significantly aided the successful operation of the farm economy. They are a vital part of a free-, competitive-enterprise system. Their basic aim is to enable the farmer to sell his products and to purchase his farm supplies under conditions which allow him to compete effectively in a mass production and distribution economy. Agricultural producers must continue to have the right to market their products, purchase farm supplies, and acquire needed services through their cooperatives. Bona fide agricultural cooperatives must be protected against certain vested interests who are using the term 'cooperative' as a guise for selfish motives. We will defend, to the fullest extent of our ability, the right of farmers to form and operate cooperative associations.

"The attacks on cooperatives under the banner of tax equality by certain groups are deeply resented. Since genuine farmer cooperatives are owned and operated by the farmers who use their services, the cooperative has the alternative of reflecting savings to the patron either through patronage refunds or through price adjustments. We are convinced that it is in the best interests of our entire economy for the savings of cooperatives distributed as patronage refunds to be taxed only in the hands of the individual members.

"*We will aggressively oppose any efforts to tax cooperatives on such savings returned as cash, or clearly shown on the books of the cooperative to be property of the patron. There is no sound basis for imposing on cooperatives an income tax on patronage earnings refunded in the form of cash refunds, certificates of stock, certificates of indebtedness, or revolving fund certificates where the obligation to the producer patron is certain.*

"*Retained and unassigned surpluses and undistributed earnings of cooperatives should be taxed in the same manner as other corporation earnings.*" [Italics added.]

From the foregoing excerpts, it is clear that in the field of Federal income taxation, the federation believes:

(1) That the personal income tax should be the major source of revenue to the Federal Government. In this way the graduated rates of taxation can be applied at the individual levels according to the ability of the taxpayer to pay.

(2) That the corporation income tax on the profits or earnings that are distributed to shareholders and members on a capital-stock basis should not be taxed, as this results in double taxation. Furthermore, such taxes do not allow the graduated personal income tax to function properly, since the income taxes collected from corporations are the same on earnings distributed to all shareholders without regard to the shareholders' individual incomes. The federation believes that the corporation tax should not apply against earnings to be distributed as dividends on capital stock, regardless of whether the corporation is a farmer cooperative or another type of corporation.

(3) The federation is unalterably and aggressively opposed to any effort to tax farmer cooperatives on savings and earnings returned as cash or clearly shown on the books of the cooperative to be the property of the patron.

A farmer cooperative is very much of the nature of a partnership. It is true that in most cases the individual stockholder member has a limited liability, but through his cooperative association he, with others, is performing services for himself and other members. A cooperative is a device for service and not for profits

to stockholders. It is therefore reasonable that farmer cooperatives should have the right of exemption from income taxes as does a partnership, provided the cooperative will do as the partnership is required to do; namely, reflect its earnings and savings in the business enterprise to the individual partners who, in turn, must make a return and pay a tax upon their respective shares of the partnership earnings.

Under existing provisions of law, a business corporation cannot accumulate surpluses and reserves for operation or expansion without paying a tax upon such accumulations. The federation is of the opinion that the same rule should be applied to farmer cooperatives, unless the farmer cooperative distributes currently the savings and earnings on a cash patronage basis or in the form of certificates of stock, certificates of indebtedness, revolving-fund certificates, or any other similar type of certificates, including credit notices, where the evidence of the equity or interest of the shareholder member or patron in such surpluses and reserves is clear and certain, and that when such distribution or evidence of interest is made, such interest becomes taxable in the hands of such shareholder, member, or patron.

Section 101 (12) of the Internal Revenue Code permits a farmer cooperative operating within the limitations of this subsection, regardless of size, to establish "reasonable reserves for any necessary purpose". The phrase "reasonable reserves for any necessary purpose" in section 101 (12) has been the cause of some misunderstanding on the part of the public. It is true that the regulations permit these "reasonable reserves for any necessary purpose" to be used for expanding the business of the cooperative. The regulations, however, of the Internal Revenue Department in more recent years have been requiring such "reasonable reserves for any necessary purpose" to be earmarked for the purpose of distribution to the shareholder, member or patron, thus placing the responsibility upon the shareholder, member, or patron for the payment of taxes on his distributive share.

It should be kept clearly in mind that any corporation, including farmer cooperatives, can set up other reserves in accordance with recognized accounting practices as one of the costs of operation.

It is our understanding that some changes have been made in administrative regulations along the lines of this statement. If there is any question as to the adequacy of the administrative regulations relative to the earmarking of accumulated reserves, this could be clarified easily by the insertion of a short sentence in section 101 (12).

It has been suggested that an exemption comparable in effect to the $75,000 gross-income exemption provided mutual fire and casualty insurance companies under section 101 (11) be granted to small farmer cooperatives which meet all requirements of section 101 (12) except the earmarking of accumulated surpluses and reserves. We believe that this suggestion is worthy of careful consideration by the committee.

Any revision in section 101 (12) resulting from action of this committee should not become effective until January 1, 1951, and under no circumstances should any change be made retroactive.

In order that there may be no misunderstanding of the federation's position, we wish to express our opposition to certain alternative suggestions which are being made.

(1) It is suggested by some that subsection (12) of section 101 should be repealed. The American Farm Bureau Federation is absolutely opposed to such treatment of the subject matter. We believe that farmer cooperatives should be entitled to exemption within the limitations of the existing subsection (12) of section 101 as herein qualified. We believe the tax-exempt status of an unincorporated association, of a partnership, and of a single proprietary business should be like that of an exempt farmer cooperative. Savings and earnings should be taxed only in the hands of the recipient patron.

(2) There are those who contend that all patronage earnings and savings should be included in the net income of a farmer cooperative and be subject to corporation tax rates. The American Farm Bureau Federation is unalterably opposed to this suggestion. The suggestion has many vices, one of which is referred to in the 1949 resolutions of the American Farm Bureau Federation. The portion of the resolution referred to reads as follows:

"Since genuine farmer cooperatives are owned and operated by the farmers who use their services, the cooperative has the alternative of reflecting savings to the patron either through patronage refunds or through price adjustments.

We are convinced that it is in the best interests of our entire economy for the savings of cooperatives distributed as patronage refunds to be taxed only in the hands of the individual members."

If a tax is imposed upon the patronage earnings and savings of a farmer cooperative, the pressure of management will be to operate on very close margins so that there will be a minimum of net income. This is a hazarous operation for any business and, in our opinion, as the resolution suggests, would be particularly disastrous to competitive businesses because it would result in undue price disturbances and price wars.

(3) There are those who would exclude from taxation of farmer cooperatives the cash patronage dividends but require inclusion of noncash patronage dividends in the taxable income of the cooperative. It is clear from the resolution of the American Farm Bureau Federation that the organization will oppose aggressively such a proposal.

(4) There are those who propose other alternatives, such as a tax upon gross receipts or a tax upon the invested capital of the farmer cooperative. The American Farm Bureau Federation, of course, is opposed to such suggestion and will resist it in every way possible.

The CHAIRMAN. I believe that is all that have been offered this afternoon.

The hearing will be recessed until 10 a. m., tomorrow morning.

(The following material was submitted for the record:)

UNITED STATES SENATE,
COMMITTEE ON BANKING AND CURRENCY,
July 11, 1950.

Hon. WALTER F. GEORGE,
United States Senate, Washington, D. C.

DEAR SENATOR: Several of the slate companies in Vermont have called to my attention a technical amendment to the tax bill, H. R. 8920, which would be of benefit to them in clarifying the percentage depletion intended to be granted to the slate industry.

The House Ways and Means Committee, according to my information, when it revised the percentage depletion sections intended that the word "stone" where it appears in section 204 on page 51 of the bill was to include slate, but for some reason in the drafting of the bill this is not made definitely clear and under the present wording, it would be left to an interpretation of the word stone to grant a depletion allowance to the slate industry. I suggest that including the expression "(including slate)" after the word "stone" on line 9, page 61 of the bill would remove the necessity for an administrative determination of the definition of the word and would make it quite clear that the slate industry was intended to be included. I hope that this action can be taken by the committee.

My attention has also been directed to what appears to me to be an illogical, arbitrary, and totally unjust action on the part of the House Ways and Means committee in removing the excise tax on household cooking appliances but refusing the same relief to manufacturers of commercial equipment of the same type. I can find little justification for excise taxes in their entirety but there seems to be no good reason why commercial cooking appliances should be subjected to a manufacturer's excise tax when no other capital goods with the possible exception of certain business machines and motor trucks are so taxed. This tax is clearly discriminatory and inasmuch as excise taxes on certain luxury items have been replealed in the House bill, it would appear sound and reasonable for the Senate to consider removing the excise tax on commercial cooking equipment which is capital equipment and the working tool of the essential public food-serving industry.

I suggest that the removal of this tax can easily be accomplished by striking out on page 35, line 15, all after the semicolon following the word "heaters" down to and including the semicolon following the word "type" on line 19. I hope that this suggestion will meet with favorable attention on the part of the committee.

Sincerely yours,

RALPH E. FLANDERS.

Statement in Support of Percentage Depletion for Crushed-Stone Producers

FOREWORD

This statement was prepared and is presented by the National Crushed Stone Association and the Agricultural Limestone Institute, a division thereof, which represent producers of a substantial majority of all the crushed stone commercially mined and quarried in the United States. It is offered for the following purposes:

1. To present a brief but clear picture of the crushed-stone industry and its importance in the general industrial field, the place it occupies in the category of natural-resource industries of the United States, and the similarity of its geological occurrence and methods of recovery to certain other natural-resource industries to which percentage-depletion allowances have been granted.
2. To point out the inequitable and unjust discrimination which now exists against the crushed-stone industry by reason of its present exclusion from the list of natural resources enjoying the benefits of percentage depletion.
3. To request a remedy for this situation by amendment of the Internal Revenue Code to extend the percentage-depletion allowance of 15 percent of gross income to the crushed-stone industry.

The principle of percentage depletion has been before Congress for so long and the soundness and equity of this method of arriving at depletion allowances have received such a thorough and technical consideration that this statement will not attempt to cover the same gound again but will only briefly refer to the principle to show its applicability to crushed-stone production. (See appendix.)

DESCRIPTION AND USES

Crushed stone includes igneous rocks such as granite, syenite, diorite, basalt, and other trap rocks; sedimentary rocks such as limestone, dolomite, and sandstone; and metamorphic rocks such as gneiss, schist, eclogite, and marble.

Crushed stone is used for concrete aggregate and road metal, metallurgical stone (flux), agricultural and ground limestone, railroad ballast, alkali works, riprap and jetty stone, refractory stone, stone sand, and for a wide variety of miscellaneous uses.

Highway construction

By far the largest single use of crushed stone is for highway construction. During the war years highway construction in the United States was greatly curtailed and held to a minimum. The postwar shortages have seriously handicapped the development of the problem. Both industry and the Government realize that our national highway systems are indequate to meet transportation problems and keep pace with other developments. Our highway systems must be developed for peacetime use and also for any future emergency. Recognizing this need the Government has embarked on a tremendous expansion program of highway construction. Under the program the Federal Government would advance $500,000,000 a year to which the States would contribute proportionate shares. This will increase the demand for crushed stone which is absolutely essential to the program and will necessitate the development of new sources. The place-utility value of deposits is the important thing to be considered. Unless deposits are economically available by rail or truck, they have no value.

Agricultural limestone

One of the important classifications of crushed stone, the use of which warrants special mention is that of agricultural limestone, because of its effect on the health and economy of the Nation. The state of our health and well-being is closely associated with the quality of food we eat and this in turn is directly connected with the condition of our soil. Exhaustion of the soil is an important factor in the decline of civilizations.

When the lime content of the soil gets dangerously low the result is an accelerating spiral of lower yields of poor-quality food and feed crops and a corresponding decline in the health and economic condition of the community. Thousands of square miles, in the East and South particularly, do not produce enough food to support the populace. These shortage areas are constantly getting larger. Although it is difficult to realize, it nevertheless is a fact that the processes of soil deterioration are going on in this rich and powerful country as they did in those countries of older civilizations and at an even faster rate.

Limestone alone will not completely restore the productivity of our worn soils but it is an important first step. That its importance has been recognized by the United States Government is evidenced by the appropriations made since 1936 to aid farmers in the use of agricultural limestone and other soil-improving practices. Statistics prove the value of this policy. In 10 years' time the normal annual use of agricultural limestone has increased from 4 to 26 million tons but the Department of Agriculture estimates we need to apply annually over 60 million tons merely to replace that which is being lost each year through cropping, erosion, and leaching.

The Congress continues to recognize the need for an accelerated soil-conserving program. The appropriate committees of both the House and the Senate are perfecting bills which will establish a long-range agricultural conservation program as the declared policy of Congress. The allowance of percentage depletion will materially assist in this program by encouraging exploration for suitable limestone deposits in those areas where the material is not now closely available.

PRODUCTION AND VALUE

Crushed stone is substantially produced in over 30 of the 48 States with the States producing the largest tonnages being: California, Illinois, Indiana, Iowa, Kentucky, Michigan, Missouri, New York, North Carolina, Ohio, Pennsylvania, Tennessee, Virginia, West Virginia, and Wisconsin.

The latest statistics available, compiled by the United States Bureau of Mines for the year 1948, show a total of 223,863,780 short tons produced in the United States with a value of $280,960,452, making the average value per ton $1.26. As can readily be seen, crushed stone sells at an extremely low price. High transportation and operation costs, together with the low sales price, leave the producer only a relatively narrow profit margin. This situation is further emphasized by action of the Interstate Commerce Commission, in granting during recent years substantial increases in freight rates amounting to as much as 60 cents per ton on products shipped in closed or protected equipment. Such increases are a severe blow to the crushed-stone industry which finds its producing areas economically more and more distant from areas of use. The producer usually sells directly to the consumer.

MINING AND PROCESSING

The various types of stone in their natural occurrence and methods of recovery, in most respects, are similar to other minerals. They are found deposited in different states of purity in beds or veins in the earth, and are recovered either by open pit or underground mining. It is difficult to determine the amount of stone recoverable even after a deposit is discovered because, in most instances, this would involve extensive and costly drilling which the crushed-stone producer is reluctant to undertake in view of the small margin of profit he can expect from his operations. The Special National Resources Economic Committee in a recent report entitled "Investigation of National Resources," in the introduction states: "Because of the hidden nature of mineral deposits, reserves can never be appraised with any degree of finality. * * *"

WHY CRUSHED-STONE PRODUCERS SHOULD BE ALLOWED PERCENTAGE DEPLETION

The producers of crushed stone do not seek any special privileges from the Government. Depletion is a recognized method of returning the value of capital of a mine to the producer. Congress incorporated this method in the income-tax laws as early as 1913. The United States Supreme Court likewise recognized this in the early case of *United States* v. *Ludley* (244 U. S. 295) where the Court said: "The proviso * * * shows that the deduction is to be regarded as a return of capital. * * *"

The producers of numerous minerals now enjoy this simplified method of returning capital to the taxpayer (see appendix), including direct competitors of the crushed-stone industry. The same factors which induced the Government to extend a percentage depletion allowance to those minerals are equally forceful when applied to the crushed-stone industry. The same or similar problems are encountered in the extraction, processing, and marketing and the same encouragement for prospecting and development should be extended to the crushed-stone producer.

DISCRIMINATION BETWEEN CRUSHED STONE PRODUCERS AND OTHER MINERAL PRODUCERS

We heartily fav r the percentage depletion method for other mining industries but the crushed-stone industry fails to see any essential difference between the mining of crushed stone and certain nonmetallic minerals and is convinced that the discrimination between crushed stone and other nonmetallic minerals which have long had percentage depletion should be eliminated.

The Select Committee on Small Business in Interim Report No. 2, June 25, 1947, while dealing primarily with small independent and marginal mines, made this general recommendation:

"From the testimony it appears that the tax laws may involve inequities to the mining industry, and particularly to small independent mines. In our opinion, these allegations should be thoroughly investigated."

Rock asphalt

As an example of the discrimination which exists we wish to point out that rock asphalt producers who were included in the 1942 and 1947 percentage depletion provision, and now enjoy the 15-percent percentage-depletion allowance, are in direct competition with producers of crushed stone.

Contrary to popular belief rock asphalt is not asphalt with just a bare trace or a relatively small percentage of rock in it. Rock asphalt is, in fact, largely stone impregnated with a relatively small amount of asphalt, varying routhly from 5 to 12 percent. The crushed-stone industry uses stone to produce an asphalt mix quite similar to rock asphalt. So far as we can determine, no rock asphalt is processed for the purpose of extracting the bitumen from it and using that as such. It is produced in much the same manner as the crushed stone with which it competes as a road-building material.

In the hearings before the Senate Finance Committee on the Revenue Act of 1942 in regard to percentage depletion allowances for the rock-asphalt industry Senator Elmer Thomas made a strong plea for that industry as a result of which it has enjoyed percentage depletion ever since. Yet, many crushed-stone operators have carefully designed expensive mining plants, where crushed stone meeting rigid specifications as to gradation, cleanliness, and wearing qualities, is mixed in carefully weighed proportions with other materials, to make a cold or hot lay road of the highest quality, suitable and being used for all the purposes enumerated in Senator Thomas' statement regarding rock asphalt. The competitive relationship beteen rock asphalt and crushed stone is such that failure to grant the same percentage depletion allowance to the crushed-stone industry as is now enjoyed by the rock-asphalt industry would be to continue an unjust discrimination.

Iron ore and coal

Senator Malone, Chairman of the National Resources Economic Committee, in his "preliminary statement" (Congressional Record July 28, 1947, p. 10653) states:

"The United States has been endowed with vast raw material resources, including mineral, agriculture, fuel, forestry and fisheries, whose equal in quantity and variety have not yet been found in any like area of the world. Possession of these resources and ability to utilize then have made possible the preeminent industrial position of the United States and its unequaled standard of living. The deposits of iron ore, coal, petroleum, metals, and other basic materials essential to an industrial civilization thus comprise one of the Nation's assets vital to every citizen in the land."

The iron and steel industry uses large quantities of iron ore, coal, and crushed stone. Similar risks, hazards, problems and difficulties, geological, physical and chemical, met with in the mining of iron ore and coal are encountered in the recovery of the crushed stone used by the iron and steel industry. The coal industry solves its most serious problem of safety by the use of pulverized stone for preventing coal-dust explosions. Unquestionably the outstanding factor in the maintenance of our present highly industrialized civilization, in both peace and war, is the iron and steel industry. The entire structure of that industry rests largely upon three mineral resources, viz, iron ore, coal, and stone, each of which is of equal importance and without any one of which the industry could not exist in its present gigantic proportions. In 1944, for the whole industry an average of 778 pounds of metallurgical stone were used per ton of pig iron produced. By 1946 that figure had risen to 812 pounds, and for 1947 some furnaces reported that the use of limestone had increased by 7.4 percent over 1944 consumption.

It is true there remain large deposits of metallurgical stone, but many of these deposits are now too remote from blast furnace operations to make their use economical. The industry is therefore forced to prospect for new metallurgical stone sources at or near the centers of pig iron and steel production. Many producers of metallurgical stone have found it necessary to engage in underground mining operation, which process is in itself speculative and costly.

Crushed stone has every factor possessed by iron ore and coal to entitle it to percentage depletion allowance, but of the great tripartite mineral base of the iron and steel industry it is the only member that does not enjoy such benefit.

Rock phosphate and potash salts

Agricultural limestone is widely used as an ingredient in commercial fertilizers along with nitrogen, phosphorus, and potash. Yet, of the three mineral constituents (limestone, rock phosphate, and potash salts), limestone alone is not subject to percentage depletion allowance, thereby discriminating against this product.

Vermiculite

According to an article in the Wall Street Journal of April 22, 1948, the producers of crushed stone are facing a new and rapidly growing competition in building construction. This is the use of lightweight aggregates in new structural techniques. "Builders in nearly every major United States city, and in foreign countries, from Africa to Japan, already have written to find how it's done."

The article lists vermiculite as one of the "most popular of the new materials" and explains that: "Vermiculite is a mineral in the mica family. The crude ore is mined like other minerals and run through a heat-treating furnace. This expands particles of the material to about 15 times their original size, entrapping countless tiny dead air cells." The lightweight aggregate thus produced is used as an aggregate in concrete just as is crushed stone.

Here again we find competitors producing minerals under much the same conditions as crushed stone producers and using them for similar purposes, yet vermiculite enjoys the added advantage of a percentage depletion allowance.

WHY THE RATE SHOULD BE 15 PERCENT

The crushed-stone industry is one of our highly important and necessary industries. It is subject to all the natural risks, hazards, and uncertainties of other mining industries. The natural risks and uncertainties are enhanced by the fact that large amounts produced must meet certain specifications for chemical purity or rigid physical specifications. Many deposits can only be developed through large investments in mining, crushing, processing, and manufacturing plants.

The deposits are wasting assets and exhaustible. Every aspect, geological, physical, chemical, and economic, of the mining industries now enjoying the benefits of percentage depletion is similar or parallel to those in the crushed stone industry. Every reason which has been advanced for the inclusion of metallic and nonmetallic mines in the list of those natural resources industries to which percentage depletion is applicable may also be assigned to crushed stone.

Crushed stone plays a vital part in the health and economy of the Nation in both peace and war. It is used in every State in the United States and for a variety of purposes. It is found and produced in numerous States. There is every sound reason why the United States Government should provide a simple method of taxing this industry while at the same time permitting the producers a fair and just return of capital, tax free. The percentage depletion method with an allowance of 15 percent of gross income has proved satisfactory in the case of similarly situated industries, such as rock asphalt, rock phosphate, potash, and ball and sagger clay, and has been easily administered at a minimum of cost to both the Government and the taxpayer. Crushed-stone producers believe that such an allowance would be eminently fair and as effective in their own case and respectfully request that your committee recommend to Congress an amendment to section 114 of the Internal Revenue Code which will extend the percentage depletion allowance of 15 percent of gross income to the producers of crushed stone.

Respectfully submitted.

NATIONAL CRUSHED STONE ASSOCIATION,
By J. R. BOYD, *Administrative Director.*
AGRICULTURAL LIMESTONE INSTITUTE,
By HENRY A. HUSCHKE, *Managing Director.*

APPENDIX

History of percentage depletion

The Revenue Act of 1913 provided 5 percent of gross income for mine depletion. The Dominion of Canada has followed the policy of percentage depletion since 1915 with substantially larger allowances than the United States. The 1918 act first placed depletion on a cost basis with a discovery depletion provision. It was because the Congress, the Treasury, and the mining industry alike perceived the difficulties in these methods when applied to mineral deposits that an attempt was made to devise some formula for figuring depletion. At a hearing before the Committee on Investigation of the Revenue Bureau in 1925, we believe, Mr. A. W. Gregg, formerly Solicitor of the Revenue Bureau, said:

"If something could be done in the law to do away with the necessity of valuing mineral properties for the purpose of determining depletion, it would be the biggest thing that has ever been done for the Bureau of Internal Revenue. * * * It would help the administration of the Bureau tremendously and would certainly be more accurate than the present system."

That simplified system was found to be a percentage depletion allowance based on gross income.

Shortly thereafter 27½ percent allowance was established for oil and gas. The 1932 act provided percentage depletion for coal at 5 percent of gross income, 15 percent for metal mines, and 23 percent for sulfer. The rate of 15 percent of the gross value at the property for mines which was written into the law in 1932 was arrived at by taking the average of the depletion actually allowed under the old methods over a 5-year period. As a matter of fact, this average was better than 17 percent and the rate finally agreed upon was a compromise. To further protect the revenue it was provided that in no case should the allowance exceed 50 percent of the net income. This act was passed after the metal-mine operators made a strong appeal for change in the then applicable system of depletion because—

(*a*) of discrimination between them and owners of other natural resources;

(*b*) of inequality in taxation between taxpayers of the same class because some metal-mine operators were unable to get any depletion allowances at all;

(*c*) depletion allowances then being taken were based principally on estimates which bore little relation to actualities;

(*d*) the costs of administration, both to the Government and the taxpayer, were excessive;

(*e*) all of these objectionable features could be corrected by the simple formula of depletion based on a percentage of gross income.

These factors are equally forceful when applied to the crushed-stone industry. Fluorspar, ball and sagger clay, and rock asphalt were included by the 1942 act on the same basis as metal mines.

In 1942 when percentage depletion was under consideration by your committee, the American Mining Congress offered a statement which substantially summarizes the testimony on the 1932 Revenue Act depletion provision. We quote a part of this statement as being equally applicable to the scrushed stone industry.

"We summarize the position of the mining industry as follows:

"1. Depletion is a return to the mining industry of the capital consumed in its operation.

"2. The present system (percentage depletion) of computing depletion resulted from careful study and affords the best means for determining the annual consumption of capital.

"3. The percentage method furnishes both uniformity and certainty in computing depletion.

"4. Percentage depletion makes for stability of revenue to the Government.

"5. Percentage depletion provides more equal treatment to those engaged in the industry.

"6. Percentage depletion is more economical of administration.

"7. Percentage depletion protects the small operator.

"8. Percentage depletion substitutes actual figures for estimates.

"9. Percentage depletion provides only a fair return of invested capital to the industry."

In the 1944 act, at the same rate, were added flake graphite, vermiculite, beryl, feldspar, mica, talc, lepidolite, spodumene, barite, and potash. The allowance for these nonmetallic minerals in 1942 and 1943 (except as to potash) was limited

to the duration of the emergency. Thus, through the cessation of hostilities as declared by the President, section 124 (e) of the act of February 25, 1944, went into effect and these allowances terminated as of December 31, 1946. Considerable study has been given to this problem facing certain segments of the mining industry and alert members of the Congress representing many mining districts directly affected had taken steps on behalf of their constituents. As early as the 1946 session of the Congress a bill, H. R. 7147, was introduced to repeal section 124 (e) mentioned above. This bill was never acted on by the Congress. Early in 1947 various measures concerning particular mining industries were introduced by Congressman Schwabe of Oklahoma; Congressman Barrett of Wyoming; Congressman Gearhart of California, Congressman Case of South Dakota; and Congressman Knutson, of Minnesota. These bills were referred to the Ways and Means Committee where public hearings were held on June 4, 1947.

H. R. 4069, restoring percentage depletion to those nonmetallic minerals, included in the 1942 and 1944 Revenue Acts and adding others, was favorably reported to the Congress by the Ways and Means Committee and on July 21, 1947 (pp. 9794–9795, Congressional Record) Congressman Knutson, chairman of the reporting committee, explained the percentage depletion section of the bill as follows:

"On the question of percentage depletion allowances, the committee considered this subject in detail. Public hearings were held, at which both sides of the question had full opportunity to present their views.

"The percentage depletion allowance, Mr. Speaker, is simply a method of allowing the mine owner an additional compensatory allowance for the risk undertaken in exploration.

"The allowance is authorized under section 23 (m) of the Internal Revenue Code upon the basis of certain prescribed percentages set forth in section 114 of the code. It is a reduction from gross income derived from the property involved amounting, in the case of coal, for example, to 5 percent, metal mines, fluorspar, flake graphite, mica, talc, and similar materials, 15 percent, and in the case of sulfur, 23 percent. The maximum allowance in any case is 50 percent of the taxpayer's net income. It is given to compensate, partially at least, those taxpayers engaged in such mining operations for the cost of discovering new sources of these products and thus encouraging their production.

"Each of these products, including those added to the list by H. R. 4069 is an essential raw material badly needed in times of peace as well as in time of war. The products added by H. R. 4069 are ball and sagger clay, china clay, or kaolin, benite, gilsonite and thenardite, or sodium sulfate.

"These products were added because the mining problems involved are similar and in some cases identical with the problems faced by producers of petroleum, coal, and minerals. The deposits of the new products added by the bill are known in some cases, but unknown in others. Yet the producers must constantly explore new fields to determine their commercial value or the existence of new deposits. The depletion allowance encourages this explorative work. It is an expensive process, Mr. Speaker, and one that cannot be avoided. Unless we make a proper tax adjustment in the case of these mining operations we will discourage, if not prevent, discovery of new sources. Obviously, we cannot afford to do that.

" * * * the percentage depletion allowance which we have learned is essential to full utilization of our resources both in peacetime as well as in war. * * *."

The bill, after passing the House of Representatives, went to the Senate Finance Committee where it received favorable attention and where several minerals not heretofore accorded percentage depletion were added. The amended bill then passed the Senate with no discussion on the floor concerning this provision except for the addition of several minerals to the list. The bill then went to conference where the Senate additions to the minerals list were accepted by the House conferees. Conference members, Senators Millikin, Taft, George, and Representatives Knutson, Reed, Woodruff, Cooper, and Mills, recommended the conference report be accepted, which was done. The President approved the bill August 8, 1947, and it became Public Law 384.

The Chamber of Commerce of the United States, in its policy declarations, July 1949, states, "The principles of the present tax law for percentage depletion should be continued, but expanded to cover other mines and quarries."

EXPLANATION OF THE TAX SITUATION ON ALCOHOL BY SCHLOTTERBECK & FOSS CO., INC., PORTLAND, MAINE

Alcohol, like other liquids, is sold by the producers on the basis of wine gallons. A wine gallon is the normal liquid measure; that is, 128 ounces equals 1 gallon. As a method for determining tax it is necessary to know the proof of each wine gallon of alcohol bought or used. This word "proof" may be considered as a measure of strength. Alcohol producers are able to supply various strengths or proof, for example: 140, 160, and 190, to name a few. Schlotterbeck & Foss use 190 proof alcohol sometimes referred to as cologne spirits.

On the basis that 100 proof is a beginning point for figuring tax, it is therefore easy to compute any desired number of proof gallons as follows: The 100 becomes 1.00 and would be multiplied by the rate of the tax, which at the present time is $9, therefore a wine gallon of 100 proof alcohol would be taxed at $9. Now, when 190 proof is the type used, the figuring is as follows: 1.9 times $9 equals $17.10.

This is the price we pay the Government in advance before actually receiving the material. The alcohol is therefore known as tax-paid spirits.

Under the present tax bill a draw-back of tax is given to those users who can satisfy certain requirements such as extract and medicinal manufacturers who use the alcohol as a nonbeverage product. All of our use, of course, comes under this classification. The amount of the draw-back tax is $6 per proof gallon, which on the basis of 190 proof alcohol amounts to $11.40 on every wine gallon.

This draw-back is not allowed until a claim has been filed and approved by the Alcohol Tax Unit, which means as the claims are filed each calendar quarter, a period of 5 months usually elapses before the manufacturer, in this case Schlotterbeck & Foss, gets the tax return of $11.40. In the meantime, all our products have been priced and sold in the expectation that the alcohol costs us the difference between $17.10 and $11.40; namely, $5.70. Our prices are figured on the net cost although, as explained above, we have to wait 5 months to get our part of the tax on our books although the goods in the meantime have been sold in advance of the refund.

We understand that the possible saving, if the new tax bill goes through, is an increase of $1 on the rate of draw-back; that is, the $6 would be increased to $7 and the net cost to the manufacturer would be $3.80 instead of the present $5.70.

We further understand that this possible saving is currently proposed to benefit only the manufacturers of medicinal products and would therefore only assist Schlotterbeck & Foss to the extent of the production of our medicines. The alcohol used in our flavoring extracts, on the other hand, would show us a net cost of $5.70.

All figures listed in this memorandum are exclusive of the cost of alcohol itself. This varies from, roughly, 50 cents a gallon to $1.30 depending on supply and demand, however, our last lot of alcohol cost us 54 cents per gallon. Alcohol is packed in various quantities but we purchase a 54-wine-gallon drum and usually buy in lots of 10 drums every month.

ROBERTSON, JACKSON, PAYNE, LANCASTER & WALKER,
Dallas 1, Tex., July 7, 1950.

Hon. J. WILLIAM FULBRIGHT,
Senator from Arkansas,
Senate Office Building, Washington, D. C.

MY DEAR SENATOR: Mr. Charles Murphy of El Dorado, Ark., has asked that I submit this memorandum to you relative to section 209 (d) of the revenue bill of 1950, dealing with abandonments and its effect on the oil industry and other industries.

Section 209 (d) of the revenue bill of 1950 (H. R. 8920) provides as follows:

"(d) ABANDONMENT OF CAPITAL ASSETS AND CERTAIN PROPERTY USED IN THE TRADE OR BUSINESS.—Section 117 (relating to capital gains and losses) is hereby amended by adding at the end thereof the following new subsection:

" '(1) ABANDONMENT OF CAPITAL ASSETS, ETC.—For the purposes of this chapter, the abandonment of a capital asset or of property used in the trade or business (as defined in subsec. (j) without regard to the last sentence of par. (1) thereof) shall be considered as a sale or exchange of such asset or property.' "

The foregoing is a part of the revenue bill of 1950, which was reported by the House Ways and Means Committee and adopted by the House. The bill is now pending before the Senate Finance Committee. Reports from Washington indicate that the hearings in the Finance Committee will be quite brief, and the Senate is expected to adopt the bill in the very near future.

The foregoing amendment will have a far-reaching effect on the oil industry. It provides, in effect, that the abandonment of a cpital asset or of property used in the trade or business shall be considered as a sale or exchange of such asset or property. This means that losses on such abandonments will be treated as capital losses, that is, such losses will offset capital gains only, and will not be deducted against ordinary income. It will have the following effect on the oil industry:

(*a*) A purchases an oil royalty which is a capital asset. A dry hole is drilled, condemning the royalty. The royalty is abandoned. The loss, instead of being an ordinary loss, deductible in full as heretofore, will be a capital loss, offsetting only capital gains.

(*b*) B owns an oil-and-gas lease acquired in connection with his producing business. The lease is condemned by an offsetting dry hole and is abandoned. Here again, the loss, instead of being an ordinary loss, will be treated as a capital loss.

(*c*) C holds, in connection with his oil business, an oil-and-gas lease, and drills a dry hole thereon. The proposed amendment provides that the cost of the lease would represent a capital rather than an ordinary loss. However, confusion results from the uncertainty as to whether (1) the capital loss will be taken in the year the hole was drilled or in the year in which the lease expired, and (2) whether this provision which would treat abandonments as capital losses will rob the oil operator of his right to charge off dry-hole expenses under the current regulations.

(*d*) D holds a producing oil and gas lease. The lease has produced for some years, but suddenly salt water encroaches and the lease is abandoned before the full cost has been returned. Here again, contrary to the existing rules, the abandonment loss would be treated as a capital loss.

The foregoing results seem highly illogical and will certainly be hurtful to the oil industry. It is certainly illogical, in the last illustration given, to allow the cost of a lease to be deducted by way of cost depletion against ordinary income, and at the same time say that the undepleted cost where the lease is abandoned shall be treated as a capital loss. It is also highly illogical to allow intangibles and dry-hole expenses to be deducted against ordinary income, and yet to say that the cost of the lease which is found to be dry shall be treated as a capital loss. This statute is an encroachment on the intangible and dry-hole-expense regulations. For a quarter of a century or more deductions have been allowed for expenditures made in dry holes and in intangibles, and these deductions were designed to encourage exploitation for oil. It is difficult to reconcile this principle of encouragement with the principle of the proposed amendment which would treat condemned leases as capital losses. Certainly, the acquisition of wildcat leases is a normal incident to the oil business, and the abandonment from time to time of some of these leases is likewise an necessary incident to the business. Expenditures of this nature which are current, normal, ordinary, and necessary expenses should be a charge against current profits, and should not be treated as a capital loss. In other words, the everyday abandonment of oil leases adquired in the ordinary course of the business should be put in a different category from the abandonment of the casual purchase of an isolated capital asset.

The proposed amendment would affect other industries as well as the oil industry. For example, the railroad industry might be vitally affected if abandoned lines can be treated only as capital losses. In view of the effect on these other industries, the Senate Finance Committee should be persuaded to pass over this amendment this year for further study and full hearings in connection with a general revenue revision next year. The proposed amendment is highly controversial. Because of its far-reaching effect on the oil industry, the railroad industry, and others, it should not be adopted without full opportunity on the part of these industries to be heard. Section 209 (d) should be eliminated entirely for further consideration at the next session. In the alternative, that section should be limited to capital assets and should not be made to apply to "property used in a trade or business."

Enclosed are two extra copies of this letter in case you wish to take the matter up with Senator George and Colin Stam.

Respectfully submitted.

J. P. JACKSON.

Statement of C. Wilson Harder, President, National Federation of Independent Business, Inc., Burlingame, Calif.

TAXATION OF COOPERATIVE BUSINESS ORGANIZATIONS

My name is C. Wilson Harder. I am president and a member of the board of directors of the National Federal of Independent Business, Inc., a national organization comprised of independent small-business men throughout the Nation. For the National Federation of Independent Business, Inc., which has the largest individual membership of any business organization in the United States, whose head office is in Burlingame, Calif., and with district offices in Chicago, Ill., Washington, D. C., Cincinnati, Ohio, and New York City, I want to take this time to request of the chairman, the Honorable Walter George, the privilege of filing this statement in behalf of the federation and its membership. Conditions have arisen which prevent my leaving California at this time so I trust that my request will be granted and this statement will be filed accordingly.

The National Federation of Independent Business is opposed to the continuation of the unfairly preferential status—in taxation and responsibility to our antitrust laws—bestowed on, and maintained for, cooperative organizations by our Federal Government.

The opposition of the federation to the preferential status of cooperatives is based on the almost unanimous personal opinions of its tens of thousands of members from all over the Nation, as expressed on mandate ballots since 1944 and given directly to Members of Congress. For instance:

During December 1944, all federation members over the Nation were asked their opinion on the Federal-tax status of cooperatives competitive with small and independent business men. Eighty-eight percent of federation members called for the taxation of cooperatives in the same fashion and to the same extent as competitive small and independent business corporations were taxed. Ten percent indicated they were satisfied with the then existing status quo. Two percent refrained from giving any opinion on the subject.

During April 1947, all federation members over the Nation were asked their opinion whether Congress should subject cooperatives to the same regulations, on taxation and other matters, that then pertained to small and independent business. Ninety-four percent of federation members called for Congress to subject cooperatives to the same regulations as applied to independent business. Five percent indicated their satisfaction with the then existing status quo. One percent refrained from giving any opinion on the matter.

During June 1948, all Federation members over the Nation were asked their opinion on H. R. 6423 (80th Cong.), a bill that would have subjected cooperatives to the antitrust laws the same as small and independent businessmen are subject to those laws. Ninety-seven percent of federation members called for Congress to make cooperatives fully subject to these laws. Two percent indicated their desire for a continuation of the cooperative antitrust exemptions. One percent refrained from giving any opinion on the matter.

During August 1949, all federation members over the Nation were asked for their opinion on H. R. 5064 (81st Cong.), a bill that would compel cooperatives to pay Federal taxes on their incomes in exactly the same fashion and to the same extent as small and independent business corporations are compelled to pay Federal taxes on their income. Ninety-six percent of federation members voted in favor of this bill. Three percent opposed it. One percent refrained from giving any opinion on it.

During March 1950, all federation members over the Nation were asked their opinion on H. R. 7343 (81st Cong.), a bill that would compel cooperatives to pay Federal taxes on their incomes in exactly the same fashion and to the same extent as small and independent business corporations are compelled to pay Federal taxes on their incomes. Ninety-seven percent of federation members voted in favor of the bill. Three percent opposed it.

During April 1950, following House Ways and Means Committee decision to ask for a withholding tax on corporate dividends, all Federation members over the Nation were asked whether it was their desire that the same type withholding tax be applied against dividend and patronage refunds declared paid by cooperatives. Ninety percent of federation members declared their desire that such a withholding tax be enacted on dividends and patronage refunds declared or paid out by cooperatives. Eight percent were opposed to enactment of such a withholding tax against cooperatives. Two percent took no position at all on the matter.

In all of this, it must be understood clearly that the majoritv of the members of the National Federation of Independent Business are not opposed to cooperative organizations as marketing methods. The National Federation of Independent Business favors free and fair competition between all methods of marketing. The onlv consideration it asks for its members and all other independent businessmen is that no special and unwarranted preferentials be shown by Government or any other agency to one form of business over another.

The National Federation of Independent Business, Inc., renews its demand that our lawmakers repeal all the preferential advantages now enjoyed by cooperative organizations so that independent business may compete with them on an equal basis.

STATEMENT OF RUSSELL SMITH, LEGISLATIVE SECRETARY, NATIONAL FARMERS UNION

As the National Farmers Union pointed out in hearings conducted in the Ways and Means Committee when the general tax bill was under consideration in the House, the present legislative situation with respect to cooperatives appears to us to be satisfactory both from the standpoint of the public and of farmer cooperatives and we urge this committee to make no change whatever in present laws. In particular, we request that this committee, if it should report out a tax bill, delete the provision approved in the House for the imposition of a 10 percent withholding tax on payments by cooperatives to farmer members. We believe this to be ill-considered and ineffectual legislation.

In the first place, as has been pointed out by highly competent witnesses on behalf of the cooperatives, the expense and red tape involved in the collection of such a tax would impose a serious burden both on the cooperatives and on the Government. In the vast majority of cases the payments to be taxed would amount only to $50 or less per individual. It can readily be seen that from the standpoint of taxation the yield to the Treasury involved in such a tax would in no way be commensurate with the burden of collection. So far as the cooperatives are concerned, the additional paper work that would be imposed upon them would be a genuinely serious and heavy burden. Again, it should be emphasized that any tax of this kind strikes at the ability of the cooperative to accumulate liquid capital for operating purposes, for expansion, or for other legitimate objectives. Since cooperatives are not comparable to ordinary corporations either in their structure or in the ease with which they may be established and maintained, this capital handicap would constitute a serious one indeed.

Finally, in many instances local cooperatives and general farm organizations have worked out arrangements whereby the members of the cooperative have authorized the deduction from the payments made to them of membership dues in the farm organization. Such arrangements characterize relationships of all of the general farm organizations with cooperatives in various areas. The levying of a withholding tax as a first charge against such payments would be of a damaging nature to this relationship.

Perhaps the most conclusive argument in our minds, however, against the proposed action is that it is being made on the basis of a record which attempts to draw a parallel between farmer cooperatives and the ordinary commercial corporation. The Farmers Union denies the existence of such a similarity. We feel that cooperatives are unique and valuable instruments of economic democracy and that as such they deserve special treatment and eucouragement by the Government of the world's greatest democracy.

CALIFORNIA FARM BUREAU FEDERATION,
Berkeley, Calif., July 10, 1950.

Hon. SHERIDAN DOWNEY,
United States Senator, Senate Office Building,
Washington, D. C.

DEAR SENATOR DOWNEY: The tax withholding provisions applicable to cooperatives, contained in H. R. 8920 (title VI), present some difficult problems to cooperative management and members due to the number and complexity of transactions between cooperatives and their members. The board of directors of the California Farm Bureau Federation considered this problem last week and took action to oppose the proposed withholding provisions on cooperative divi-

dends as being administratively impractical and involving heavy costs disproportionate to anticipated returns.

During a given year, a cooperative may be involved in 8 or 10 different transactions with its members most of which would meet the definition of "dividends" as set forth in H. R. 8920. A cooperative may make two or three progress payments as the crop is marketed. At the end of the year, it may make a final distribution based upon complete information as to marketing costs and sales proceeds. It may make one or more payments from funds established in previous years. It may establish a new revolving fund or funds during the current year by the retention of "retains." It may distribute net returns from a storage operation. It may establish credits for members on the books of the cooperative for interest earned on revolving funds or other funds. It may pay interest on stock owned by the cooperative patrons. Most of these payments or transactions are complex in character but involve relatively small amounts per member.

A withholding would be required by H. R. 8920 for all of these operations, except the repayment of previously established revolving funds (and possibly the progress payments). The bookkeeping operations of deducting the amount withheld from each payment would be extensive. But these would be dwarfed by comparison with the obligation of the cooperative to inform each member about each payment and each withholding, citing what had been done in each case and why and how the individual member is affected so far as his own return is involved.

The regulation would press most heavily upon the small or newly organized cooperatives, and upon members not too familiar with cooperative procedures. These cooperatives represent a healthy and vital segment of our American economy. Their development and operations should not be weighed down by complex tax regulations.

There is a disagreement among local authorities on cooperatives and cooperative taxation as to whether or not the language of H. R. 8920 is intended to involve withholdings on progress payments. If this is the case, a new principle will be established, namely, withholdings on gross rather than net returns. If this principle is established, cooperative marketing organizations will be severely handicapped in competition with other operators who are not required to make such deductions from their purchases from producers.

Most farmers do not have accountants or attorneys to advise them. But a farmer who is a member of a cooperative, or three or four cooperatives, which is not at all unusual, would be required to maintain more complicated records of his operations. For each of the various types and kinds of payments he receives during the year and for each retain or revolving fund credit to his account on the books of the cooperatives, it would be necessary to determine the exact character of the payment or credit; whether or not it was taxable income; whether or not any withholding had been made in connection with such payment or credit; and reflect all such payments, credits and withholdings in his income report. This would involve a large number of separate and different transactions covering each commodity. Thus, the income reporting of each farmer-member of a cooperative would be tremendously more complex than at present.

The provisions of the bill require a cooperative to make withholding payments on behalf of cooperative members in connection with retain or revolving fund credits, even though there is no complete assurance that such credits will eventually result in payments to the cooperative member. In any event, settlement of such credits are normally deferred for many years.

Most farm people will be faced with additional bookkeeping and clerical work as a result of the approval of H. R. 6000. Other State and Federal programs and regulations are expanding at an accelerating rate. The new wage-and-hour regulations affect many farm people despite general exclusions. The situation is rapidly reaching the point where a farm operator cannot make a move without an accountant, an attorney, and a representative of one or more Government agencies to advise him.

The House report estimates that the withholding feature on cooperative dividends will increase the yield of the individual income tax about $20,000,000 a year. It is suggested, however, that the additional costs to the thousands of cooperatives and millions of cooperative members in the United States, in accounting and taxation functions, will constitute substantially an equal expenditure. When the cost to individuals and individual firms of collecting taxes is such a large percentage of the amount collected, a question is raised as to the desirability of the procedure. We do not object to the principle of withholding, but we do feel that the expense and difficulty of the tax-collecting procedure should not be disproportionate to the amount of money collected.

It is believed the same objectives as those contemplated by the withholding provisions of H. R. 8920 may be achieved by an adequate system whereby payors of dividends file reports of such payments as a basis for checking individual returns. This can be achieved economically and at less cost and difficulty to cooperatives and to millions of individual taxpayers.

Your support of the elimination of the withholding provisions applicable to cooperatives is recommended.

Sincerely yours,

RAY B. WISER,
President, California Farm Bureau Federation.

CALIFORNIA FARM BUREAU FEDERATION,
Berkeley 4, Calif., July 10, 1950.

Hon. SHERIDAN DOWNEY,
United States Senator, Senate Office Building,
Washington, D. C.

DEAR SENATOR DOWNEY: On July 7, 1950, the board of directors of the California Farm Bureau Federation adopted the following resolution with reference to the proposed 7 percent excise tax which the new revenue measure proposes to place upon the manufacture and sale of home freezers:

"Whereas the House of Representatives has voted to place a 7 percent excise tax on the manufacture and sale of deep freezers on the false premise that said freezers are a luxury item instead of an actual necessity for many farm homes, and

"Whereas the new revenue bill which incorporates said excise tax is now before the Senate Finance Committee for its consideration: Be it hereby

"*Resolved*, That the board of directors of the California Farm Bureau Federation go on record as strongly opposing said tax and wire copies of this resolution to Senators Downey and Knowland, requesting their support in eliminating the proposed excise tax from the new revenue bill."

We urge you to do everything in your power to eliminate this item from the new revenue bill. Home freezers cannot be considered a luxury for farm people in any sense of the word. They are, as the resolution points out, an actual necessity and we trust that you will do everything you possibly can to eliminate this unnecessary tax burden upon the farm people.

With kindest personal regards, I am,

Yours sincerely,

RAY B. WISER,
President, California Farm Bureau Federation.

STATEMENT OF E. I. THOMPSON, AUSTIN, TEX., EXECUTIVE VICE PRESIDENT OF TEXAS INDEPENDENT PRODUCERS & ROYALTY OWNERS ASSOCIATION

Mr. Chairman and members of the committee, my name is E. I. Thompson and I live in Austin, Tex. As executive vice president of Texas Independent Producers & Royalty Owners Association I represent over 4500 members, who are Texas independent oil and gas producers and royalty owners. Following is a statement of our concept of the application of section 209 (d) of the revenue bill of 1950 (H. R. 8920) pertaining to the abandonment of producing and nonproducing oil and gas leaseholds and mineral interests:

The House of Representatives recently passed the revenue bill of 1950 (H. R. 8920). Section 209 (d) of the above revenue bill adds a new section (1) to section 117 of the Internal Revenue Code, which new section provides, "For the purposes of this chapter the abandonment of a capital asset or a property used in the trade or business (as defined in subsection (j) without regard to the last sentence of paragraph (1) thereof) should be considered as a sale or exchange of such asset or property."

The Bureau of Internal Revenue has held that the interest of a lessee in oil and gas is an interest in "real property" for Federal tax purposes. (I.T. 3693, 1944 C.B. 272). This ruling applies in all cases, regardless of how the oil and gas lessee's interest is treated under State laws. Therefore, if the oil and gas leases are used in the taxpayer's trade or business they are not capital assets, for code section 117 (a) excludes from the definition of "capital assets" real property used in the trade or business of the taxpayer. However, section 117 (j) (1) defines the term "property used in the trade or business" as including real property used in

the trade or business and if the real property has been held for more than 6 months, the net gain or loss from a sale or other disposition thereof would be subject to the special provisions of code section 117 (j) (2). The net effect of the two sections is to treat the abandonment of producing and nonproducing oil and gas leaseholds as losses from the sale or exchange of a capital asset and the amount of the loss subject to the limitations of section 117 (d) and the carry-over provisions of section 117 (e).

Historically, the abandonment, cancellation, or surrender of nonproducing leases and the abandonment of producing leases because of dry holes drilled have been treated as deductions from ordinary income (*Felt v. Commissioner*, 7 BTA 263; *Forrester v. Commissioner*, 23 BTA 942; *Simms v. Commissioner*, 28 BTA 1107). The proposed section 209 (d) would be a departure from a long-established practice of the oil industry, which, in the past, has been approved by the Commissioner and the courts.

In order for the loss arising from an abandonment to be deductible from ordinary income it must meet the tests of section 23 (a) (1) (A) of the Internal Revenue Code. This section provides, "In computing net income there shall be allowed as deductions all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business * * *." The above section has been interpreted as requiring three elements to indicate whether a particular item of expense is deductible as a business expense: (1) it must be incurred in a trade or business carried on by the taxpayer; (2) the "expense" expenditure must not be permanent in nature; (3) the expense must be ordinary and necessary.

The business of an oil producer is to produce oil; in other words, oil is the inventory of an oil producer. Oil wells do not produce forever. The oil operator and producer must be constantly on the search for new sources of supply, which means the constant drilling of new wells. The first step in the drilling of a well, which may or may not result in an addition to the reserves of a particular oil producer, is the acquisition of the lease on which to drill; therefore, it can be safely said without argument that the amounts spent for nonproductive and undeveloped acreage are expenditures incurred in a trade or business.

The investment in nonproductive oil and gas leaseholds is not necessarily permanent in nature. The permanency of the expenditure is determined by events occurring subsequent to the acquisition of the lease. Prior to 1939 the Bureau of Internal Revenue treated amounts spent for oil and gas leases as true lease purchases and permitted the amortization of such costs over the primary term of the lease. Subsequent to that date there have been no amortization provisions with respect to amounts spent for oil and gas leaseholds. The Bureau thus recognized that such expenses were more in the nature of a deferred expense to be written off if the lease proved nonproductive or to be capitalized if oil was found.

Since continued production depends upon new sources of supply, which in turn depend upon the undeveloped acreage that an oil operator secures, it would follow that such expenditures are ordinary and necessary. This is substantiated by the fact that oil producers generally acquire large amounts of acreage which are never developed. Some are released because of facts indicating a lack of oil productivity; others are permitted to expire by their own terms for similar reasons.

Therefore, the amounts spent for undeveloped oil and gas leaseholds would meet the three tests of section 23 (a) (1) (A) of the Internal Revenue Code, and the question arises as to why there should be a differentiation between such expenses and comparable expenses incurred by other industries. A department store is in the business of selling merchandise. The merchandise on hand at any particular time is the inventory of the department store. Considerable sums are spent each year by the merchandising business for sending buyers to sources of potential supply. Such sums have always been considered ordinary and necessary business expenses and have never been considered as capital items to be added to the cost of the merchandise purchased. The same should be true of amounts spent for oil and gas leaseholds. If the leaseholds acquired proved to be nonproductive, the expenditures incurred in connection with the acquisition thereof should be deductible as an ordinary and necessary business expense in the year in which the nonproductivity of the leasehold is proven.

In the manufacturing business considerable sums are spent in the development of proposed new models. If the model proves successful the costs are written off over the useful life of the model. If the project is abandoned before any production the costs are deductible as ordinary and necessary business expenses in the year of abandonment. In such case the costs are incurred for purposes of keeping abreast of competition or in maintaining a continuing salable inventory. The same should be true of amounts spent for nonproductive oil and gas leaseholds.

Aside from the fact that such expenditures constitute ordinary and necessary business expense, there are other reasons which indicate that the treatment of abandonments of producing and nonproducing oil and gas leaseholds as capital losses is not justified.

The practical effect of the proposed new section upon the oil and gas producer should be considered. Since the abandonment would be treated as a capital loss it would be subject to the capital loss limitations of section 117 (d). The deduction for abandonment, cancellation, or surrender of leases in the case of an active producer will approximate the same amount from year to year. The producer would thus be sustaining a capital loss which could not be utilized unless a capital gain was incurred to offset it. Only by disposing of producing leases could the average operator create capital gains; thus, he must dispose of income producing property to secure tax deductions. Certainly methods of raising tax revenues should not result in "killing the goose that laid the golden egg."

Under I. T. 4006 (1950 C. B. No. 8, p. 8, published April 17, 1950), the Commissioner of Internal Revenue requires that geological and geophysical expenses incurred in connection with surveys, which serve as a basis for the acquisition or retention of properties, must be capitalized as a cost of the properties acquired or retained. A further impact of the proposed section 209 (d) of H. R. 8920 would be the denial of a deduction of geological and geophysical expenses applicable to acreage which is released, abandoned, or surrendered before production is obtained therefrom by requiring the lease abandonment to be treated as a capital loss.

In conclusion, the arguments that abandonments of productive and nonproductive oil and gas leaseholds should not be considered capital losses can be summarized as follows:

(1) Comparable expenditures in other industries are deducted from ordinary income;

(2) Expenditures incurred in locating oil and gas properties would not be deductible; and

(3) Geological and geophysical expenses incurred in oil industry would not be deductible.

We feel that the provisions of section 209 (d) work a particular hardship upon the small producer, who continually sustains losses, but on the application of this section would be forced to create capital gains through the sale of valuable producing properties, in order to avail himself of any deductions for such losses sustained.

In closing, may I express my appreciation to the committee for the opportunity of filing this statement.

E. I. Thompson,
Executive Vice President,
Texas Independent Producers and Royalty Owners Association.

Staso Milling Co.,
Poultney, Vt., July 7, 1950.

Mr. Colin F. Stam,
Chief of Staff, Joint Committee on Internal Revenue Taxation,
New House Office Building, Washington, D. C.

Dear Mr. Stam: H. R. 8920, described as the Revenue Act of 1950, provides in section 204 percentage depletion in the case of certain minerals.

When this bill was under consideration by the House Ways and Means Committee, it apparently was intended that the mineral "slate" should be included to be granted 5 percent percentage depletion allowed to certain other minerals. The bill, as passed by the House, did not specifically mention slate on the assumption that it would be classified under the term "stone."

In support of this, we refer you to the following excerpt from page 9413 of the 1950 Congressional Record prepared by the staff of the House Ways and Means Committee under the following heading:

"SUMMARY OF PRINCIPAL PROVISIONS OF THE REVENUE BILL OF 1950

"(d) Percentage depletion of 5 percent extended to stone (including slate), brick and tile clay, shale, oyster and clamshell deposits, sand, gravel, marble and granite."

Marble and granite, which are a form of stone, have been specifically mentioned for percentage depletion in the House bill. In order to avoid ambiguity, the mineral "slate" should also be expressly mentioned.

The matter is not controversial and the action requested is simply a rectification of an apparent oversight in the drafting of the House bill.

We respectfully request that the matter be made a part of the committee's hearing for consideration of expressly including slate as a mineral to be included for percentage depletion.

Yours very truly,

CHAS. T. KETT, *President.*

STATEMENT BY E. S. HALL, OF FARMINGTON, CONN.

Your kind invitation to tell all I know about this bill is appreciated, but it would not be possible to do that in the 5 minutes allotted. From my testimony on H. R. 6000, Senator Kerr was good enough to remark that he figured I knew more about taxes than any other witness. Besides, time does not permit my personal appearance this week. This is an election year. I am too busy planning to hand those of you who understand freedom millions of votes in return for your pledge to repeal our compound, complicated, complex, comatose, compromising, communizing revenue system, and replace it with a simple tax system to collect enough revenue, openly and fairly, to balance the budget, pay as we fight, and for other purposes more worthy than any within the purloining purview of this present bill.

H. R. 8920, a bill (152 pages plus 160 pages of report) to reduce (not repeal) some (not all) of the visible wartime excise taxes (in the face of another wartime after 5 years of alleged peace—too little and too late, again); to raise (not repeal) the hidden sales taxes and jack up the high cost of living still higher by taxing tax-exempt business and raising the taxes on profits; and for other purposes (of which the least said, the soonest mended)—extra perplexities for the experts—a technical masterpiece.

Worn out by your earnest but unsuccessful labors trying to make something more than a fraudulent lottery out of H. R. 6000, you will not waste much time on H. R. 8920. Barring a miracle, you will approve it, without understanding more than the high spots, trusting the political perspicacity of your two beloved and respected chairmen. Caught in the snarl of the worst Communist conspiracy in America, they and you will go on unconsciously following the teachings of Karl Marx. You will paste another patch on the progressive tax system which uses, in whole or in part, 8 of the 10 commandments of communism—how to communize any country—from the Communist Manifesto.

Stalin does not have to fight us. Give us a little more time, and we'll deliver ourselves into his hands by acts of Congress, by such acts as H. R. 6000 and H. R. 8920, by your acts, gentlemen. If this be treason, whose treason is it?

Five minutes are up. You are too busy trying to solve your problems the hard way to have time now for the easy solution (business tax-exempt, but withholding a flat-rate tax on the national income). But before you approve H. R. 8920, why not take time to read the remarks of the Honorable Charles A. Plumley, of Vermont, a State that still believes in liberty and freedom, on page A4729 of the Congressional Record for June 15, 1950?

Why not let your right hand stop what your left hand is doing?

WASHINGTON, D. C., *July 12, 1950.*

SENATE FINANCE COMMITTEE,
United States Senate, Washington, D. C.

GENTLEMEN: In view of the fact that the present conflict in Korea is of a very serious nature, and may involve the expenditure of funds beyond what is conceivable at present, and since our Nation ought to prepare itself at present for rearmament in view of the possibility of a conflict with Soviet Russia; it appears to my mind that steps should immediately be taken by the House and the Senate to plan increased revenue for the near future.

I am presenting below, suggestions as to possible increases in revenue, which are very practical, involving a partial restoration to the wartime methods of raising revenue. If possible, I would like to have this letter printed in the current hearings on the Revenue Act of 1950.

My proposals, explained in greater detail, in the body of this letter, are as follows:

(1) Retention of present excise taxes.
(2) Reduction of the amount of decrease in individual income taxes.
(3) Increase the corporation income tax.
(4) The enactment of a combined excess profits and undistributed profits tax on corporations at moderate rates, with the provision for a $50,000 specific exemption; and other new provisions as explained hereinafter.
(5) A more vigorous application of section 102.

I. RETENTION OF PRESENT EXCISE TAXES

All of title I of H. R. 8920 (Revenue Act of 1950) should be stricken out, except section 142.

II. AMENDMENT OF SECTION 12 (C) OF THE INTERNAL REVENUE CODE

Section 12 (c) should be amended to read as follows:

"The combined normal tax and surtax under section 11 and subsection (b) of this section shall be the aggregate of the tentative normal tax and surtax, reduced as follows:

If the aggregate is—	The reduction shall be—
Tax: Not over $1,000	10 percent of the aggregate.
$1,000, but not over $50,000	$100, plus 3 percent of excess over $1,000.
Over $50,000	Maximum of $2,550 reduction in tax."

It is further recommended that the maximum standard deduction to be allowed shall be restored to $500; for those taxpayers above $5,000 adjusted gross income, who do not itemize their deductions. This proposal would also involve an increase in the taxes provided under the tax table for those under $5,000, under section 400.

The above proposals should be effective for taxable years of individuals starting after December 31, 1950. Other provisions of the Revenue Act of 1948, such as splitting of income, and increase in exemptions would still remain in force for year of 1951. The following illustrates comparative increase in taxes for single and married individuals at various income levels:

(1) Single individual: 1 exemption: Adjusted gross income of $16,100

	Under Revenue Act of 1948	Per this proposal
Adjusted gross income	$16, 100 00	$16, 100 00
Less standard deduction	−1, 000 00	−500 00
Net income	15, 100 00	15, 600 00
Less exemption	−600 00	−600 00
Tentative normal and surtax net	14, 500 00	15, 000 00
Total tentative tax	4, 495 00	4, 730 00
Less reduction in tax	−559 40	−286. 50
Net tax liability	3, 935 60	4, 443 50
Less tax under Revenue Act of 1948 (as above)		−3, 935 60
Increase in tax		507 90

(2) Married individuals: 2 exemptions: Adjusted gross income of $201,600 (standard deduction used for illustrative purposes)

	Under Revenue Act of 1948	Per this proposal
Adjusted gross income	$201,600.00	$201,600.00
Less standard deduction	−1,000.00	−500.00
Net income	200,600.00	201,100.00
Less exemptions	−1,200.00	−1,200.00
Tentative normal and surtax net income	199,400.00	199,900.00
Combined tax on one-half of net income	67,059.00	67,276.50
Less reduction in tax	−8,067.08	−2,550.00
One-half of net tax	58,991.92	64,726.50
Total net tax liability	117,983.84	129,453.00
Less tax under Revenue Act of 1948		−117,983.84
Net increase in joint tax (splitting of income)		11,469.16

In addition I would suggest that section 209 (e) of H. R. 8920 should be stricken out; which would mean that holding period of capital assets would remain as at present, namely, 6 months.

III. INCREASE IN CORPORATION INCOME TAX

Sections 218 (a) and (b) of H. R. 8920 should be amended to provide for the following:

(1) Normal tax of 21 percent on all corporation normal tax net incomes.

(2) Surtax of 20 percent of the amount of the corporation surtax net income in excess of $5,000.

As can be seen from the above, the corporation income tax rate proposed would range from a minimum of 21 percent (as at present) on all net incomes under $5,000; and approach 41 percent for the larger corporations; an increase of only 3 percent over the maximum 38 percent rate at present. (But see IV.)

On a net income of $50,000; the increase in corporation tax would be $500; from $19,000 to $19,500. On a net income of $200,000, the increase in corporation tax would be $5,000—from $76,000 at present rates to $81,000—at the proposed rates.

Section 603 of H. R. 8920 should be applied effective with corporation income and excess profits tax returns due on or after March 15, 1951.

IV. PROPOSED COMBINED EXCESS PROFITS AND UNDISTRIBUTED PROFITS TAX

Effective with taxable years beginning after December 31, 1950, the following is proposed:

(1) A specific exemption of $50,000.

(2) An excess profits credit, consisting of the greater of (a), (b), or (c):

(*a*) 150 percent of the excess profits credit, based on income as provided by section 713.

(*b*) 135 percent of the constructive average base period income allowed under the provisions of section 722;

(*c*) An excess profits credit, based upon invested capital, except that the credit provided by section 714, shall be computed as follows:

Invested capital—	Credit—
Not over $1,000,000	10 percent.
$1,000,000 to $100,000,000	$100,000, plus 9 percent of excess over $1,000,000.
Over $100,000,000	8 percent on invested capital over $100,000,000.

The relief provisions of section 722 shall not apply for returns filed under this proposal. If a section 722 application under the prior excess profits tax (1946 or prior years) has not been finally settled by date for filing 1951 return; and the commissioner determines that excess profits credit allowed in such application multiplied by 135 percent results in the greater credit, he shall invite claim for refund on form 843; for redetermination of 1951 or subsequent tax.

(3) Reduction of the excess profits net income by the following:

(*a*) 75 percent of taxable dividends declared on or after January 1, 1951. (The purpose of this provision is to reduce possible tax liabilities of corporations that have a liberal dividend policy; which will in effect increase individual income tax revenues, by application of sec. 601 of H. R. 8920: "Collection of Income Tax at Source on Dividends.")

(*b*) 25 percent of the depreciation allowed under section 23 (1); but not section 124. (The purpose of this provision is to recognize the increased cost of replacement of depreciable assets for these corporations who may be subject to the proposed tax on excess profits or undistributed profits.)

These reductions of excess profits net income could be provided for by addition of new sections 711 (a) (1) (L) and (M); and 711a (2) (M) and (N).

(4) No unused excess profits credit carry-over from 1950 to 1951 shall be allowed; but a 1 year unused excess profits credit carry-back shall be permitted from 1952 to 1951.

The following illustration will clarify the provisions of the proposed excess profits and undistributed profits tax, stated above:

X corporation has a 1951 net income of $2,000,000; invested capital (using invested capital credit) of $12,000,000; dividends declared in 1951 of $400,000; depreciation deduction allowable under section 23 (1) of $200,000.

The total tax liability of 1951 would be computed as follows:

Net income	$2, 000, 000
Less:	
75 percent of dividends declared of $400,000	300, 000
Additional 25 percent of $200,000 depreciation	50, 000
Total additional decreases in excess profits net income	350, 000
Excess profits net income (as adjusted)	1, 650, 000
Invested capital, $12, 000, 000:	
Credit on first $1,000,000, at 10 percent	100, 000
Credit on $11,000,000, at 9 percent	990, 000
Total excess profits credit	1, 090, 000
Specific exemption	50, 000
Total	1, 140, 000
Adjusted excess profits net income	510, 000

The proposed combined excess profits tax and undistributed profits tax rates should be as follows:

On adjusted excess profits net income of—	*Percentage rate*
First $50,000	60
Next $100,000	65
Next $150,000	70
Next $200,000	75
Remainder (over $500,000)	80

Applying the above rates to this illustration, of an adjusted excess profits net income of $510,000:

First $50,000, at 60 percent	$30, 000
Next $100,000, at 65 percent	65, 000
Next $150,000, at 70 percent	105, 000
Next $200,000, at 75 percent	150, 000
$10,000, at 80 percent	8, 000
Total combined excess profits and undistributed profits tax	358, 000

The total taxes of this corporation would be computed as follows:

Net income	$2,000,000
Less income subject to excess profits tax	−510,000
Net income for normal and surtax	1,490,000
Less exemption for surtax (proposed)	−5,000
Surtax net income (assume no surtax credits)	1,485,000
Surtax rate (percent)	20
Surtax	297,000
Normal tax ($1,490,000, at 21 percent)	312,900
Combined normal tax and surtax	609,900
Add excess profits and undistributed profits tax	358,000
Total tax	967,000
Less income tax at present rate of 38 percent ($2,000,000 at 38 percent)	−760,000
Increase in combined taxes	207,900

Of this total increase in tax of $207,000, the amount of $59,000 is applicable to the approximately 3 percent increase in income tax rates; and the balance of $148,900 would represent the application of the proposed excess profits and undistributed profits tax.

As can be seen from this illustration, the proposed tax would produce the greatest revenue in cases where the following conditions exist:

(1) Corporations which distribute none or small amounts of dividends;
(2) Small amounts of fixed assets, or small borrowed capital; and
(3) Profits in excess of 9 percent of invested capital.

V. SECTION 102 OF THE INTERNAL REVENUE CODE

Particularly with respect to corporations with net incomes under $50,000, or those that have a large invested capital, resulting in a large excess porfits credit, it is recommended that a more vigorous application of section 102 be made.

Section 102 could be amended to eliminate the word "Formed" in the phrase in section XX 102 (a) "formed or availed of for the purpose of preventing the imposition of the surtax on shareholders."

In other words, if shareholders in a corporation use the corporation device to accumulate profits therein without distributing a reasonable amount of dividends to themselves, then section 102 should be applied. The burden of proof should rest with the taxpayer, as to why section 102 should not be applied.

Section 102 (c) should be amended to read as follows: "If dividends declared within a taxable year are less than 50 percent of the section 102 net income and an individual or members of his family own 50 percent or more of the outstanding stock of a corporation (see stock ownership rule: Sec. 24 (b) (2), IRC); then prima facie evidence of a purpose to avoid surtax on shareholders shall exist; unless the taxpayer proves the contrary by a clear preponderance of all the evidence."

H. R. 8920 goes a long way in correcting many loopholes in the Revenue Code; and, except for the elimination of title I, (Reductions in Excise Taxes); it should be enacted; plus the new proposals for increasing revenues, as suggested above.

As stated above, if possible, I would like to have this letter printed in the current hearings on the Revenue Act of 1950.

Very truly yours,

SOL COHEN.

(Whereupon, at 4:10 p. m., the committee recessed to reconvene Thursday, July 13, 1950, at 10 a. m.)

REVENUE REVISIONS OF 1950

THURSDAY, JULY 13, 1950

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D. C.

The committee met, pursuant to recess, at 10 a. m., in room 312, Senate Office Building, Senator Walter F. George, chairman, presiding.

Present: Senators George, Connally, Byrd, Hoey, Millikin, and Butler.

Also present: Mrs. Elizabeth B. Springer, chief clerk.

The CHAIRMAN. The committee will come to order.

Congressman Mason, you are first on the list this morning. You may be seated there, if you wish.

Representative MASON. Thank you.

The CHAIRMAN. Before you commence, I desire to offer for the record a statement by the Secretary of Defense on sections 216 and 219 of H. R. 8920, as to taxation of citizens in the Canal Zone, in which the Secretary of Defense requests that the bill not be made retroactive if the Congress decides to impose this tax upon the citizens who live there who are paid by the Federal Government.

(The statement referred to follows:)

THE SECRETARY OF DEFENSE,
Washington, July 12, 1950.

Hon. WALTER F. GEORGE,
Chairman, Finance Committee, United States Senate.

MY DEAR SENATOR GEORGE: Reference is made to sections 216 and 219 of H. R. 8920, Eighty-first Congress, a bill to reduce excise taxes, and for other purposes.

Under present law, military and civilian personnel assigned to duty in the Panama Canal Zone, Guam, and American Samoa are exempt from Federal income tax, providing 80 percent of their income is actually earned within such possessions of the United States. Section 216 of H. R. 8920, above would amend the Internal Revenue Code, so as to subject to Federal income tax, the incomes of all such personnel. Under the terms of section 219 of this bill, such amendment would become effective from and after January 1, 1950. This letter is addressed solely to the effective date of such change in the Internal Revenue Code.

While there is no compelling reason, so far as I am aware, why personnel assigned to duty or employed in the Panama Canal Zone, etc., should be exempt from Federal income taxation, the practical effect of making such income from wages and salaries taxable from and after January 1 of this year will be to impose a severe hardship upon the personnel affected, who have, in the great majority of cases made uo provision in their personal and family budgets for such payments. The problems that would be created by a sudden reduction in income, as distinguished from such a reduction on timely notice, can be readily visualized. In order to insure the collection of taxes for this period, during the remaining months of 1950, it would be necessary to withhold from salary and wage payments at rates roughly double those normally applicable.

I am mindful also of an additional hardship to an undetermined number of personnel formerly stationed or employed in the Panama Canal Zone or Guam who

have been discharged or who have resigned, after service in those areas. Such personnel would be required to reimburse the Government for unpaid income taxes, the imposition of which was neither anticipated nor provided for. In a large number of cases, the collection of such taxes would be difficult if not impracticable.

The Federal income tax, so far as salaried individuals are concerned, is largely based upon the withholding principle and computed on a calendar year basis. These features permit the taxpayer to discharge his obligation as it accrues and to make personal and family plans on a reasonable basis. I feel that in equity and fairness to the personnel affected by the sections cited, they should likewise be afforded a reasonable notice to make necessary adjustments in their personal and family budgets before such withholding is made effective. This might well be accomplished by making the provisions of section 216, above, effective January 1, 1951.

Time has not permitted submission of this letter to the Bureau of the Budget for advice as to whether it is in accord with the program of the President.

With kind regards, I am,

Sincerely yours,

LOUIS JOHNSON.

The CHAIRMAN. All right, Mr. Mason.

STATEMENT OF HON. NOAH M. MASON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Representative MASON. Mr. Chairman and Senators, first I want to say that I made three speeches on the floor of the House on the general subject of taxing the untaxed to ease the tax load upon the overtaxed, and the material in those three speeches was worked up into a magazine article carried in the American Magazine. Then the Reader's Digest took that American magazine article and condensed it, saving all the real meat, into an article which was carried in the Reader's Digest, which gives as good a summary of the picture as can possibly be presented, as I can see it. I would like to have that short condensation from the Reader's Digest made a part of my testimony, if I may.

The CHAIRMAN. You may do so. Yes, sir.

(The article referred to follows:)

UNCLE SAM'S UNTAPPED TAX MILLIONS

[Condensed from The American Magazine]

Noah M. Mason, Member of the House of Representatives Ways and Means Committee

Administration leaders today are frantically searching for new ways to raise revenue. I maintain we can raise at least $1,000,000,000 in new revenue merely by plugging the loopholes in our present tax laws that permit United States businesses to hide behind tax-exempt fronts. And we can raise this revenue without adding a single cent to the bill of the regular taxpayers.

Our tax laws, as now written, exempt charitable, educational, and religious organizations, cooperatives, labor unions, and many others. When these exemptions were granted, many years ago, our lawmakers did not dream that they would be used to shield vast corporate, profit-making enterprises. But that is precisely what has happened. By various means—all perfectly legal—thousands of organizations are escaping the normal 38 percent tax on their business profits, forcing numberless conscientious taxpaying businessmen to the wall and shrinking the pool of taxable United States wealth.

Here are the five devices most widely used to escape taxes:

The Charity Trust Device.—There are many conscientious trusts and foundations dedicated to public service. But thousands have sprung up in recent years that are little more than pawns in the game of outsmarting the tax collector. The Russell Sage Foundation, a conscientious organization, has made a study of some of the newcomers. Its report states: "A disturbing number of such 'foundations' * * * appear to have no headquarters other than the office of a law firm, to be

modest to the point of complete silence about any program for social or public welfare, and indeed to be making no present contributions of any sort from their accumulated and accumulating wealth."

The fabulous 95,000-acre Montana wheat ranch of Tom Campbell, America's largest wheat farmer, has been sold to a "charitable" trust in Omaha for $2,000,000. Its earnings, which have been subject to a 38 percent tax, now go tax-free. Mr. Campbell continues to manage his ranch at a handsome income.

An enterprising young Omaha lawyer named Gordon Diesing bought the ranch on behalf of the "U. S. Wheat Corporation," which Diesing set up last April "exclusively for charitable purposes." This corporation's profits, after paying Diesing's salary, expenses, etc., go to another charitable corporation, the Sacred Heart Foundation Fund, which is capitalized at $10.

Mr. Diesing is listed as its president, secretary, treasurer, chairman of the trustees, general counsel and resident agent. In effect, his second corporation, capitalized at $10, bought control of a $2,000,000 ranch. Evidently not much money changed hands.

Mr. Diesing also has "bought," for $4,800,000, the 35,000 acres of cotton land in the San Joaquin Valley run by California's cotton king, Russell Giffen. For this he set up another "charitable, nonprofit corporation," which he heads. Giffen remains as manager.

A significant aspect of these deals is that the two ranches in the past year have drawn almost $5,000,000 in United States Government farm loans. Thus, in effect, the United States Government guarantees that they make a profit, while not being able to tax those profits.

Then there are the six tax-exempt "charitable" trusts set up by President Royal Little and his aides in the $60,000,000 Textron Corp. To these trusts was given title to much of the Textron empire. A Senate subcommittee which investigated this set-up reported: "Many millions of dollars have been received by the trusts and but an infinitesimal portion thereof has been paid to the beneficiaries. * * * It is clear that [Textron] has made wide use of so-called charitable trusts as a means of providing risk capital to itself. * * * These trusts have never paid a cent of income tax."

The Educational Device.—Our founding fathers decided, properly, that education should not be burdened with taxes. But they had no notion that universities would go into business in direct competition with taxpaying companies—as several dozen have done.

The University of Michigan now owns Willow Run Airport. Wittenberg College in Springfield, Ohio, has purchased a $200,000 supermarket. Girard College, Philadelphia, through a trustee foundation, operates coal mines. Oberlin College owns 5-and-10-cent stores Washington University in St. Louis has money invested in 51 business buildings, a railroad freight station and a switching yard. The University of Louisville is in the horse-racing business. A tax-free foundation which will have the university as a beneficiary has bought the famous Churchill Downs track, the profits of which no longer will be taxable.

Yale University (through a subsidiary called Connecticut Boola, Inc.) recently bought a new $4,500,000 department-store building which R. H. Macy & Co. had built for itself in San Francisco. Then Yale leased the building back to Macy's for 31 years, at an average annual rental of $240,000. This sale-and-lease-back procedure is today fairly common. Both sides win: the business firm involved gets cash for expansion; the educational institution gets a tax-free real estate investment. The United States Treasury, of course, loses.

The C. F. Mueller Co., macaroni manufacturer, sold out to a "nonprofit" foundation acting in behalf of New York University. New York University and its affiliated foundations own and operate, in addition to the macaroni factory, a $3,000,000 piston-ring factory in Missouri, a $3,300,000 pottery factory and a vast $35,000,000 leather-goods company. A spokesman for the university has admitted that these four companies would have to pay $1,500,000 in United States taxes each year if they were not under the university's protective wing.

The religious device.—Churches are taking millions of dollars' worth of property off the tax rolls with their investments. Father Divine has bought a large hotel in Newark, N. J., giving it tax-free status. It is estimated that Milwaukee is losing $2,500,000 a year in real-estate taxes because churches and fraternal organizations have become such large property owners. Methodist officials are disturbed over the untaxed profits some of their churches are making on properties which have such nonreligious tenants as taverns and pool halls. Samuel Cardinal Stritch of Chicago denied permission to the Catholic order that sought to purchase real estate in Lake County near the city; one factor in his decision was that the county already was seriously burdened by tax-exempt properties

It is my belief that churches should be taxed on all profits from nonreligious enterprises. The Mormon Church engages in a great variety of commercial businesses, yet has always insisted on paying its full share of taxes on profits.

The cooperative device.—Co-ops were given their privileged tax-exempt status in 1916, when they were merely small groups of neighboring farmers trying to get a better return on their crops. The Federal tax then was only 1 percent. Today, however, the tax concession is 38 percent, and many co-ops are monster corporations performing multimillion-dollar transactions in fierce competition with taxpaying businessmen.

A spectacular example is the California & Hawaii Sugar Refining Co., which operates the biggest sugar refinery in the world at Crockett, Calif. Dominated by businessmen who also operate plantations, department stores, etc., in Hawaii, C & H makes millions of dollars in profits but hasn't paid a Federal income tax since 1927. In that year it became a "farmers' cooperative," simply by changing its corporate structure. It remained, however, a corporation, with many of the same stockholders.

Independent oil jobbers in the Midwest have had a desperate time surviving in the face of a great upsurge of tax-free co-ops, which are buying up hundreds of millions of dollars' worth of oil wells, pipelines and refineries. One single co-op owns 805 wells.

Co-ops run vast machine-assembly factories, chemical plants, phosphate mines. They handle 75 percent of the Nation's fluid milk, operate vast feed mills and the biggest grain elevators in America.

One of the so-called farmer co-ops is the California Fruit Growers Exchange, which did a $300,000,000 business last year. It markets the famous Sunkist orange and 85 percent of America's lemons. One of its subsidiaries, the Fruit Growers Supply Co., in 1944 bought the entire lumbering town of Westwood, Calif., for $11,000,000. The purchase included lumber mills, veneer mills, box factories and valuable timber.

There are today at least a dozen co-ops that would have to pay the Treasury an average of a million dollars each per year if they were taxed on the same basis as their competitors. Yet they escape most taxes because they claim to be nonprofit. When co-ops split a melon at the end of a year they say they are handing out a "rebate" or a "refund" or a "final payment due."

The labor-union device.—When tax exemption was granted to labor unions, I'm sure the lawmakers did not anticipate that unions would branch out into commercial enterprises having no relation to union needs. In many cities unions receive rentals on store and office buildings they own, and pay no tax on the income. In La Salle, Ill., a local union is even in the saloon-renting business.

Our biggest unions are planning to operate giant co-op supermarkets in union towns throughout America, in competition with taxpaying grocers. CIO's United Automobile Workers already has a dozen co-op stores in the Detroit area, selling groceries, appliances, clothing, etc. Their announced aim is to capture 50 percent of all local retail trade.

Some small progress is being made in getting tax-exempt organizations to pay their fair share of taxes. The Treasury Department has finally forced a show-down with the Mueller macaroni firm, contending that there is nothing "charitable, scientific, literary or educational" in noodle-making, even though the profits go to New York University. The issue is now in the courts. Also, a few States are taking action. Indiana, for example, has a law taxing business income of all churches, colleges, foundations, co-ops, etc. The law has produced no noticeable hardship. And—partly because of public outcry—a few farm co-ops are now voluntarily paying some taxes.

Isolated State laws and voluntary acts, however, are not enough. What is needed is an overhauling of our national tax laws to eliminate tax inequalities. Such a change would not in the least hinder schools, churches, unions and charitable institutions in their primary functions. It would, however, cut the props out from under most of the legal tax-dodging by commercial profit-makers.

Representative MASON. Now, Mr. Chairman, with war clouds indicating a third world war on the horizon, with the consequent need for more spending rather than less spending by the Federal Government, with a tax burden of $32 per week now bearing heavily upon the average American family of four, it is evident that a peacetime tax bill such as H. R. 8920, as worked out by the Ways and Means Committee, is not what we need for war conditions. Instead of

balancing certain desirable excise-tax cuts with certain fairly unobjectionable increases, as we did in the House, it may now perhaps be wiser for the Senate to consider other ways of raising more funds for the Treasury.

Senator CONNALLY. You are on the Ways and Means Committee?

Representative MASON. Yes, sir.

For more than a year, I have urged the full taxation of the business earnings of tax-exempt organizations as the best and most equitable source of new revenue.

H. R. 8920 just contains a foot in the door, as you might say, to this new revenue. The Treasury itself estimated that about $100,000,000 will result from taxation of the business earnings of educational and charitable institutions and labor unions.

My own careful calculations indicate that $900,000,000 more can be had by taxing the commercial income of mutuals, building and loan associations, savings banks, Government businesses, cooperatives, and other institutions that are engaged in commercial business in direct competition with tax-paying businesses.

In the matter of co-ops, which are the biggest among the tax-exempts, there are now before the Congress three ways to tax them. There is my own bill, H. R. 5064. There is the amendment offered to this committee by Senator Williams of Delaware. There are the proposals of our own joint committee staff which were not acted upon by the House committee.

Full taxation of cooperative earning would produce approximately $300,000,000 a year of new revenue. This is an accurate figure, based on the $18,000,000 volume of business that co-ops are now doing. It will be verified by the calculations of our own tax experts, in complete contradiction of the puny figure presented to you yesterday by an attorney who was trying to discharge the taxation of the co-ops.

There can be no excuse for delaying action further in this important matter of taxing the untaxed. Fears of political reprisals must take a back seat when our national honor in war is at stake. No business, no individual, can complain when called upon to pay a proper share of the costs of equipping our armies to fight on to victory.

In the circumstances, we must prepare financially for war. To this end, I recommend that you start with the revenue-producing provisions of H. R. 8920, taxing the business income of colleges, charities, and labor unions, and that you add immediately to these the building and loan associations, the mutuals, the savings banks, the Government businesses, the cooperatives, and all other free tax riders in our business community.

Senator CONNALLY. When you say "Government businesses," what do you mean?

Representative MASON. I mean all the businesses that the Government is engaged in, in competition with, and carrying on in competition with, taxpaying industries.

Senator CONNALLY. Well, the Government would not make any money out of that tax. It would be just taking it out of one pocket and putting it into another, would it not?

Representative MASON. That is true, Senator. They would not. But it is only fair that that amount be set aside, because they are competing with and, you might say, handicapping, if not destroying, private businesses that are now paying taxes and that will not be

able to pay taxes, if the Government continues to compete with them in these other businesses.

Senator CONNALLY. All right.

Senator BUTLER. Could you give us some illustrations, Congressman?

Representative MASON. Yes. There is the TVA, and there are a lot of other illustrations. The barges on the Mississippi River, for example, operated by the Government in competition with other barges. There are a good many of them.

The CHAIRMAN. Did your committee consider these several recommendations, Congressman?

Representative MASON. The committee did consider them, but not very completely or seriously. The committee only adopted that part of my bill which the administration recommended, and that was the taxing of the businesses operated by labor unions, by charitable trusts, and by educational institutions.

Senator CONNALLY. The unrelated activities.

Representative MASON. That is what we call them; the unrelated activities of these organizations. They refused to touch the unrelated activities of church institutions or of co-ops.

The CHAIRMAN. Or of the mutual savings banks.

Representative MASON. Yes. We did at one time include taxing the reserves of mutual savings banks and building and loan associations. But on my own motion that was stricken out, because they refused to tax the reserves of co-ops, which I thought was only consistent. If you did not tax them, as parallel to these others, I felt we should not tax the others.

I think this is the best possible financial solution, as this war is staring us in the face, and as the need for more revenue rather than less revenue indicates.

That is the end of my prepared statement, Mr. Chairman.

The CHAIRMAN. Very well, sir. We thank you for your appearance. Is there anything else you wish to add, or are there are questions?

Representative MASON. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. William A. Sutherland?

Mr. SUTHERLAND. I am not appearing, Mr. Chairman. I thought my name had been stricken.

The CHAIRMAN. All right, sir.

Mr. Alvord?

Are you appearing for the United States Chamber of Commerce, Mr. Alvord, or as an individual?

STATEMENTS OF ELLSWORTH C. ALVORD, CHAIRMAN, AND JOHN DANE, JR., MEMBER, COMMITTEE ON FEDERAL FINANCE, CHAMBER OF COMMERCE OF THE UNITED STATES

Mr. ALVORD. I appear as chairman of the committee on Federal finance of the United States Chamber of Commerce, Mr. Chairman.

I have a prepared statement, a copy of which I will give to the reporter to be included in the record, if I may.

The CHAIRMAN. You may do that.

(The statement referred to follows:)

Statement by Ellsworth C. Alvord, Chairman, Committee on Federal Finance, Chamber of Commerce of the United States

INTRODUCTION

My name is Ellsworth C. Alvord. I appear before you as chairman of the committee on Federal finance of the Chamber of Commerce of the United States. A member of our committee, Mr. John Dane, Jr., is appearing with me to present our views upon the provisions of title III of the bill relating to certain tax-exempt organizations, the proposed taxation of their income, and the disallowance of certain deductions. I shall discuss our position with respect to tax legislation generally at this time, with respect to many of the provisions of the pending bill, and with respect to certain other recommendations.

I am filing for inclusion in the printed record of these hearings a statement which I have prepared setting forth our views and recommendations.

PURPOSE AND EFFECT OF THE BILL

In this strange, inexplicable, violent, and apparently unavoidable struggle of governments for more power over more people, much of our resources are devoted to discovering better methods to kill people or to make them suffer and much to discovering better methods to save lives and to let people live longer and happier. The bill pending before you cripples the participation of private industry in both endeavors.

The bill as it passed the House of Representatives will stop all exploration and development for oil and gas and minerals and other natural resources. It says to the oil industry, the mining industry, the steel industry, the aluminum industry, the chemical and drug industries, the construction industry, the automobile industry, to all public utilities, to the transportation and the shipping industries, the amusement industry, the cosmetic industry, to manufacturers, wholesalers, and retailers—in fact, to every individual engaged in industry (other than those engaged in purely personal services):

"Stop your research, your development, your expansion. Abandon your plans to improve your products. Forget your efforts to decrease your costs and lower your prices."

It says to labor:

"We have no patience with your hopes for continuity of employment, for promotions, for increased wages, for retirement and pensions."

It says to youth:

"We have so planned it that there will be no jobs and no opportunities for you when you reach employable age."

The foregoing effects, fantastic but indisputable, will be found in the nonrevenue provisions of the bill. Specifically, I refer you to page 65, lines 3 to 8, or to all of section 209, of the bill, beginning on page 62, denying to industry its losses on the sale or abandonment of property used in its business. These provisions will be discussed in detail hereinafter.

We challenge anyone to deny the effect—though we trust everyone will disclaim, if he can, the intent and the purpose.

A FEW FISCAL FACTS

Before discussing the specific provisions of the bill, a brief review of the basis of our present position seems desirable. We begin with a very few pertinent fiscal facts:

(1) The Federal deficits for the fiscal years 1949 and 1950 aggregated about $5,000,000,000.

(2) The estimated deficit for the current fiscal year is about $5,000,000,000.

(3) Expenditures of 42.5 billion dollars are proposed for the current fiscal year—some 8 billion dollars more than in 1948.

(4) Additional requirements of our military could increase its current costs by as much as $5,000,000,000.

(5) Our largest net revenues, derived from a wartime tax system (in 1945), were less than $45,000,000,000.

(6) No endurable tax system can be devised to produce the revenues necessary to pay for the current spending programs.

OUR BASIC OBJECTIVE

For years the Chamber of Commerce of the United States and its committee on Federal finance have set forth "strength" as the basic objective for our country—military strength, economic strength, fiscal strength, moral strength. The peace of the world admittedly rests today upon our strength. Our strength is the foundation of our welfare, our security, our freedom.

Assuming that we are not presently faced with war, the fundamental issue respecting Federal fiscal policy turns upon the soundness of the theory that economic and fiscal strength can be created and assured by excessive and wasteful spending, a very high level of general taxation, a steadily rising level of payroll taxes, and acceptance of deficit financing.

We believe, on the contrary, that the fiscal policies presently advocated by the administration lead not to strength but to weakness. Strength will not be found in Federal deficits and greater debt. A wartime tax system is no creator of peacetime strength or of cold-war strength. A rigid control of costs of government, a determination to live within the income produced by a sensible tax system, and serious efforts to place our tax system upon a peacetime basis will provide pillars for a foundation upon which we can grow, progress, and become stronger.

The pattern represented by the present expenditure and tax programs tends definitely toward assumption of ever greater responsibilities by government. Instead of offering encouragement and incentive to private enterprise in performing its part in economic expansion, excessive spending and taxes constitute a serious deterrent to investment essential to the maintenance of a high level of productivity and employment. The prevention of private investments, through failure to provide relief from oppressive taxes, is a definite if not consciously intended stride toward the use of Government funds for financing private industry—a step toward socialism, from which there is no retreat.

The committee on Federal finance reiterates its faith in those fiscal principles which offer the greatest hope for economic peacetime expansion upon a sound and enduring basis.

OUTLINE OF OUR VIEWS

Our views may be summarized as follows:

(1) Consideration of the pending tax bill should be postponed.

(2) Adjustments in some of the wartime excise taxes are essential and should be made, with especial attention to those upon transportation and communications and to those deliberately designed to prohibit or seriously curtail production.

(3) Reduction of revenues from excise taxes should be offset by reductions in nonessential expenditures.

(4) The full amount needed by our military must be made available.

(5) Rigid and prompt control of expenditures for nonmilitary purposes is vital.

(6) Excessive spending and deficit financing must end unless we incur extraordinary expenditures for military purposes which cannot be financed from current revenues.

(7) The damage to military production and preparedness and to industrial growth, resulting from some of the nonrevenue provisions of the pending bill, is immeasurable. There can be no justification for the provisions denying loss on the sale or abandonment of business assets, for example. And, strangely, the disastrous effect of these provisions upon our economy—upon employment, industry, and the Treasury itself—is not even mentioned in the revenue estimates or in the report of the Committee on Ways and Means.

POSTPONEMENT OF TAX LEGISLATION

Admittedly the international situation is serious. It may become more serious. Whether or not we call it "war," American boys are being killed and wounded. Everyone hopes and prays that the Korean crisis can be confined to Korea. Even so, it may prove costly in lives and will prove costly in dollars. If events take a turn for the worse, a system of wartime taxes must be devised and imposed. But even if events take a turn for the best, we are confronted with increased costs for our military and for military protection.

As of today, we are not prepared to recommend the adoption of a wartime system of taxation—a system of high excise taxes; of higher taxes upon all individual incomes, of a war-excess-profits tax of confiscatory rates after the payment of a much lower normal rate than now; a system which is justified solely by the demands of war. But we may be compelled to do so tomorrow. As of today, we are not prepared to recommend a system of peacetime taxation. Admittedly

we are in a "cold war" or a "close-to-war" period. But if our hopes and prayers are answered, it may be that tomorrow we will be prepared to recommend that substantial steps be taken toward a peacetime system of taxation. The Korean crisis may prove to be the prelude to a more or less prolonged period of uncertainty. No one knows, however, how long the period of uncertainty will be, nor what will follow.

It is our considered opinion that general tax legislation should be deferred until the international picture is clearer and until we can predict more accurately the course we may follow for the immediate future. We know that our military costs will increase. On the assumption that the Korean crisis does not lead to war, that increase may amount to $5,000,000,000 for the current year. There is little upon which we can base hopes for adequate reductions in nonmilitary expenditures for the current year. The Congress should not enact today that which it may be compelled to repeal tomorrow. Nor is it wise to enact a new law which will provide a poor basis for the tax system of tomorrow.

On the other hand, there are some excise taxes which should not have been imposed, or which were imposed to prevent or discourage sales. Excise taxes falling within the first class should be repealed entirely and those falling within she second class should be adjusted so that greater revenues will result. We recommend that this action be taken.

I come now to a discussion of the more important provisions of the pending bill, in the order in which they appear in the bill—not in the order of their importance. In many instances, we shall omit present discussion, for our views and recommendations are adequately presented in the hearings (Vol. II) before the Committee on Ways and Means.

SECTION 203. DIVIDENDS RECEIVED CREDIT

This provision should not be adopted. The cure is worse than the disease.

This so-called loophole is the result of the unsound policy of taxing intercorporate dividends. It can be easily and certainly closed at the minor cost of postponement of imposition of tax by providing that such intercorporate distributions of property shall be tax-free, but with the distributee taking the distributor's basis. The proper tax will then be collected when the distributee sells the property. This is in substance the present consolidated return rule.

SECTION 204. PERCENTAGE DEPLETION

Our views are presented in the House hearings, page 2530 and pages 2541–2542.

In addition, we join the American Mining Congress in its opposition to section 204 (c).

SECTION 205. PRE-MARCH 1, 1913, EARNINGS AND PROFITS

We oppose the adoption of this section. It would overturn the settled policy consistently adhered to by Congress since 1916, in the face of intermittent attacks upon it from the Treasury.

It may well be true, as stated by the Treasury, that there are only a relatively small number of taxpayers who still have undistributed pre-March 1, 1913, earnings or appreciation in value accrued on March 1, 1913, but realized thereafter. But we submit that this is the weakest justification possible for changing the long-established rules at this late date, after the vast majority of the taxpayers concerned have received the full benefit of such rules. It has the appearance of discrimination in its most invidious form.

Another weighty consideration against change is that the reason some companies have not long since distributed all these earnings and realizations is that the rules of the Federal income-tax law itself have made iti mpossible for them to do so. The effect of these rules has been to prevent any distribution being treated as one out of such prior earnings and realizations unless, first, all earnings and profits accrued since March 1, 1913, as well as (since 1936) the earnings of the taxable year have been, fully distributed. The change recommended by the Treasury would, in effect penalize the shareholders of such companies because of their failure to do something which it was factually and legally impossible for them to do.

SECTION 206. LIQUIDATION OF FOREIGN SUBSIDIARIES

Section 206 of the bill proposes to add to the code a new paragraph, section 115 (c) (2). The purpose of the provision is to tax as ordinary income to each domestic corporate stockholder (if there are less than five)is ts share of the sub-

sidiary's accumulated earnings, upon its partial or complete liquidation or upon its merger or consolidation into a domestic corporation. Under existing law, gain from the liquidation would be taxed as a capital gain under section 115 (c) of the code, or, in approved cases, the tax would be postponed, with a carry-over basis.

The proposed provisions are unsound in policy; are directly contrary to the Treasury's policies (discussed hereinafter) designed to encourage foreign trade; are in direct conflict with the proclaimed policies of our Government; and cannot be justified.

Stated very briefly, our Government proposes to say to its citizens:

"We urge you to organize foreign corporations to do business abroad and we hope they will be profitable. But you cannot bring your profits back to the United States."

For years our leaders in Government and in business have been advocating and working diligently toward the removal of restrictions upon the return to the United States of money from abroad. Considerable headway has been made. Legislation has been recommended by the President and is now under consideration by the Congress designed to assist in making further headway. Such efforts and such legislation may as well be abandoned if the present provision is adopted.

Furthermore, as a practical matter, it merely means that there will be no liquidations and no mergers or consolidations. We know of no loophole. But even assuming one or more loopholes exist, nothing is to be gained by preventing the return of property and funds to the United States. Quite to the contrary.

The advocates of the proposed provision must have known that it would be unfair—unjustifiably unfair—to existing businesses and in direct conflict with present policies. We fail to understand how they were authorized to advocate it.

Section 206 should be killed.

SECTION 208. REDEMPTION OF STOCK TO PAY DEATH TAXES

A great many executors are being faced today with an extremely serious income tax problem arising out of the necessity of financing the payment of the decedent's estate taxes. This problem exists particularly in the case of decedents who have devoted their lives to the establishment of small "one man" business enterprises. On the decedent's death his entire wealth is tied up in the business. His estate tax liability forces his executors to find some means of realizing on this investment.

Generally speaking, there are two courses by which this might theoretically be done under existing law. One is to have the business corporation distribute sufficient funds to pay the estate tax liability. The practical consequence of this course, however, is that even where stock is surrendered in exchange for such funds, the Commissioner may take the position that section 115 (g) of the code is applicable and that the distribution is subject to tax as an ordinary dividend. If he is sustained in this position, so much of the funds may be diverted to the payment of the estate's income taxes that not enough is left for the payment of estate taxes.

The other course is for the executors to sell the decedent's stock to outsiders. Obviously, in the case of closely held businesses, stock can seldom be sold except at a considerable discount under its true value. Furthermore, there are practical disadvantages both from a public and private standpoint. Sale of stock to outsiders results in a division or transfer of control involving new people who have not grown up in the business and been trained in its efficient management. Indeed, in perhaps the majority of cases, the purchaser will prove to be a considerably larger business enterprise, thereby leading to a loss of independence on the part of the smaller firm.

Section 208 proposed that in the event a corporation redeems so much of a decedent's stock in this situation as will enable the executors to discharge the estate tax liability, the Commissioner would be forestalled from attempting to treat the redemption as a payment of a dividend.

The court decisions applying section 115 (g) make it clear that in a bona fide case of this sort no dividend tax should be imposed. (See *Girard Trust Company (Wood Estate)*, 32 B. T. A. 926; *Clara Louise Flinn*, 37 B. T. A. 1085; *Estate of Henry Vernon Foster*, T. C. Memo. Docket No. 110891, Mar. 22, 1944, P. H. par. 44091.) However, considerable uncertainty has been expressed as to the scope of this section under recent decisions of the Supreme Court. (See *Kirschenbaum* v. *Commissioner*, 155 F. 2d 23.) Moreover, the refusal of the Commissioner of Internal Revenue to approve such redemptions in many recent cases has added to this uncertainty. Unless the Treasury is prepared to recognize and apply

existing decisions, however, a proposal such as that embodied in section 208 is necessary to rid executors of their present dilemma.

In some respects, however, section 208 as passed by the House is unnecessarily narrow in its application. As it now stands, it would apply only to distributions in redemption "within the period of limitations for assessment of estate tax * * *." In many instances the executors of estates presently in the process of administration have conscientiously proceeded to discharge their estate tax liability with borrowed funds, still being faced, however, with the same basic problem of discharging the loan.

Section 208 should be amended by removing the limitation on the time in which the distribution must be made and substituting a requirement that the proceeds of the distribution be used to discharge an estate tax liability or a debt contracted to pay an estate tax liability. This would not enlarge the scope of the provision beyond its stated purpose, and still would avoid penalizing a prompt payment of estate taxes by conscientious executors who could not foresee the enactment of this provision.

Secondly, the section is too narrow in its application only to situations in which the stock involved constitutes 70 percent in value of the net estate. Estates often have other nonliquid assets. To afford proper relief, this limitation should be reduced.

Finally, the provision should be amended so as to make it clear that its application is not restricted to holdings and redemptions of the stock of a single corporation. Two or more closely held corporations, all or most of whose stock is held by an estate, create the same problem as does a single corporation.

SECTION 209. SALES AND ABANDONMENTS OF BUSINESS PROPERTIES

In practical effect, this section proposes to disallow to practically every corporation losses it incurs upon the sale or abandonment of its business assets. This is accomplished by calling the losses "capital losses"—which means that they are allowable only to the extent of capital gains. But corporations generally do not have capital gains and thus to them the losses would be denied in full.

The effect of these provisions is obvious, direct and disastrous:

(1) Plans for the purchase of new plant or facilities, whether as replacement or as expansion, will be abandoned;

(2) Growth and progress of American industry will be halted;

(3) New exploration for undiscovered mineral resources will be arrested; and

(4) Taxpayers must demand and claim increased depreciation rates, with years of controversy and litigation resulting.

The provisions in question were doubtless accepted by the Committee on Ways and Means of the House of Representatives upon the recommendation of the Treasury. This recommendation was based upon the theoretical conclusion that the present law was a "one-way street." We discussed this recommendation in great detail before the Committee on Ways and Means, both in our written statement and our oral testimony.

Assuming, for the sake of argument, that the present law is a "one-way street," we point out that it is a direct result of (1) a "one-way street" for the Treasury, resulting from the adoption of the emergency policy, which apparently has become permanent, that capital losses must not be allowed except to the extent of capital gains; and (2) the disproportionately high corporate tax.

But, as we have repeatedly pointed out, the present law is not a "one-way street." It merely recognizes that (1) ordinary business losses should be deductible in full—and losses from the sale or abandonment of assets used in the business are ordinary losses; (2) the high corporate rate, disproportionately high as compared with the capital gains rate, would tend to interfere with the disposition of corporate assets no longer needed in the business; and (3) the growth, progress, health, and strength of American industry is based upon exploration, research, development, and expansion—which result in greater employment, lower costs, lower prices, and greater revenues to the Government.

This history of our system for treating corporate gains and losses is well known. Prior to 1934, corporate losses on business properties had always been allowed in full against any type of income; corporate gains on such properties, although subject to ordinary corporate rates, had not been taxed very differently from capital gains. The capital gains rate was 12½ percent, and the ordinary corporate rate during the same period had fluctuated between 10 and 13¾ percent.

This same scheme in its main outlines was continued from 1934 to 1942, although certain changes were made in the 1934, 1938, and 1939 Revenue Acts.

The 1934 act, under the pressure of sagging Government revenues attributable to heavy property losses in the depression years, prohibited capital losses except to the extent of capital gains, plus $2,000.

Under the 1938 act, the treatment of corporate sales of land used in the trade or business remained as it was during the preceding 4 years, but that act, by excluding depreciable property used in the trade or business from the category of capital assets, again allowed losses thereon without limitation.

The only substantial change from this scheme made by the 1939 act affected corporate sales of land, and somewhat liberalized their treatment. This change was the separation of such transactions into two subcategories, according to whether the land had been held more or less than 18 months. The long-term losses were allowed in full, while short-term losses were limited to the extent of short-term gains.

To summarize the 1934 to 1942 treatment of corporate losses on the sale of business property: From 1938 to 1942 losses on depreciable properties were allowed in full without limitation as they had been prior to 1934; from 1939 to 1942, long-term losses were similarly allowed on land. However, from 1934 to 1938, losses on depreciable properties were limited; and from 1934 to 1939 losses on land were limited—with prompt correction made as soon as the effect of the limitations was felt.

Throughout the entire period, gains on such properties continued to be taxed at regular corporate rates. These rates inched upward from 13¾ percent in the 1934 act to 22$\frac{1}{10}$ percent in the Second Revenue Act of 1940, and then made a leap ahead, to 31 percent in the 1941 act. Furthermore, the corporate excess profits tax was enacted as a part of the Second Revenue Act of 1940.

Here again, however, ordinary corporate rates were at a reasonable level, both absolutely, and relative to capital-gains rates. From 1934 to 1938 the latter ranged in effect from 20 to 100 percent of the applicable individual rates, depending on the holding period. From 1938 to 1942, the maximum capital-gains rate was 30 percent, compared with the corporate high for that period (in the 1941 act) of 31 percent. From 1940 to 1942, the excess profits tax made the over-all corporate rates considerably higher, but net long-term gains from the sale of business property were expressly excluded from this tax.

Finally, we come to the 1942 act, which made extensive technical changes in the definition of capital assets, the maximum capital gains rates and the holding period provisions, and added section 117 (j). The effect of all of these changes, so far as corporate dispositions of business property is concerned, was to allow losses in full and without limitation, and to tax gains at a rate of 25 percent. The corporate rate on ordinary corporate business income was simultaneously raised to 40 percent. The treatment of corporate transactions involving business properties provided in the 1942 act has continued unchanged until the present time.

This history has been set forth in detail in order to demonstrate clearly to the committee the historical validity of three propositions: (1) The Congress has never taxed gains on dispositions of corporate business properties at a rate higher than 31 percent; (2) the Congress has never declined to allow the full amount of losses on the disposition of such properties, subject to certain maximum limitations applied during the depression-psychology years, 1934 to 1939; and (3) the Congress has never declined to allow the full amount of abandonment losses.

The policy does not turn upon whether property used in the trade or business is in some theoretical, economic sense a "capital asset" or not. The practical policy involved has been stated adequately.

Nor is there any greater merit in the Treasury's alterntive proposal that, if losses on these properties remain allowable in full, gains on them should be taxed as ordinary gains. Again, the question here is not an abstract question as to the theoretical nature of these properties. The reason for the decision in 1942 to treat gains on the sales of business properties as capital gains is sound when considered in the light of the simultaneous increase in ordinary corporate rates to unprecedented heights. It was recognized that any gains which might be realized on the sales of these properties were not ordinary business gains; they would usually be attributable to general rises in the price level; and the confiscation of 40 percent of this type of appreciation would deprive corporations of the means with which to obtain the replacements which had to be acquired at the same inflated prices. However, if the Congress desires to adopt a policy of discouraging growth and expansion, less damage will result from the Treasury's alternative proposal.

Directly contrary to the effect of the provision under discussion we recommend that serious consideration be given to the sound proposals we have advocated for

revision of the present depreciation rules; and we think the time is rapidly approaching for the adoption of appropriate provisions for the optional amortization over a period of 5 years of the cost of new facilities.

SECTION 211. COLLAPSIBLE CORPORATIONS

Section 211 is directed at the so-called collapsible corporation device for avoiding ordinary corporate and individual income tax rates on business earnings. This device originated in the motion-picture industry about 1942–43. It has had many variations, but in its simplest form it involved the following: a small group of motion-picture talent would organize a corporation; contribute a small amount of capital; borrow the balance required for the making of a picture; usually pay themselves little or no compensation; make a picture; contract for its distribution; and liquidate the corporation, giving to each of the stockholders a certificate representing his share in the income from distribution after payment of debts. It was contemplated that the corporation would incur no tax liability and that the stockholders would have only capital gains. Section 211 would expressly provide for the taxation of any gain realized by the shareholder, either on a liquidation of the corporation or a sale of his stock, at ordinary rates.

Early in 1943 we called the attention of Treasury officials to the existence of this practice and gave them a copy of our opinion to the effect that such plans would not be successful under existing statutory law and court decisions. If the Treasury had seen fit at that time to contest this device and had announced its intention to do so, the commercial financing of such projects would have become impossible. Few would ever have been undertaken and those, in our opinion, would have been properly dealt with by the courts. Decisions in related situations since 1943 have confirmed the soundness of our earlier opinion.

It is now common knowledge that after investigation of a large number of these cases, the Treasury has asserted certain deficiencies against some of the parties involved. None of the cases has reached the state of litigation.

Section 211 as proposed, not being retroactive, cannot assist the Government on past cases. Indeed, in most of them, the corporations involved will already have been dissolved and the profits will have been dissipated. And the present provision, with its history, may well validate past practices. As to the future, there probably will be no cases in the motion picture industry for a very practical reason. Banks are now refusing to make the loans.

Section 211 is not a mere unnecessary redundancy, however. It represents an attempt to fix the boundary between legitimate capital gain and tax avoidance rigidly, in terms of proportionate stock ownership and gains. The inevitable consequence is that schemers can tailor their plans so as to avoid the application of this provision. Legitimate and unsuspecting investors will be unjustly penalized. The clause making owners of more than 10 percent of the corporation's stock subject to this section, whether or not they were privy to an improper plan, is an example of the arbitrary nature of this section.

Much worse is the extreme breadth of application of the section, extending to many areas of legitimate enterprise. For instance, if section 211 were enacted, the Bureau might seek to apply it to any liquidation of a parent corporation even where the subsidiary corporation was engaged in an ordinary business enterprise, if the parent's liquidation had occurred at a time early in the life of the subsidiary corporation. The Bureau might also seek to apply the provision to legitimate business promoters who initiate a business venture and, after its successful establishment, dispose of their stock in a bona fide sale to buyers who expect to continue the business indefinitely. True, section 211, according to Treasury statements and the Ways and Means Committee report, is not intended to apply to these situations. Perhaps the Bureau would not seek to apply it in an improper fashion. Nevertheless, it is bad lawmaking to declare everybody a criminal on the assumption that the police will arrest only wrongdoers.

Section 211 is unnecessary and its application and effect cannot be foreseen. It should be rejected.

SECTION 212. CAPITAL GAINS OF NONRESIDENT ALIENS

Our views on the Treasury proposal appear in the House hearings, page 2536.

We see no reason for the proposed legislation. It does not even lock the barn door—although the horse was stolen several years ago.

The statement of the issue gives the answer. Should the nonresident alien individual temporarily in the United States be denied the opportunity to buy and sell securities and commodities on exchanges located within the United States, through brokers residing and working in the United States?

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SECTION 214. NET OPERATING LOSS DEDUCTIONS

This section is very important and constructive. It involves no immediate loss in revenue. We urge its adoption, but we believe that under existing conditions the 2-year carry-back should be retained. The Secretary's recommendation, however, unfortunately ignores the urgent need for a thorough-going revision of the net-operating-loss provisions in section 122 of the Code so as to eliminate the so-called economic loss adjustments which are so inequitable and discriminatory in their operation and which prevent section 122 from approaching the ideal of an averaging of business profits over a reasonable period.

H. R. 6712 in 1948 contained an amendment which incorporated this vital and long overdue reform, except that due to drafting difficulties it did not relieve intercorporate dividend income from the burden of absorbing operating losses.

In order to deal fairly and without discrimination with corporations having the same amount of net income over the total period, but with some having a fairly even flow and distribution of income between the years in the period while others have some years of large profits and others of losses, it is essential that these so-called economic-loss adjustments shall be eliminated and that the intercorporate dividend problem be solved. The latter will be technically difficult only so long as the unsound policy of subjecting intercorporate dividends to tax is continued.

The principle which should be applied in the application of the net operating loss is plain. It should operate to produce the same result in terms of net tax liability for the period, except for the effect of changes in rates as between different years in the period, as though all the profits and all the losses realized within the period were gains and losses within a single taxable year.

SECTION 218. INCREASE IN CORPORATE INCOME TAXES

We believe that nothing further need be presented at this time upon this subject. Consideration of increasing or decreasing corporate tax rates should be deferred. Furthermore, unless we are headed directly into a war economy, we strenuously oppose any increase in corporate rates—for all the reasons known by the members of this committee and for all the reasons known to advocates of sound fiscal policy. We might, however, repeat the warning we have so often given. The unavailability of equity capital for most corporate enterprises is reflected today, precisely as we predicted, in demands for Government loans. As we have stated Government financing of corporate enterprises is an irretraceable step toward socialism.

SECTION 501. TRANSFERS IN CONTEMPLATION OF DEATH

We approve the adoption of a conclusive presumption that transfers made more than a certain period of time prior to death shall not be deemed to be made in contemplation of death.

We believe that it would be just and reasonable to exclude from the contemplation of death clause all inter vivos gifts, except those "causa mortis," leaving them subject to the gift tax only. Failing this, the committee should at least reduce the 3-year cut-off date fixed in section 501 of the bill to 2 years. Two years is the period which all preceding estate tax laws have considered to be sufficiently long that no preceding gifts could be presumed to fall within the contemplation of death provision.

We believe also that fairness requires that the provision be made retroactive. Controversy and endless litigation have resulted from the position so frequently taken by employees of the Treasury if any substantial gift was made in contemplation of death—even though made 10, 12, or 15 years prior to death. Purely to avoid the cost and delays of litigation, the executors of many estates have settled such claims by agreeing to pay a portion of the amount demanded. Others are presently contemplating such action. Fairness requires that the provision in question be made applicable to all such cases.

SECTION 601. WITHHOLDING ON DIVIDENDS

The views of the minority of the Committee on Ways and Means with respect to this section are well stated and sound. We endorse them. In addition, there follows a discussion of the practical impact of the proposed provision, prepared by one of the members of our committee who is an officer of a large bank and trust company:

The following are some of the costs and consequences of section 601 of the revenue bill of 1950, as proposed.

A great hardship is imposed on all payers or their disbursing agents by section 1312 (method of return subject to regulation by the Commissioner, with approval of Secretary) and section 1314 (statement to payee shall show amount of the dividend and the amount deducted).

The cost of preparing a return by listing the payees showing the gross dividend paid to each and the amount of tax withheld would range conservatively from $25 to $45 per thousand stockholders.

The annual cost of preparing a statement to payees showing similar information would range from $120 to $180 per thousand payees, including postage.

It is reported that the 213 leading companies have 10,619,539 stockholders. There are 286,400 manufacturing companies according to the latest available figure. Considering stock companies in other categories and the large numbers of beneficial owners of shares registered in the names of brokers and nominees, it is estimated there are some 30,000,000 shareholders who will be subject to this program. This means several hundred thousand returns listing 30,000,000 names and amounts, and also 30,000,000 statements to payees.

On this basis, the estimated annual cost imposed on payers would be from 4¼ million to 6¾ million dollars. This increased expense would reduce corporate taxes paid (using a 40-percent rate) between 1.7 million and 2.7 million dollars a year.

Equipment of many payers would become obsolete as new systems and machines would be needed to furnish information required. Instead of having only one amount to deal with, two amounts must be computed, recorded and balanced each time a dividend is paid. If an average of 3 dividends are paid a year, this leads to 90,000,000 additional factors for payers to consider.

Treatment of fractional cents while seemingly insignificant becomes a tremendous problem out of all proportion to the amounts involved. The 10-percent tax greatly increases the incidence of this problem as all odd amount payments will result in fractional adjustments (25 cents becomes 22½ cents, etc.), for instance:

A customary action of all fiduciaries and agents, who handle income collections in volume, is to prepare journal or tabulating-card records, of dividends to be collected, in advance of the payment date. Mechanical processing is necessary if funds are to be made available as soon as required. If it is left to the discretion of the paying agent whether fractional-cent adjustments should be made up or down, accurate preprocessing becomes impossible. If the proposed tax is adopted, regulations should prescribe a uniform procedure. Whether it is up or down makes no difference, but it should be the same for every dividend and for every paying agent.

Many shares are held by brokers, nominees, and trustees for others. Burdens similar to those described above would be added to this class of stockholders in reporting withholdings to beneficial owners. Serious problems in trust accounting arise, such as:

(1) Allocation of withholding to several beneficiaries where only part of the income is from dividends.

(2) Allocation of withholding where fixed payments are made and residual amounts accumulated.

(3) Payment involving nontaxable beneficiaries.

In all of these cases if the trustee could wave his hands and say to the beneficiary "that's your problem" the arithmetic would not be insurmountable but most of the time he must be helped in filing his return or claiming refund as the case may be.

The problem becomes even more acute should it become necessary, as proposed in the House Ways and Means Committee report, to itemize dividends on the recipient's income-tax return.

Revision of accounting procedures would be required of all brokers, nominees, and trustees to provide means of accumulating gross dividends and tax paid at source. Furthermore, section 1314 would require reports to payees not later than January 31 of the year following payment. This time is wholly inadequate as corporate trustees now find it is extremely difficult to complete advices under existing requirements by March 1. It would be impossible in discretionary trusts where the "65-day rule" under the Revenue Act of 1942 is used.

Many claims would arise imposing much additional expense on the people as well as the Government. What is the poor aged blind person who relies on his small investment in A. T. & T. to do about the 10 percent taken from him? Hire a lawyer?

The report of the House Ways and Means Committee states that $300,000,000 of dividends were paid in 1947 to tax-exempt institutions and to individuals with incomes below the filing requirements. Therefore, $30,000,000 would be subject to refund for excess tax withheld and nontaxable institutions.

General Motors Corp. states that 77,445 or 18 percent of its 434,075 stockholders are "charitable organizations, insurance companies, churches, schools, and other groups representing not one but many individuals." Claims and delays will be costly to this class of stockholders.

Dividends where the taxable portion cannot be determined at time of disbursement (sec. 1311 (b)) will result in many claims. Take Anaconda Copper with 123,000 stockholders as a case in point. Or take a holding company like United Corp. with 71,800 holders whose dividends are considered "tentatively" to be a return of capital. The problems of the recipients of these and many similar dividends become fantastic and those of the Government Claims Section as great.

It would seem highly probable that the cost to the Government in honoring claims alone could better be spent in policing the information it now gets by means of Form 1099. The small dodger could be picked up by requiring 1099 returns for all apyments.

Section 601 (g) would amend section 148 relating to Form 1099 to require showing amount of dividends paid and the amount deducted. This creates an additional cost in preparing 1099's. If the proposed bill must be passed this section could be simplified by changing it to read "the net amount of dividends paid to him, and the rate of deduction and withholding under section 1311 with respect to each shareholder."

SECTION 602. REDUCTION OF RATE OF INTEREST ON OVERPAYMENTS

Much can be said in support of reduced interest rates upon both deficiencies and refunds, applicable only after some specified future date. In our opinion, nothing can be said for the establishment of different rates of interest—a 6 percent rate of interest on deficiencies, for example, and a 3-percent rate on refunds, as section 602 proposes. Furthermore, it seems rather apparent that the complications of a two-rate system have not been adequately analyzed and provided for. Nor does section 602 seem to meet the situation resulting from those provisions of our tax laws which provide that during certain periods of time no interest will be payable upon resulting refunds, or where a deficiency is ultimately wiped out or offset, in whole or in part.

SECTION 603. ACCELERATION OF INSTALLMENT PAYMENTS

Our dislike of this proposal is adequately set forth in my testimony before the Committee on Ways and Means in response to questions by Chairman Doughton (p. 2594, et seq.) and Congressman Mills (p. 2583, et seq.). The position we took with respect to the acceleration of payments by corporations is equally applicable to acceleration by estates or trusts.

TAXATION OF FOREIGN INCOME

Certain measures have been recommended to the committee by the Treasury Department which are calculated to mitigate the excessive burdens of taxation on American technicians and capital in foreign countries.

The President in his message to the Congress on January 23, 1950, urged the enactment of some such measures in furtherance of his point 4 program. Five particular changes in the income- and estate- tax laws directed at this objective were suggested by the Secretary of the Treasury to the Ways and Means Committee in February. Although no opposition to any of these proposals was expressed at the Ways and Means hearings, none of them was included in the bill which was reported out by that committee and passed by the House. In his testimony before the committee on July 5, the Secretary again defined and advocated the passage of the same proposals which had been submitted to the House committee.

We believe that these measures would be extremely effective in encouraging American enterprise abroad, both on the part of those who might enlist their personal services and those who might provide capital. This, as the President urged, is dictated in the interest of our national relations with other non-Communist countries, particularly in those areas where American private services and capital are most in demand. It is also dictated in the interest of fairness toward those American individuals and corporations working or operating abroad who are penalized by double or discriminatory taxation.

The first of these five proposals would grant United States firms the election to have the income of foreign branches treated for tax purposes like that of foreign subsidiaries. Foreign branches of American firms are taxed on foreign earnings in the year accrued; foreign subsidiaries operating abroad are not themselves taxed by the United States—their earnings become liable to United States taxation only when returned to this country.

This difference in tax liability has no rational basis in the tax-paying capacity of the firms concerned, nor in any other national policy. The decision whether to incorporate abroad a foreign operation is most likely to derive from foreign laws to which the business will be subject, or from other considerations unrelated to tax policy. Where these militate against foreign incorporation, the venture concerned, besides having to pay what amounts to a tax penalty, is sometimes deprived by present United States taxes of the benefit which would otherwise accrue under the tax laws of other countries to foreign capital employed therein.

The second of the Treasury proposals would broaden the conditions under which a credit is allowed against our income taxes for taxes paid other countries on business operating in those countries, so that the credit will be granted to corporations holding minority as well as majority interests in foreign enterprise. This would not only end an existing discrimination between large and small stockholders in a single enterprise, it would also extend the credit to those cases where two or more domestic interests wish to enter a venture on an equal footing, and where foreign law or business conditions dictate local participation in large proportions.

The third proposal relates to the limitations on the foreign tax credit. At present these limitations are twofold: one limits the allowable credit for any particular foreign tax to that part of the Federal tax which net income within that country bears to total net income; the other limits the total credit to that part of the Federal tax which net income from all foreign sources bears to total net income. The proposal would abolish the second, or "over-all limitation."

We agree that the two limitations together are not required. Either alone would prevent any unwarranted infringement upon Federal collections with respect to income from domestic sources. Repealing the "over-all limitation" and retaining the "country-by-country limitation," as the Treasury suggests, would permit a credit to be allowed where losses in one foreign country offset gains in another. On the other hand, repealing the "country-by-country limitation" and retaining the "over-all limitation," which is the converse of the Treasury suggestion, would permit relatively lower tax rates in one country to offset higher rates in another in computing the allowable credit. Either change would be an improvement over existing law, in that some encouragement would be offered to American enterprise abroad at no cost to Federal revenue from taxes on income from domestic sources.

A fourth proposal is to establish a credit against Federal estate taxes for death taxes paid to foreign countries. This measure is in accord with the policy against double taxation which has already been given expression in three estate tax treaties. The adoption of this proposal would make that policy generally effective, thereby rendering personal participation in foreign enterprises considerably more attractive to American citizens with substantial means.

The fifth and final Treasury proposal in this field calls for a liberalization of the section 116 (a)-exclusion of income earned abroad by United States citizens resident abroad. Under present law, the exclusion is allowed only where the taxpayer has been resident abroad for the entire taxable year The Treasury has rightly suggested that there is no reason not to allow the exclusion from the date foreign residence is first assumed. Thus, if an American citizen moves to Venezuela in February, it is not good policy to say to him: "You should not have to pay a Federal tax on your salary earned down there as long as you are a resident of Venezuela, but we are going to make you do so anyhow the first 10 or 11 months you are there, and if you ever return to the United States, you will again be taxed on your Venezuela salary for the last few months abroad—depending on the month of the year in which you choose to return."

In one respect, however, this proposal does not go far enough. Since the present provision was enacted in 1942, the courts have inclined toward construing "residence" as tantamount to "domicile." For example, they have refused to recognize foreign residence because the taxpayer left his family in the United States, or gave other evidence of an intention to return at some time in the future.

This construction entirely misconceives what we believe to have been the purpose of the 1942 amendment. The people whom that act was supposed to benefit were not expatriates who had renounced the United States forever. They were the armies of managers, technicians, and skilled workmen who are induced

to commit themselves for 18 to 36 months abroad. In many instances the nature and location of their work does not permit them to take their families. In practically no instances do such men have an intention on their original departure of making their home abroad permanently, even though they may renew their contracts many times and stay abroad for years. We know of no single tax measure which would be so helpful to all American enterprise abroad as an amendment to section 116 (a) making the exclusion date from the inception of the foreign residence, and clarifying the meaning of foreign "residence" to include physically residing in some foreign country perhaps for some minimum period of time.

RESEARCH AND DEVELOPMENT EXPENSES

For some years it has been the policy of the Treasury to allow research and development expenditures to be deducted as business expenses, rather than to require that they be written off over the life of the resulting device or process or on the abandonment of the project. This policy is understood to have been adopted in recognition of the national importance of private investment in research activities, the fact that successful modern research is usually carried on as a continuing program involving fairly regular costs from year to year, and the difficulty or impossibility of allocating all of such costs to various specific projects for tax accounting purposes.

We believe that this is an enlightened policy from the standpoint of encouraging technical advances in all fields of American industry, and that every precaution should be taken to see that it is continued.

A recent court decision, however, raises some doubt as to whether a change is being effected toward requiring these expenditures to be capitalized. (*Hart-Bartlett-Sturtevant Grain Co.* v. *Commissioner*, Eighth Circuit, May 5, 1950.)

If the Government position in this case represents a general reversal in policy, rather than the result of some possible peculiarity in this particular case, we urge strongly that the Congress promptly recognize and approve the practice existing heretofore.

OTHER RECOMMENDATIONS

We have made many recommendations from time to time for the improvement of our tax laws and their administration. The intercorporate dividend tax, the penalty imposed upon consolidated returns, the multiple taxation of corporate earnings, the outmoded tax upon the transfer of silver bullion, and a number of so-called technical and administrative problems, all have for years demanded consideration. We urge the appropriate committees of the Congress to consider all such problems at the earliest possible time.

Mr. ALVORD. And I would like to make just a few remarks.

Two weeks ago today, our committee on Federal finance decided that the wise and sensible policy at the present time would be to defer consideration of general tax legislation. That recommendation was promptly approved by the board of directors. The reasons I set forth in our prepared statement. Basically, of course, it is the international situation.

Whatever else can be said about the Korean crisis, certainly it means that we are in for a more or less prolonged period of uncertainty, and no one knows what will follow at the end of that period. With American soldiers losing their lives either in warfare or manslaughter, it seems highly untimely that reductions in revenues should be considered. On the other hand, I don't think anyone is today presently prepared to determine what kind of a tax system we need for tomorrow. If the Korean crisis becomes more serious, unquestionably we will have to consider a system of wartime taxes.

As of today, I would recommend against consideration of wartime taxes. Certainly today is no time to reduce revenues, because whatever else happens in the Far East or elsewhere in the world, we certainly can expect a very definite, substantial increase in our costs for our military and costs for military protection.

I made an estimate, which I trust will prove too large; but I personally would not be a bit surprised to see military expenditures for the current fiscal year exceeding present estimates by $5,000,000,000. Facing a $5,000,000,000 deficit, plus a possible additional $5,000,000,000, it seems that the wise policy is to just sit and not rock the boat too much; sit until we know more definitely which way we are going.

That does not mean that a few things cannot be done. There are, as you gentlemen know, a limited number of excise taxes which were imposed unsoundly in the first place, or were imposed with the specific design of prohibiting or seriously curtailing production. Those unsound taxes, such as our taxes on transportation of property or taxes on communications, I think it would be wise to repeal. Those taxes go directly into costs, and I make a rough guess that they cost the Treasury in revenues, directly and indirectly, more than they produce. Other taxes, those which were imposed for the purpose of prohibiting sales, prohibiting production, and those taxes which are not producing the maximum amount of revenues which they could produce, I think should be revised—and there are only a few of those. Many of those taxes are costing the Treasury money.

The principal objective I would have in mind is the attainment of maximum revenues under what, in effect, is the present system. Beyond that, with the possible exception of two points, I think this committee would be wise to do nothing. I think our depreciation problems must be worked out in a more satisfactory way, and I think quite contrary to the wholly unjustifiable, improper, ill-considered provisions of section 209 of the bill, you might well give immediate consideration to a provision for a 5-year amortization of the costs of new facilities.

I will close by urging that you consider very carefully the provisions of section 209 of the bill, which, as I read them, would stop progress, expansion, new projects, new facilities, in industry in the United States. That is the section, you will recall, which says that no business can get a business loss on the sale or abandonment of business properties no longer needed in its business. I suggest to Senator Connally that the oil industry in Texas——

Senator CONNALLY. You mean the one that deducted from capital gains?

Mr. ALVORD. That is right.

Senator CONNALLY. Well, you did not make that clear.

Mr. ALVORD. Senator, I still will let my statement stand as it is, because there is practically no industrial corporation engaged in business which will have capital gains against which these losses can be offset.

Furthermore, these are business losses. They have nothing to do with capital gains. No more do drilling expenses in Texas, Senator, represent capital expenditures; no more does the abandonment of the property represent a capital loss.

I give in my written statement quite a lengthy discussion of this provision, because of its importance, including the history of it. The justification for 117 (j) of the present law exists today exactly as it did back in 1942. The reason that capital assets were subjected to the capital gains rate on sales is because the normal rate was just too high. It was not because they were considered capital assets. They

are business assets. And I quote one of the greatest authorities of the United States, the Chief Justice of the United States. In 1939, the present Chief Justice of the United States, who was then on the Committee on Ways and Means, gave you a very excellent report of exactly what was going on with respect to the sale of business assets used in the business. That is why 117 (j) says that when you sell business assets you are subjected only to the capital-gains rate; not that they are capital assets, but because the normal rate on corporations was just plainly too high. It was interfering tremendously with the sale of capital assets.

The loss provisions of 117 (j) are as sound today as they ever were, because these are perfectly normal business losses. If more should be said, I am very happy to refer you to my written statement, where the only fear I have is that I do not condemn the provisions strongly enough. I have never seen a more poorly timed provision get into a revenue bill in all my experience. And I am not exaggerating.

Now, Mr. Chairman, it is needless for me to say that we approve what I understand to be Secretary Snyder's present position. He took a position 2 weeks earlier, when he appeared 2 weeks ago Monday, that he seemed still to favor passage of a tax bill. But we certainly endorse his present position, except that there are rather minor adjustments we think should be made at this session of Congress, and we think they can be made.

I have asked Mr. John Dane, Jr., of Boston, who is a member of our committee, to discuss with you the provisions of the bill with respect to charitable and the other tax-exempt organizations and the changes in deductions and the changes in the manner of taxation.

And with that, I am very happy to submit the written statement prepared for you, and to answer any questions.

The CHAIRMAN. Are there any questions, gentlemen?

Then you may call Mr. Dane.

Mr. DANE. Mr. Chairman and Senators, I am John Dane, Jr., of Boston, and I appear before you as a member of the committee of which Mr. Alvord is chairman, the committee on Federal finance of the United States Chamber of Commerce.

My testimony will deal solely with the complicated and intricate provisions which are in title III of the new bill.

The CHAIRMAN. You may be seated, if you prefer.

Mr. DANE. Thank you, sir.

For a moment may I discuss the general policy of the chamber with regard to this bill? It is our policy that we are opposed to Government favoritism in any form, and we urge that no enterprise be favored over any other form, and that each enterprise, whether it is cooperative, individual, or corporate, should stand on its own feet, with protection from unfair competition, and free from either tax exemption or other public subsidy. We have examined the provisions of the new bill in the light of these general policies.

We feel that part I of title III of H. R. 8920, insofar as it seeks to tax the unrelated business income of charities, which are now exempt, is a principle which should be recognized in our revenue laws.

We note with regret that the special treatment and privileges which which are now accorded to cooperatives are not changed in this law, and we feel that if the presently favorable provisions of the code affecting religious, charitable, and certain other organizations are cut

into, the tax favoritism now available to cooperatives would be even more unjustifiable.

We find some faults of draftsmanship in those parts of part I having to do with unrelated business income. That is dealt with more in detail in my prepared statement.

We are opposed, and very strongly opposed, to those provisions of Part I of title III of the bill which seek to tax charities—and by "charities" I want to include the religious and educational institutions, as well as strictly charitable institutions—on their accumulated investment income which is not spent in any given year. We feel the result of this section is to take away from those organizations and from the management of those organizations their right to decide the timing of the spending of their own funds. So long as this income can be spent only for charitable or other designated exempt purposes, we see no reason for the Government to compel its distribution within any particular period.

We now refer to part II of title III of the bill, which seeks to limit the deduction which trusts now enjoy under section 162 for any income which is paid or permanently set aside for charity. This deduction now, in the case of trusts, is unlimited and is not confined to 15 percent of their income, as in the case of individuals. We disagree with those portions of the bill which seek to tax these trusts on accumulations.

Part III of title III of the bill imposes two sets of qualifications before gifts to certain organizations can be deductible for income, estate, or gift tax purposes. The first of these qualifications merely provides that the organization in question must meet certain requirements. Those requirements are dealt with more in detail in my prepared statement, and subject to certain minor exceptions, we are in sympathy with them. I think your committee has heard considerable testimony from representatives of hospitals and universities on those requirements, and I think that they have presented the matter fully.

Another set of restrictions deals with the deductibility of charitable gifts when these gifts are made in corporate stock. These provisions disallow any charitable deduction for gifts of stock in a corporation in which the contributor or his family has a substantial interest, if at the same time the recipient charity is also controlled by the contributor or his family.

Charitable corporations which do not depend upon public support would be penalized, we believe, by adoption of this provision. Many estates now consist almost entirely of stock in closely held corporations, because of the fact that our tax laws have made it impossible for them to secure sufficient funds for investment in market securities. The bill effectively deprives those estates of the incentive for contributions to charities of a nonpublicly supported nature.

I think we ought to realize that these nonpublicly supported charities form a very large proportion of all the charitable organizations of the country. Many local hospitals, libraries, orphanages, and institutions of that type are supported in preponderant measure by endowment funds contributed by a few individuals. These organizations relieve the community of a large obligation which the community would otherwise have to undertake.

If under this bill these organizations are required to go out and seek contributions from the general public, the present publicly supported charities, such as the American Red Cross and the Boy Scouts of America, will suffer, if only because it will become necessary for the public to distribute in a wider field the amount of money which it has to give to charity.

We feel the implications of part III of title III are enormous. They go to the very heart of the American system of charitable contributions. No other provisions of the bill in our opinion are more dangerous or more inequitable.

In conclusion, let me say that we favor the closing of any real loopholes which exist in connection with section 101 organizations, particularly where they offer unfair competition to taxable organizations, but we recommend that before legislation in the form of title III of this bill is passed, substantial revision be made in order to avoid hardships which we feel the present draft would make upon bona fide undertakings which are in the public interest.

The CHAIRMAN. Was your statement included in the general statement by Mr. Alvord?

Mr. ALVORD. No, sir; it was not. May I suggest that Mr. Dane's written statement be incorporated in our joint appearance?

The CHAIRMAN. Yes, sir.

You may hand it to the reporter, Mr. Dane, and it will be included in the record.

(The prepared statement of Mr. Dane follows:)

STATEMENT BY JOHN DANE, JR., MEMBER, COMMITTEE ON FEDERAL FINANCE, CHAMBER OF COMMERCE OF THE UNITED STATES

I am John Dane, Jr., of Boston, Mass., appearing as a member of the committee on federal finance, Chamber of Commerce of the United States.

My testimony deals with title III of H. R. 8920 and certain cognate provisions.

GENERAL POSITION

As a matter of general policy the Chamber of Commerce of the United States is opposed to Government favoritism. It urges that no form of lawful enterprise be favored over any other form and that each, whether cooperative or individual, should stand on its own merits with protection from unfair competition and free from tax exemptions and any other public subsidies.

In the spirit of this declaration of policy the chamber committee has weighed (1) the provisions of the bill which are being advanced to prevent abuses of various exemptions which Congress has extended in the past to organizations and institutions covered by section 101 of the Code as well as (2) those provisions of the bill which affect deductions now permitted trusts for amounts paid to or set aside for charity and (3) those provisions which impose new restrictions upon other deductions for gifts and bequests.

The chamber committee favors the general principle embodied in part I of title III of the bill insofar as it seeks to subject to income tax the income derived by charities and the other affected organizations from activities not related to the purpose which gives rise to their exemption.

We note with regret, however, that there is nothing in the bill which seeks to restrict the special treatment and privileges now extended to cooperatives. We believe that such special treatment and privileges are now so broad as to expose other businesses to unfair and destructive competition at their hands. If the favored position of charitable and other organizations is to be curtailed, the tax favoritism now available to cooperatives will be even more unjustifiable.

The provisions of the bill defining the unrelated business income subject to tax contain certain faults of draftsmanship which should be corrected if your committee decides to persist in the endeavor to frame legislation at this time. I shall deal with the more important of these in my testimony and will cover all of them in the memorandum I shall file with the committee.

The chamber is opposed to the provisions of part I of title III which seek to tax certain previously exempt organizations on so much of their income from investments as is accumulated and not spent in any given year. The result of this section of the bill is to take away from these organizations the right to decide the timing of the spending of their funds. So long as the income in question can be spent only for charitable and other designated exempt purposes, we see no reason for the Government to compel its distribution within any given period.

We also oppose the policy of part II of title III which is, in broad substance, an attempt to disallow any deduction from the income of certain trusts which is permanently set aside for exempt purposes and not paid out in the current year. All charitable gifts should be encouraged rather than discouraged. It is important that funds be accumulated for charitable purposes at the earliest possible moment. The establishment of hospitals, scholarship funds, scientific research projects, etc., will not always await a person's death and they cannot be supported entirely by a few rich persons who might be in a position to put their funds to work immediately. The average person desiring to contribute to a worth-while charitable project should be given the privilege of making a relatively small contribution with a provision for the accumulation of income until the fund is sufficiently large to carry out the charitable project. The abuses which this bill proposes to correct are insignificant in comparison with the hardships and inequities it imposes upon bona fide charitable trusts.

Part III of title III seeks in the first place to disallow a deduction for certain charitable gifts and bequests unless the recipient falls into certain classified classes or unless the instrument under which the recipient is organized meets certain requirements.

Subject to certain specific criticisms of the standards set up, we are in sympathy with the general policy of these first restrictions.

The second set of restrictions upon the deductibility of charitable gifts embodied in part III of title III of H. R. 8920 relate to gifts of stock. These provisions would disallow any charitable deduction for gifts of stock in a corporation in which the contributor or his family might have a substantial interest, provided that the recipient charity is controlled by the contributor or his family. Any charitable organization which does not depend upon the general public for its support is penalized by this provision of the law. Many estates now consist almost entirely of stock in closely held businesses because of the fact that our tax laws have made it impossible to accumulate sufficient funds for investment in general market securities. The bill effectively deprives those estates of the incentive for charitable contributions of a non-publicly supported nature. Non-public-supported charities form the bulk of the charitable organizations of this country. Local hospitals, libraries, orphanages and old ladies' homes are largely supported by endowment funds contributed by a few individuals. They relieve the community from its obligation to support such institutions. If, by this bill such institutions are required to seek public contributions for their support, the present publicly supported charitable institutions, such as the American Red Cross, the Boy Scouts of America, etc., will suffer simply because it will become necessary for the general public to distribute its charitable contributions over a much wider field. The implications of this provision of the proposed law are enormous and go to the heart of the whole American system of charitable contributions. No other provision of this title is more dangerous, more inequitable or more unfair.

ANALYSIS OF SPECIFIC PROVISIONS OF TITLE III

Title III of the bill is divided into three parts.

Part I imposes a tax on unrelated business income and accumulated investment income of organizations which are now exempt from Federal income tax by virtue of subsections (1), (6), and (7) of section 101 of the Internal Revenue Code. These subsections deal respectively with labor, agricultural, and horticultural organizations, charitable, religious, and educational organizations, and business leagues, chambers of commerce, real etate boards, and boards of trade.

Part 2 deals with the taxation of trusts which are not exempt under section 101 (6) but which are entitled to deductions for amounts paid or permanently set aside for religious, charitable, or educational purposes.

Part 3 deals with the disallowance under the income, estate, and gift tax provisions of the Code of any deduction for gifts to charitable, educational, and religious organizations which do not meet the requirements set out in the bill.

CLASSES OF EXEMPT ORGANIZATIONS SUBJECT TO TAX

Section 421, added to the Code by section 301 of H. R. 8920, subjects to tax at the appropriate rates, corporate or individual, the so-called supplement U income of organizations hitherto exempt under section 101 (1) labor, agricultural, and horticultural organizations; (6) charitable, etc., organizations, and (7) business leagues, chambers of commerce, etc. An exclusion is made for "churches" but corporations previously exempt under section 101 (14) because they hold property for a church and pay the income over to it are not exempt from the supplement U tax. The failure to exclude these latter organizations seems to be open to some question. If a church itself is not subject to supplement U, no matter how much business property it may hold in its own name, it seems unrealistic to levy a tax on property owned by it through the medium of a "subsidiary corporation." At this point it should be borne in mind that section 101 (14) covers merely corporations organized to hold property and to pay the income over to an exempt organization. Feeder organizations of the Roche's Beach case type are specifically made taxable under another section of H. R. 8920. Furthermore, the use of the term "church" in section 421 (b) (1) seems ill-advised. This term is not used anywhere else in the Internal Revenue Code and considerable litigation may be necessary before its meaning is clarified. The term "religious organization" would seem preferable to the term "church" since it is used in all other places in H. R. 8920 and corresponds more closely to the other provisions of the Code.

DEFINITION OF INCOME OF EXEMPT ORGANIZATIONS MADE TAXABLE BY SUPPLEMENT U

The supplement U income subject to tax is the excess over $1,000 of (*a*) the net income from any trade or business regularly carried on "the conduct of which is not substantially related (aside from the need of such organizations for income or funds or the use it makes of the profits derived) to the excise or performance by such organizations of its charitable, educational, or other purpose or function constituting the basis of its exemption under section 101," and (*b*), in certain specified situations, the accumulated investment income.

The crucial question will be whether any particular business is "substantially related" to the exercise of the chief charitable function of a given organization. In view of the difficulty inherent in making a decision on this point, the quoted definition should be made more workable. The word "substantially" should be omitted.

In any event, it would seem unwise that the answer to this question in the first instance should be left to the decision of any subordinate official of the Bureau with the charity being forced to sustain the burden of proof that his determination was erroneous. In order that charities be not put to unnecessary legal expense, it would seem desirable to have a procedure instituted in the Bureau under which charities could get rulings from the Commissioner's office not only as to the status of any presently carried on activity but as to the status of proposed new ones. It is possible that present procedures in the Bureau will adequately take care of this situation but if they do not, the bill should be amended to provide for rulings, particularly on proposed activities before the charity has gone to the expense of getting them under way. It is essential also that adequate personnel be available to pass on these matters. In the case of many modern scientific organizations, the general run of Bureau employees would be unequipped to determine whether a particular activity was or was not substantially related.

The Ways and Means Committee report (p. 109) makes it clear that in determining the total supplement U income of any organization, the gains and losses of separate unrelated business can be offset one against the other. Regulation 104 dealing with consolidated income-tax returns should be amended to contain a specific provision permitting the filing of consolidated returns for corporations subject to supplement U.

DEFINITION OF UNRELATED BUSINESS INCOME

In the definition of unrelated business net income in section 422, a number of questions arise.

(1) Are capital gains from the sale of securities includible in unrelated business income? Section 422 (a) (2) specifically exempts gains on the sale of rental real estate. This would leave an implication that gains on the sale of securities would be taxable. On the other hand, in the technical amendments appearing in section

301 (d) of the bill certain changes are made in section 117 (c) to provide for the application to an organization subject to supplement U of the alternative capital gain rates.

The committee report says (p. 126):

"This provision can apply only in the case of an organization carrying on an unrelated trade or business and which has a profit, treated as a capital gain, from the sale of property used in the unrelated trade or business. It has no application to capital gains derived from sales of stocks, bonds, and the like, since such capital gains will not be included in computing supplement U net income."

Despite the above provisions, it would seem very much better to have capital gains on security transactions excluded both from unrelated business income and from accumulated investment income by specific provision.

(2) There is excluded from unrelated business income by section 422 (a) (2) "rents from real property (including personal property leased with real property)." Consideration should be given to whether this exemption should not be extended to cover personal property leased separately. Similarly, in the definition of a supplement U lease in section 423, it would seem that leases of personal property, machinery for example, not made under or in connection with a lease of real estate, should be covered.

(3) Section 422 (a) (5) eliminates from unrelated business income all income derived from "research" for the United States or any of its agencies. The term "research" is too narrow. Many Government contracts specifically refer either to "research" or "development" so this latter term should be included. Consideration should also be given to the question whether, as a matter of fact, any substantial amount of research is done for the various States and their agencies, and whether income derived from such should not correspondingly be excluded.

(4) There is a certain lack of logic in the whole conception of the supplement U lease. A section 101 (6) organization can borrow money and buy securities or royalty earning property and not have any of the income from such property included in unrelated business income, but if it borrows money and purchases real estate, it runs into the supplement U lease provisions. Further the concept of supplement U indebtedness is not a satisfactory one. Suppose that a charity has $100,000 of investible funds which it uses to buy a piece of business real estate. It then borrows money and buys securities. Clearly there is no supplement U real estate here. On the other hand, if the charity had the securities instead of cash as in the previous example, sold the securities and bought the real estate, and then borrowed money to buy corresponding securities, would it not be likely that the Commissioner would contend that the indebtedness was "incurred as a proximate result of the acquisition" of the real estate?

(5) Another inequity involved in the supplement U lease situation arises in connection with the provision of section 423 (b) that an unassumed mortgage is to be treated as a supplement U indebtedness. Where the mortgage has been either assumed or incurred by the charity, the situation is open to the interpretation that the charity has been "selling its exemption," but where, for instance, a charity receives from a donor a gift of mortgaged real estate and does not assume the mortgage, the evil which section 423 is aimed against would not appear to exist.

(6) A final defect in the provisions of the bill taxing net income from a supplement U base is that they could have very serious effects in the case of such bases which are now in existence and where the schedule of repayments by the exempt organizations to the lender has been drawn up on the assumption that the rental income would be tax-free. The exemption of such income from existing supplement U bases for a minimum period of 5 years is desirable in order to prevent unnecessary hardship.

ORGANIZATIONS TAXABLE ON ACCUMULATED INVESTMENT INCOME

The entire concept of the taxation of "accumulated investment income" is ill-conceived in that it takes away from certain charitable organizations not coming within the exempting provisions of section 424 (a) (1) and (2) any discretion as to the timing of the spending of their income. Any possible evils attributed to accumulations are insufficient to justify such an interference by the Government with private charitable management decisions.

The exemption from taxation on accumulated investment income provided in section 424 (a) (1) (c) for organizations "primarily supported by contributions of the general public" is not broad enough. The term "general public" has not hitherto been used in the Internal Revenue Code and there would seem to be some

question as to what this exempting language means. Regardless of how the term is defined, the typical private hospital will not come within this exemption.

In the determination of accumulated investment income, no consideration seems to have been given to circumstances where funds have been given to an organization upon condition that it accumulate the income for a given number of years or until the fund has reached a specified amount. Certainly all accumulations under existing deeds of gift should be freed from tax. There is a limited exemption of this type of accumulation in section 424 (a) (2) in the cases of trusts taxable at individual rates but nothing with respect to organizations taxable at corporate taxes.

Section 424 (d) should be amended by adding to the deductions allowable in computing "accumulated investment income" the bond premium deduction which is an allowable deduction in computing net income under code section 23 (v).

NEW REQUIREMENTS FOR CONTINUED EXEMPTION UNDER CODE SECTION 101 (6), AND FOR UNLIMITED CHARITABLE DEDUCTIONS BY TRUSTS UNDER CODE SECTION 162 AND FOR DEDUCTIBILITY OF CHARITABLE GIFTS BY INDIVIDUALS FOR INCOME, ESTATE AND GIFT TAX PURPOSES

Next to the taxation of assumulated investment income of organizations exempt under Code section 101 (6), the most objectionable feature of title III of the bill is contained in the set of standards to be met if an organization is to continue to be exempt under section 101 (6) and if gifts to it are to be deductible under the income, estate, and gift tax laws. A very similar set of standards must be met by trust if it is to retain its present privilege of unlimited charitable deductions. If these standards are not met, its deduction is narrowly limited to 15 percent of its net income.

The new section 101 (6) requirements are included in an amendment made by section 301 (c) of the bill, and the new requirements to be met by any organization, if contributions to it are to be deductible, are contained in a new Code section 3810 added by section 331 (a) of the bill. These requirements are substantially identical.

The organization either must be one of the following: (1) a fraternal society, etc., (2) a religious organization, (3) an educational organization meeting certain specific requirements, (4) an organization supported in whole or in part by Government funds, State or Federal, or "primarily supported by contributions of the general public," (5) an organization operated, controlled, etc., by a religious organization, or, it must not have any of the following transactions with a substantial contributor or an officer, or a member of the family of such a contributor or officer: (1) lend property, (2) pay compensation, other than a reasonable salary for personal services, (3) provide services on a preferential basis, (4) make substantial purchases from or sales to.

In the case of trusts taxable under section 162, only the second set of requirements must be met in order that the trust may continue to secure an unlimited deduction for amounts paid or set aside for charity in excess of 15 percent of its net income.

For some unexplained reason the second set of requirements may be met for the purpose of section 101 (6) and section 162 if the organization is "operated in accordance with" these provisions. However, in order that contributions to an organization may be deductible, the second set of requirements must be contained in the "instrument under which the trust or other organization is administered."

We believe that these alternative requirements are subject to the following objections:

(1) With regard to the second set of requirements, it seems illogical that operation of the organization in accordance with them is sufficient for section 101 (6) and section 162, while they must be incorporated in the instrument of organization for section 3810. It would seem that operation in accordance with these requirements should suffice for the purpose of section 3810.

(2) Private nonprofit hospitals should be included along with fraternal societies, religious organizations, educational institutions, and organizations supported in whole or in part with government funds or "primarily supported by contributions of the general public." Most such private hospitals receive less than 10 percent of their support from public contributions and hence, under the bill as drawn, would have to meet the second set of requirements.

(3) In the second set of requirements there is no reason for a prohibition against sales to and purchases from a substantial contributor or an officer provided that these are not on a preferential basis.

(4) The term "substantial contributor" is ambiguous.

(5) If operation in accordance with the second set of requirements is not to be deemed sufficient under section 3810, inclusion of the second set of requirements in the bylaws should suffice. Amendment of the "instrument under which the trust or other organization is administered" may be expensive, and when such instrument is in the form of an act of a state legislature, time-consuming or impossible.

In conclusion, while, as we have stated, we favor the closing of any real loopholes in connection with section 101 organizations in substantial business competition with nonexempt enterprises, we recommend that title III be substantially revised to avoid hardships upon bona fide undertakings in the public interest.

Mr. ALVORD. And, Mr. Chairman, I would like to have included as an appendix to my written statement, a statement prepared by the domestic distribution department and the transportation and communications department of the chamber with respect to excise taxes. To the extent this statement goes beyond the one I made this morning, it should be considered to be a proposal upon the handling of excise taxes at the appropriate time, when we find that the international situation permits the consideration of a sound step toward a peacetime tax program.

The CHAIRMAN. You may put that in.

(The supplementary statement referred to follows:)

APPENDIX I

CHAMBER OF COMMERCE OF THE UNITED STATES

(Testimony on July 13, 1950, before Senate Finance Committee on H. R. 8920)

EXCISE TAXES

The chamber believes that Congress should give high priority to elimination of war increases in excises, especially those applicable to essential services rendered by publicly regulated agencies. The burden of such taxes upon transportation of goods and persons and upon communications increases the cost of doing business generally and constitutes a serious drag upon the economy.

Freight tax discriminatory

The 3-percent freight tax (and the 4-percent-per-ton tax on coal), imposed in December 1942 are clearly discriminatory and unduly increase prices of goods to consumers. As President Truman indicated in his Economic Report to Congress last year, "The tax on transportation of goods, which enters directly into such a large number of business costs, should be eliminated."

The freight tax increases the discrimination against long-haul shippers in reaching common markets in competition with short-haul shippers. Such discrimination becomes even more pronounced as business competition develops.

As Secretary Snyder has recommended to both the Senate Finance Committee and the House Ways and Means Committee, the 3-percent freight tax should be completely eliminated.

Passenger tax discourages travel

Passenger travel on trains and intercity busses has sharply declined. This past year train travel dropped 15 percent and bus travel 10 percent under the preceding year. Many common carrier passenger operations are showing increasing deficits. According to estimates of the Interstate Commerce Commission, the railroads are losing over $600,000,000 annually in passenger train services. These losses clearly show the need for encouraging, rather than discouraging, passenger travel on public carriers.

The 15 percent tax on pullman car charges, in addition to the 15 percent on the cost of the ticket, causes many people not to travel at all. The total cost of traveling is too much for many small business people and family pocketbooks. Their only recourse is to stay at home or use the family car if they have one. Those who have a car are using it more and more. There has been a sharp increase in intercity automobile traffic since the war. The automobile now carries over 80 percent of all intercity traffic and the percentage is continuing to climb.

Transportation executives recognize that the availability and convenience of the automobile, weighed against the present cost of using commercial transport facilities, has been a major reason for the drop in revenue passengers.

While the excise tax on most international travel was eliminated last year, the passengers on America-flag steamships and airlines going to the Caribbean, Central America, Hawaii, and Alaska still must pay the 15-percent tax.

We believe the 5 percentage point reduction voted by the House is insufficient and, therefore, strongly urge complete elimination of the 15-percent passenger tax.

Communication tax undue burden

Since 1941 the communication excise taxes have been increased so that today the rate on long-distance telephone and telegraph is 25 percent and on local telephone service 15 percent.

The depressing effect of the tax is felt by many businesses, particularly the telegraph business.

Communication costs are a larger proportion of total costs for some firms and types of business than for others and consequently the taxes tend to discriminate against those having the greater need for communication services. This discrimination is being felt more and more as increased competition develops. In this connection we can see no reason for reduction in taxes on long distance communications only: The tax on local telephone service also should be repealed.

These taxes also discriminate against sellers competing in the same market but situated at unequal distances from the market, as rates for certain long-distance-communication services vary with distance. This discrimination is similar to the one already cited concerning the long-haul versus short-haul shippers of goods.

To every business and household user of the service, the tax is a direct burden on an essential service and is levied at luxury tax rates.

A specific handicap placed upon taxed communications results from additional competition with untaxed air mail. The user of communications should no more be taxed than the user of air mail.

Instead of the reductions on telegraph messages from 25 percent to 10 percent, as passed by the House, we urge a reduction to 5 percent. We also urge a reduction from 25 percent to a flat 10 to 20 cents on telephone-toll messages over 49 cents, instead of the 20 percent excise tax passed by the House on messages over 24 cents. Further, we believe that the 15 percent excise tax on local telephone service should be eliminated. The House bill would reduce this tax to 10 percent.

The retailers' excise taxes on furs, jewelry, toilet preparations, and luggage also should be removed entirely, rather than be reduced by 50 percent, as in the House bill.

The cost of collecting these taxes is a burden on each retailer. These costs add to his expense. They add to the mark-up retailers must apply to all merchandise and pass along to consumers. This whole collection process is one more complication for the small-business man.

The uncertainty about future action by Congress in changing these taxes causes many prospective purchasers to hold off buying taxed items. As a practical matter "lost sales" of this type are not fully regained later. The seasonal or gift occasions do not wait.

Excises on service industries

Three other kinds of excises are collected by distributors. One is the admission tax to motion pictures and other amusements. Second is the tax on night club receipts. Third is the tax on billiard and bowling establishments, which is in the class of a nuisance tax since it yields only a small amount of revenue. The business of night clubs, motion-picture theaters and other amusement enterprises in the service industry has been steadily declining in recent years.

These excises enormously increase the difficulties of continuing profitable operations. When profitable operations cease, many of these businesses will collapse and their employees will lose their jobs.

All excises hurt business volume

Sales of most types of durable goods are highly sensitive to relative price changes. Business in these lines will be substantially boosted by reduction of manufacturers' excise taxes.

A Government study[1] identifies and measures a number of these "sensitive" product lines. On most of these items there is a sizable manufacturers' excise tax. This tax is included in the cost of merchandise and reaches the consumer after having been marked up several times along the way. The resulting increase in price reduces the number of units which can be sold and lowers employment in the producing industries.

This tax policy reduces the number of people employed in productive industry and increases the number employed collecting taxes. It does not add to the national well-being but substantially subtracts from it.

Among items which the Government finds highly sensitive to demand factors are the following: All are subject to Federal excise taxes, which must be collected either by the manufacturer or the retailer—Radios, phonographs, records, musical instruments, automobiles, luggage, jewelry, watches, electrical appliances, sporting goods, tires and tubes, automobile parts, refrigerators, admissions, railway transportation, photography, billiards, and bowling.

The Government figures show that sales of the above items should increase from 100 percent to 310 percent of the amount of excise taxes removed.

These excise taxes were set up by Congress as war measures to discourage consumer purchases of scarce "luxuries." They succeeded. Many of these items are not luxuries during peacetime.

It is doubtful that Congress wants to continue to discourage purchases and production of consumer goods at this stage in our national development.

Retail and service excise collections off sharply

Cumulative figures for a recent 11-month period show the following declines in excise-tax receipts from 1 year ago:

	Percent		Percent
Furs	27	Admissions	4
Jewelry	10	Night clubs	16
Luggage	6	Toilet preparations, no change.	

These declines occurred on sales made between May 1949 and April 1950. They compare to the same sales period of 1948–49.

Mr. ALVORD. And I would also like to endorse the five tax recommendations made by the Secretary of the Treasury to the Committee on Ways and Means and to this committee with respect to promoting international trade and commerce.

I point that out in my written statement, but I suggest that his recommendations with respect to 116 (a) be broadened, so that Americans can leave the United States, as they did prior to the 1942 act, without necessarily establishing a domicile. And one reason I would like to see these five recommendations adopted is because it will be convincing proof that the Congress is definitely opposed to the provisions of section 206 of the present bill. Those provisions are in direct opposition to the policies of the Treasury advocated in these five recommendations, and directly contrary to the policies of the administration.

Thank you.

The CHAIRMAN. Is there any further statement on behalf of the chamber?

Mr. ALVORD. No, sir.

The CHAIRMAN. Thank you very much for your appearance.

Mr. ALVORD. Thank you, sir.

The CHAIRMAN. Mr. Carroll?

Mr. CARROLL. Mr. Chairman, I am willing to yield a moment to Mr. Tarleau, who has to catch a train.

The CHAIRMAN. All right, Mr. Tarleau. Glad to see you back again.

[1] U. S. Department of Commerce, January 1950, Survey of Current Business, p. 17.

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STATEMENT OF THOMAS N. TARLEAU, NEW YORK, N. Y., APPEARING ON BEHALF OF SEABOARD AIR LINE RAILWAY

Mr. TARLEAU. Thank you, Mr. Chairman.

Mr. Chairman and Senators, I am appearing on behalf of the Seaboard Air Line Railway Co.

The CHAIRMAN. You may be seated, if you wish.

Mr. TARLEAU. Thank you, sir. My presentation will be very brief. It is concerned with that same section of H. R. 8920 that Mr. Alvord spoke so feelingly about just a few moments ago, namely, section 209 (d) of the bill, which deals with the denial to corporations of a deduction from income arising from the abandonment of property which is used in their trade or business. This section, I believe, so far as the railroads are concerned, is the most dangerous innovation to the tax system that they have experienced during the history of the income-tax laws. And the reason for that, I suppose, on a moment's reflection, is obvious. The wearing out of equipment in the railroad industry occurs from two sources, from depreciation and from obsolescence. Where the obsolescence is reasonably foreseeable, the obsolescence deduction is merged into the depreciation deduction, and it is taken concurrently. Where the obsolescence occurs suddenly and unexpectedly, for example, when it is suddenly decided to change a switching system or a safety device or to go from steam railroads to Diesel railroads, it means that a large amount of unexpected and unforeseen obsolescence takes place immediately, and that property has to be abandoned.

Up to now we have always been given our abandonment losses at the time that the abandonment occurs. Under section 209 (d), suddenly this operating loss arising from abandonment is lost to us. That, of course, would just put to an end the dieselization of a great many American railroads and would interfere with our transportation modernization and would have an exceedingly serious effect upon us.

My prepared statement goes into the matter in some technical detail. But I do wish to point out that for the first time a distinction is taken by reason of section 209 (d) between obsolescence that is gradual and foreseeable and obsolescence that occurs more suddenly. Of course, obsolescence that is gradual and foreseeable you take as part of your depreciation deduction, while extraordinary and unforeseen obsolescence, which is evidenced by the scrapping or the abandonment of the facility, is denied that ordinary deduction treatment by 209 (d).

I just wish to emphasize again that in our opinion the rate structure and everything else in the bill is secondary, in consideration, to us, to the seriousness of section 209 (d). It is a matter, I would almost say, of life and death to the railroad industry.

Senator CONNALLY. How about where you abandon a line entirely? Sometimes the Interstate Commerce Commission put the heat on them, and they abandon the whole line, a branch line, or something. What would be the effect on that?

Mr. TARLEAU. We consider those operating events, operating losses. As I have said, Senator, if we get unexpected obsolescence, that is taken in the year in which the obsolescence is evidenced by the physical act of abandonment. Where we are notified, for example, 5 or 10 years in advance that this method of procedure is outmoded—for example, if we are notified that we have to dieselize between now and 1960 a given stretch of road—we know what the expense is going

to be; and we currently take a tenth each year from 1950 to 1960, or a twentieth if it goes to 1970. And we have no problem under this bill.

Very frequently, the special obsolescence, which this is—it isn't that the physical life of the property is gone, but that its functional life is gone, and very frequently that functional life disappears very quickly, in which event we have to take that and abandon that property in the year in which that functional life terminates. And it is the denial of the right to take that in the year in which it occurs which arises because of the fact that under section 209 (d) abandonment losses are no longer allowed as operating losses. That is the problem that confronts us under the bill.

I don't want to take too much time, because I know you have other witnesses, but I hope that if I leave any impression with you at all about this, it is that before you do anything about it, it needs most serious reflection. Because it is a matter which would effectively cripple the modernization and the dieselization program, certainly of our particular railroad, the Seaboard.

The CHAIRMAN. It would apply to other than utilities?

Mr. TARLEAU. Certainly. And it is because of the fact that Mr. Alvord has spoken for the larger group of taxpayers that I thought it valuable to let you know just how one of the class I railroads of the country would be affected by it. It is not only complex so far as the railroad is concerned, and difficult, because a railroad that can guess at its obsolescence with a certain amount of accuracy can take this deduction for obsolescence; which means a deduction on account of the lack of future useful use of an asset, despite the fact that its physical life is longer. If you can do that with accuracy over a given stretch of time and take it prior to abandonment, you get a deduction. But if it comes suddenly, 209 (d) denies you the deduction.

The CHAIRMAN. Except as to capital gains.

Mr. TARLEAU. Yes. And as far as railroads are concerned, we are not in the business of making capital gains and losses. We are operating carriers.

Moreover, it introduces a diversity of treatment between unexpected and rapid obsolescence, where you would get under this bill a capital loss treatment, and foreseeable obsolescence, in which you would get ordinary loss treatment. And the same economic event would give rise to two different tax consequences.

The CHAIRMAN. Thank you very much, Mr. Tarleau.

You wish to file your full statement for the record?

Mr. TARLEAU. If you please. And thank you, Mr. Chairman.

(The prepared statement of Mr. Tarleau follows:)

STATEMENT OF THOMAS N. TARLEAU OF NEW YORK, N. Y.

Section 209 (d) of the revenue bill of 1950 as passed by the House amends section 117 of the Internal Revenue Code to deny to taxpayers the right, which they now have, to deduct as costs of operation the losses resulting from abandonments of property used in the taxpayers' trade or business. In applying the capital loss limitations to abandonments, the House bill conflicts with well established concepts which recognize such losses to be costs of producing ordinary income. Furthermore, it is believed that one effect of the amendment is to introduce into the code a distinction having no basis in fact and which can only cause discord and confusion in the administration of the tax law, especially as it affects the railroads' physical operating properties. Such property is generally subject to two kinds of loss resulting directly from its use in the production of income:

(*a*) Physical depreciation: The gradual result of normal wear and tear;

(*b*) Obsolescence: The inevitable loss of economic usefulness due to continuous technical progress in the business.

A long-established provision of the Internal Revenue Code recognizes physical depreciation and obsolescence (or functional depreciation) as costs of producing income. Section 23 (1) IRC establishes as a deduction from gross income a reasonable allowance for such costs. Normally the taxpayer, with the approval of the Commissioner, predicts, on an engineering experience basis, the time when depreciation and obsolescence will have made his investment in a piece or class of property worthless, and there is established a rate of depreciation whereby the taxpayer is enabled to deduct these costs over the useful life of the property.

Obsolescence—the loss arising from forces unrelated to physical condition—occurs in two generally recognized ways. There is "normal obsolescence," which has been described by the Bureau of Internal Revenue as follows:

"Normal obsolescence is caused by factors which can be anticipated with substantially the same degree of accuracy as other ordinary depreciation factors, such as wear and tear, corrosion or decay. Accordingly, it is included in estimating the normal useful life of depreciable property, the effect of which is to include the allowance for normal obsolescence in the depreciation deduction."

However, obsolescence, especially in the case of railroad property, more frequently occurs, and is recognized, abruptly and unexpectedly. It is an everyday occurrence on the railroads for a piece of property which was expected to continue to be useful (in terms of both physical depreciation and normal obsolescence as described above) suddenly to become wholly obsolete long before the life comprehended by the rate of depreciation has expired. A new invention, a new safety requirement, a change in operating techniques, or a shift in economic conditions, without warning, requires the retirement of a piece of equipments till useful for the now outmoded purpose for which it was designed. This is recognized as "extraordinary" or "special obsolescence." In its Bulletin "F," the Bureau of Internal Revenue states that such special obsolescence "rarely can be predicted prior to its occurrence." In some cases, however, special obsolescence can be predicted 2, 3, or 5 years prior to its occurrence, and in those cases, provision is made to amortize the unrecovered cost of the property over the shortened remaining life. But in most cases, special obsolescence cannot be predicted even that far in advance of the need for retirement. Every year, the operating departments of the railroads find it economically necessary to retire numerous items of property on the basis of developments which come to light unexpectedly. Characteristic of the properties so affected is abandonment or scrapping shortly after such discovery occurs, and the loss for tax purposes is deducted currently under either one of two provisions of the Internal Revenue Code: Section 23 (1) (the deduction for depreciation and obsolescence above described) and section 23 (f) (the deduction for business losses).

Thus, the regulations under section 23 (f) governing abandonment losses provide that

"When, through some change in business conditions, the usefulness in the business of some or all of the assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in such business, he may claim as a loss for the year in which he takes such action the difference between the basis and the salvage value of the property. This exception to the rule requiring a sale or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property has been prematurely discarded * * *"

In the case of depreciable property, the two provisions are overlapping and allow a deduction, in the cases here under consideration, for losses due to the same economic event. What we are considering is abandonment or loss of useful value due to special obsolescence. The railroad's act of abandonment or scrapping in these cases is not the occasion of the loss, but only its disposition of the relict after the real loss has occurred. Under the code in its present form, it has not been necessary to characterize such losses as either "abandonment" or "special obsolescence," because the tax treatment presently given in the cases here considered properly recognizes both to be merely different descriptions of the same event.[1]

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[1] No distinction exists as between the case where the railroad can predict special obsolescence a few years in advance of retirement, and the case where the necessity for retirement transpires within the year of retirement. That the railroad in the former case is able to amortize its loss likens it, in the matter of mechanics only, to depreciation and normal obsolescence, but otherwise both cases involve precisely the same economic loss. Such prediction is usually not possible and there is no reason for imposing suchan impossible burden on the taxpayer on pain of being subject to the capital loss limitations. The practical effect of reliance on the supposed "distinction" would be the capitalization of innumerable obsolescence losses which have always been recognized as charges against ordinary income, and it must be emphasized that the undesirable practical effect would arise from a purported distinction having no basis in logic or fact.

However, section 209 (d) of the House bill introduces a distinction here which has no basis in fact. It sets up a category of "abandonment losses" to which it proposes to give capital loss treatment. Section 209 (d), when considered along with the obsolescence deduction, erroneously implies, in the case of thousands of these retirements, that two kinds of economic events are involved rather than one. This plain inconsistency would result in different tax treatment of different taxpayers who had suffered precisely the same economic loss. The resulting controversy and litigation would be time-consuming, costly, and in light of the real absence of any factual issue, altogether unnecessary. In the case of taxpayers who became subject to the capital loss limitations in the cases of losses resulting in abandonment, the tax would be totally inequitable, because these losses, like physical depreciation and "normal" functional obsolescence, are direct costs of producing income.

It must also be recognized that to the extent that section 209 (d) deprives the railroads of realistic tax treatment of losses on abandonment, the cost of modernizing our transportation system would be increased. The continuous effort of the railroads to take advantage of technological progress in the art of transportation would be impeded to the cost of the country as a whole.

The CHAIRMAN. Mr. Carroll?

STATEMENT OF MITCHELL B. CARROLL, SPECIAL COUNSEL, NATIONAL FOREIGN TRADE COUNCIL TAX COMMITTEE, NEW YORK, N. Y.

Mr. CARROLL. Mr. Chairman, I am Mitchell B. Carroll, representing the National Foreign Trade Council of New York, which is comprised of practically all the corporations engaged in international business.

I should like to submit for the record first of all a brief statement, and secondly, a memorandum entitled "Tax Incentives for Foreign Investments," which treats mainly with what other countries are doing in regard to the taxation of income from sources outside their territory.

The CHAIRMAN. Yes, sir. You may do so. You may put them in the record in the order in which you desire them to appear.

(The statement and memorandum referred to follow:)

STATEMENT IN BEHALF OF THE NATIONAL FOREIGN TRADE COUNCIL, INC., BY MITCHELL B. CARROLL, SPECIAL COUNSEL, TAX COMMITTEE

Mr. Chairman and members of the committee, I beg leave to emphasize certain points not heretofore thoroughly considered that we respectfully submit should be studied in connection with the administration's program to improve the economy of underdeveloped areas so that they can better withstand the worldwide conflict in which we are all now engaged.

May I state first that the National Foreign Trade Council, which is representative of American business engaged in international trade and investments, heartily endorses the objectives of the point-4 program, and is glad that Secretary of the Treasury Snyder included his tax proposals to implement that program in his statement before this committee on Wednesday, July 5.

Risks of business abroad

Today's military conflict in Korea only sharpens the realization of the risks that American corporations must face in other underdeveloped areas which are dependent on us for defense and also for economic aid to withstand the infiltration and corrosion of communism. To the generally existing risks abroad of devaluation of currencies, blocking of income and capital, and even nationalization and expropriation, are added the risks of war losses.

Need for competitive equality abroad

In addition, it is of primordial importance to place American enterprises as nearly as possible in a position of competitive equality with enterprises of the foreign countries themselves and of third countries that are operating in the same

market. A serious deterrent to operations abroad is found in article 218 of the House bill, which increases the domestic tax rate to 41 percent and thereby widens the gap between the domestic rate and the relatively low rate in many foreign countries in which our enterprises must compete.

Treasury's proposed tax incentives inadequate

We heartily applaud the proposals of the Secretary of the Treasury to facilitate the activities and investments of American corporations abroad, but beg leave to point out that to accomplish the objectives they should go a step or two further.

Treatment of foreign branches as subsidiaries.—The council is wholeheartedly in agreement with the Secretary's recommendation to include an amendment which "would treat the income of foreign branches established by domestic corporations as the tax laws now treat similar income obtained through foreign subsidiaries," so that "tax would be postponed until the foreign earnings are brought home."

Credit for taxes borne by minority stockholders.—Furthermore, we are gratified over the proposal that the credit for foreign taxes under section 131 (f), IRC, should be liberalized so as to cover minority investments in a foreign subsidiary, but urge that this provision be made coextensive with the present provisions in that section so as to cover the case of an investment in a foreign subsidiary, which in turn owns a minority interest in a second foreign subsidiary.

Removal of per-country limitation on credit.—The Secretary stated that there is need also for liberalizing the foreign tax credit provisions as they apply to firms that derive income in one foreign country but incur an offseting loss in another. After a careful study of the effect of the limitations in section 131 (b), IRC, we have come to the conclusion that it would be far more conducive to the expansion of business abroad if Congress should eliminate the so-called per-country limitation on the foreign tax credit but maintain the so-called over-all limitation.

The reason for our position is that such an amendment would permit a company operating in countries where rates are high to spread, in effect, the amount by which the foreign rate exceeds the allowable credit over the income of countries where the rates are low. Presupposing that, in general, foreign operations show at least a small profit, this would permit companies which wish to extend their activities into a number of foreign countries to obtain more advantage from the credit provisions.

Relief for employees abroad.—While supporting the Secretary's proposal to amend section 116 (a), IRC, so as to permit the exemption from tax of the earnings of a United States citizen who is a bona fide resident of a foreign country to begin as from the time he starts his residence therein, we feel that this provision should be supplemented so as to take care of the businessman or technician who stays abroad for a period of at least 12 consecutive months. Under present interpretations of the Treasury, such a citizen would not be entitled to the benefits of this provision because he is not deemed to acquire a bona fide residence abroad. In view of the troubled conditions abroad it will be very difficult to prevail upon citizens to leave their families and homes in the United States to go into some area where the risks are great, unless this incentive is offered.

Credit for foreign death taxes.—While all the foregoing incentives are offered to the living, it is also important to do something for citizens who have a realization that they may happen to die with property abroad, and therefore we urge adoption of the Secretary's proposal to grant a credit for foreign estate taxes similar to that now granted for foreign income taxes.

Rate increase on foreign income of Western Hemisphere trade corporations

It is evident from the record of the hearings before the Committee on Ways and Means that the increase in corporate rates of 3 percentage points was adopted partially to offset reduction in excise taxes, which are purely domestic levies, and therefore it may be said that the increase in the tax burden was adopted for purely domestic reasons. Nevertheless, in the case of Western Hemisphere trade corporations, the Ways and Means Committee proposed to increase the rate on income earned primarily in Latin American countries where the rates are generally much lower than ours by not only 3 percentage points but even slightly more. This was done by replacing a simple exemption from surtax by a credit of 34 percent against normal tax net income and surtax net income. Taking as an example a Western Hemisphere trade corporation with a normal tax net income of $500,000 the result is to increase the effective rate of normal and surtax to 26.06 percent on corporations operating in Latin American countries, in a number of which the generally applicable tax rates are lower. If the Western Hemisphere trade corporation is included in the consolidated return, it will be subject to an

additional tax, which it does not now bear, of 1.32 percent, making an effective rate of 27.38 percent or an increase of 3.38 percentage points.

In other words, at this time, when the administration is recognizing that tax incentives should be given to encourage American corporations to face the risks inherent in foreign commerce, which are greater than those in the United States, the House bill would increase substantially the tax cost of doing business abroad.

Inasmuch as stability in the tax regime is of paramount importance in encouraging investments and private enterprise abroad, the council recommends that the present rate of 24 percent for Western Hemisphere trade corporations be maintained, or, preferably, that Congress continue the more simple solution of exempting such corporations from the surtax. The latter solution is urged, although, if section 218 of H. R. 8920 is adopted, it would mean applying only the reduced rate of normal tax in the case of Western Hemisphere trade corporations. Our reason is that we believe the gesture of reducing the rate by 3 percentage points on the income of such companies, which are tantamount to foreign enterprises, would mean little loss of revenue to the Treasury as compared with the psychological advantages to be gained by convincing American business that the administration really desires to encourage the aid of private enterprise in improving the economy of underdeveloped areas. A sharp differential in the tax rate is needed to offset the many unfavorable and inhibitory factors which stand in the way of initiating new enterprises or expanding existing ones.

Need for globalizing reduced rate

The underdeveloped areas in which the aid of American enterprises is needed are not only in Latin America but also in southeast Asia, Africa, the Near East, and even in certain European countries. In many of these countries the rates are even lower than the reduced rate applied in the case of Western Hemisphere trade corporations. However, in these underdeveloped areas, generally the risks of doing business are greater than in the United States, and capital and business enterprises are indisposed to go to countries where they must face a larger total burden of taxes and risks.

At this point I wish also to submit for the record and for study by your experts a statement entitled "Tax Incentives for Foreign Investments," which summarizes the practices under the laws of numerous other countries to encourage foreign commerce by outright exemptions of income attributable to permanent establishments abroad, whether by provisions in their internal tax laws, or treaties. American enterprises which have to compete with the enterprises of such countries are placed at a very serious competitive disadvantage. Therefore, the National Foreign Trade Council recommends that the Senate Finance Committee take cognizance of the measures adopted by other countries to encourage foreign commerce, and adopt a program of tax incentives that corresponds as closely as possible with what these other countries give. The amount of revenue involved is small, but the advantages to the economic well-being of the United States and the countries concerned will be great.

National Foreign Trade Council recommendations

It is hoped that this committee will be in favor of placing American enterprises in a position of competitive equality with those of the numerous countries which, either by law or by treaty, do not tax their domestic enterprises on income earned in another state. In order to realize this objective at least approximately, the council offers the following amendments:

1. *Authorization for appropriate provisions in tax treaties.*—The Internal Revenue Code should be amended so as to authorize the Executive to provide in treaties, and on a reciprocal basis, that, if a corporation of one country maintains a permanent establishment of any kind in another, the income attributable to such establishment will be taxable only in the country where it is produced.

2. *Generalization of reduced rate.*—In cases where no such treaty provision is applicable, the reduced rate for Western Hemisphere trade corporations should be imposed on a global basis in order that American corporations will not have to bear, in general, a heavier tax from operating anywhere abroad than the corporations of other countries competing in the same markets.

The application of a reduced rate to income of a foreign branch would make much more attractive the proposal of the Secretary of the Treasury to postpone the United States tax on the income of a foreign branch until it is remitted to the United States. This is due to the fact that frequently through fear of devaluation a company brings home its accumulated foreign earnings in order to enjoy the safety resulting from conversion into United States dollars. The knowledge in advance that this would involve payment of only the reduced rate applicable to

foreign income rather than the high rates applicable to domestic income would remove a serious obstacle to the taking of such a wise step.

3. *Application to branch abroad of any domestic company.*—Furthermore, the council recommends that this reduced rate be applied in the case of a branch abroad of any American corporation which maintains a separate accounting and may therefore be treated as a separate subsidiary company.

4. *Application to dividends of foreign subsidiary.*—In addition, as it is often necessary to form a corporation under the laws of foreign countries to operate therein, we urge that this reduced rate be applied to the profits received by the domestic parent in the form of dividends, in order that operations through such a foreign subsidiary may not be placed at a disadvantage as compared with a branch abroad.

5. *Clarifying section 131 (h), Internal Revenue Code.*—Finally, it must be noted that underdeveloped countries are not likely to rely on taxes which are comparable to our highly developed income tax, and therefore the provisions of section 131 (h), Internal Revenue Code, which were adopted in 1942 to liberalize the credit for foreign taxes, should be clarified so as to remove any doubt that this subsection was intended from the beginning to cover the various levies imposed by foreign countries in lieu of, or instead of, income taxes "that might otherwise be imposed"—to borrow the words from the Senate report on the 1942 bill. Somehow the phrase "in lieu of income taxes otherwise generally imposed" was adopted, and this precludes the intended relief in cases where there is no such tax, or where such a tax was subsequently superimposed upon a tax intended to serve the purposes of an income tax, but, for practical reasons, was based on the prevailing market price for the article sold, on a certain rate per unit produced, or was computed in some other empirical manner.

It is understood that the Treasury has already drafted language for its proposals and it will be very simple to add additional language to cover these proposals of the National Foreign Trade Council.

Hence, in all earnestness, we respectfully urge that these amendments be incorporated in the pending tax bill.

TAX INCENTIVES FOR FOREIGN INVESTMENTS

Just as water will not run uphill, capital will rarely flow from one country to another where the level of risks and taxes is higher than in the first country. This is especially true today because the margin of savings is so much slenderer than in former periods of economic expansion that the would-be investor inevitably appraises with greater care than ever the real value of the undertaking in which he will place his money, and computes the prospective net return after the interested governments have taken their toll. When he adds up all the costs and risks he will probably prefer to take advantage of opportunities in the United States for a profitable and safe investment than venture his capital abroad, unless he is given some real incentives to do so.

Prerequisite of tax equality abroad

Looking abroad for investment opportunities one finds, in addition to a varied array of taxes, a long history of defaults; losses through currency devaluation; income or capital blocked by exchange restrictions; losses of investments in public utilities bankrupted because of the refusal of the local authorities to permit an increase in rates to keep abreast with increasing expenses or other arbitrary action; expropriations with no payment of compensation or merely the giving of worthless bonds; slow-motion nationalization through restrictive labor laws which progressively reduce foreign personnel until only the American manager is left; the threat, if not enforcement, of obligatory allotments of earnings or shares to employees; exorbitant labor demands, etc. etc.

Moreover, costs are often higher abroad than in the United States, whether because of the devaluation of the dollar vis-á-vis a country still on gold (e. g., Venezuela), or because inflation has carried prices to relatively higher levels than here.

Obstructive effects of United States tax on foreign income

Obviously if, in the face of all these and other deterring factors, a corporation has also to pay in a foreign country the same tax rate as, or a higher rate than, in the United States, the tax cost may be the deciding factor in preventing the initiation of an industrial or commercial undertaking in that foreign country. If such country has a higher rate than that of the United States and wants American investments, a reduction in its rate may be a prerequisite. If it has an appreciably

lower rate than that of the United States, and if the corporation had to pay only this rate, the tax advantage might be sufficient to attract investments despite the other costs or risks mentioned above. However, in such a case, this advantage is reduced to nil as the result of the fact that the American investor remains subject to the high United States rate on profits or dividends or other income from sources in that foreign country.

The United States law would have the same obstructive effect if the foreign country granted a reduction in rate or an exemption to attract foreign capital. For example, a corporation in Brazil pays a profits tax of 12–15 percent and then withholds 15 percent from dividends; in the case of a branch in Brazil, the 15 percent is withheld from profits credited to the head office abroad. Brazil exempts from this 15-percent tax income invested in the expansion of the plant in Brazil,[1] but an American corporation is not tempted to plow back its earnings as long as the United States continues to apply to the income exempted by Brazil its 24 percent rate in the case of a Western Hemisphere trade corporation, or its general corporation tax of 38 percent, or 40 percent if the domestic corporation is included in a consolidated return. The Brazilian tax of 12–15 percent applicable to profits may be credited (under sec. 131, I. R. C.) against the United States tax of 24 percent, 38 percent, or 40 percent, but the excess of about 9 percent, 23 percent, or 25 percent partially or wholly nullifies the benefit of the exemption from the 15 percent tax in Brazil.

Similarly, the American corporation may defer liability to the United States tax by organizing a corporation in a foreign country and having the latter utilize its profits in the development of its business. However, it knows that sooner or later when some of the subsidiary's earnings are brought home, it will have to pay the full 38-percent or 40-percent tax thereon, except for the credit allowed for foreign taxes. If, for example, the American corporation owns a majority of the stock in a Brazilian corporation, its credit will cover (1) the proportion of the Brazilian profits tax of 12–15 percent paid by the Brazilian company which corresponds to the dividend received by the American corporation and also (2) the 15-percent tax withheld in Brazil from the dividends. If the American corporation has only a minority interest, the credit covers only the dividend tax of 15 percent. Hence, the price in United States taxes of repatriation of earnings is roughly from 8 percent to 10 percent (38 percent or 40 percent—30 percent) in the case of a majority holding, but is from 23 percent to 25 percent (38 percent or 40 percent—15 percent) in the case of a minority holding in the Brazilian company.

United States tax nullifies foreign tax inducements

Some countries, like Mexico, may offer the inducement of an exemption from income taxes for a certain period (e. g., 5 years) to establish a new industry,[2] but this inducement may seem of little value to shareholders who will have to pay the full United States tax if any profits are distributed to them. The same inducement may also lose its appeal if after the period of exemption expires the local company is faced with Mexican taxes as high as, or higher than, those in the United States. For example, at present a Mexican tax of 30 percent is paid on profits exceeding 500,000 pésos, now about $57,000, and profits exceeding 12 percent of capital and reserves bear an excess-profits tax of up to 25 percent. Branch profits that might be transferred to the head office abroad of a foreign corporation and dividends bear a tax of 8 percent. There are also other foreign countries where the effective rate of income tax is as high as or higher than that in the United States. Inevitably, all such countries may not expect to receive much economic aid from American private investors.

Obstructive effects of not allowing United States credit for foreign empirical taxes

However, even if foreign countries have lower effective income-tax rates than those in the United States, the application of the high American rate to foreign income is obstructive to the movement of capital and business enterprises to foreign countries. The situation is complicated in numerous foreign countries by the existence of taxes on income which, because of difficulties in assessment, are determined empirically and therefore are not exactly like our own. This is especially true in Latin American countries, where years ago Spain introduced a tax on net income but in view of the inadequacy of the taxpayers' methods of keeping accounts for tax purposes, resorted to practical methods of computing tax liability, such as using the average price of a cartload of sugarcane grown or milled in Cuba, or the price quoted in London and later in New York of minerals

[1] Decree Law No. 24,239 of Dec. 22, 1947, art. 97.
[2] Law of April 21, 1941, art. 2.

produced in Mexico, or a tax based on the number of units of certain articles produced which is paid instead of the profits tax. Examples of the last-mentioned empirical form of income tax are a tax equal to 1½ centavos per stem of bananas, or the similar levy adopted in Cuba in 1903 to service the Speyer loan of $35,000,000, or the tax imposed by Cuba in 1917 on the basis of bags of sugar to reach extraordinary war profits.

Companies liable to such empirical income taxes were in many cases later subjected to income taxes which are allowable as credits under section 131, Internal Revenue Code. However, such empirical taxes are generally deducted in computing the foreign income tax, with the consequence that the amount of the latter tax is reduced and the credit against the United States tax is reduced, thereby generally leaving a larger excess of the United States tax over the credit allowed for the foreign income tax. Hence, if such empirical taxes are not also included in the credit allowable under section 131, Internal Revenue Code., the total burden of the disallowed tax, the tax allowed as a credit and the excess of United States tax over the credit may together constitute a far heavier tax burden on the American corporation in respect of doing busiess through a branch or subsidiary in Cuba, Mexico, or another foreign country with similar empirical taxes, than it would bear if it operated only in the United States. The relief from double taxation is also inadequate if, for example, the credit is not made liberal enough to cover not only the Colombian income and excess profits taxes but also the patrimony tax. The credit should cover all three levies because they are declared by Colombian law to constitute "an indivisible whole." [3]

Obstructive effects of applying high United States rate in low-tax countries

The collection by the United States of the excess of its effective rate over that of the foreign country is inhibitory to business expansion in a number of countries in Latin America and elsewhere which have an effective rate appreciably lower than that in the United States. These countries are generally the less developed countries which would especially come within the President's point 4 program. In such countries the costs of initiating a new enterprise may be high and the risks great, with the consequence that a large difference in tax rates is needed to offset these disadvantages. Obviously, the offering of an exemption from taxes, or a reduced rate, to encourage the building of a railroad or some important enterprise, may count for nothing if the United States still imposes on the business its present high rates.

Inadequacy of foreign tax credit

In short, the foreign tax credit is a great help to United States citizens and corporations having foreign enterprises and investments but it is not a complete means of assuring equitable taxation. This is due to the fact that in the case of countries with lower income-tax rates or with empirical taxes, the collection by the United States of the excess of its tax over the allowable credit places American taxpayers in a position of competitive inequality as compared with nationals of the foreign country or of third countries operating therein, who only bear the lower rate.

Treasury proposals for taxing foreign income

To implement from a tax viewpoint the Administration's plans for encouraging American private enterprise to aid in economic development abroad, the Treasury has submitted to Congress a number of proposed amendments to the Internal Revenue Code, the objects of which may be briefly summarized as follows:

1. To treat a foreign branch as a subsidiary and tax its income only when remitted to the United States;
2. To amend section 131 (f), Internal Revenue Code, so that a domestic corporation owning even a minority interest in a foreign corporation may have credit for the income taxes paid by the latter which correspond to the dividends distributed by it to the former;
3. To remove the "over-all" limitation on the foreign tax credit, leaving only the "per country" limitation in section 131 (b), Internal Revenue Code;
4. To permit the exemption for the income earned abroad by a United States citizen under section 116 (a), Internal Revenue Code, to begin when he commences his bona fide residence in a foreign country or countries at any time during the course of a taxable year;
5. To grant a credit for foreign estate taxes paid by an estate of a deceased citizen against the United States estate taxes.

[3] Law No. 78 of 1935, art. 21.

Inadequacy of Treasury proposals

The foregoing proposals are much to be desired but they do not go far enough. While the fifth proposal for allowing a credit for foreign estate taxes is most commendable, the others are singly and collectively inadequate. Their shortcomings may be summarized as follows:

1. The proposal to treat a foreign branch as a subsidiary means only deferring liability to the United States tax at the present or future rates, which are generally higher than those in foreign countries. Therefore, in many cases the mere deferring of liability to tax at home may not be an incentive to investments abroad for the reasons stated above. Nevertheless, in other cases, the difference in rates will induce companies to take advantage of an opportunity to defer United States tax liability by investing their surplus of foreign branch profits after foreign taxes in the development of their business abroad.
2. The proposal to amend section 131 (f), Internal Revenue Code, should also extend to a domestic corporation with a minority holding in a first-degree foreign corporation which in turn holds a minority interest in a second-degree foreign corporation.
3. Instead of removing the "over-all" limitation to the foreign tax credit, Congress should repeal the "per country" limitation as this would permit averaging foreign taxes (i. e., spreading high foreign taxes over income from low-tax countries) when a domestic corporation operates in several foreign countries. This would generally benefit more taxpayers than the repeal of the over-all limitation, as the latter would only permit the offsetting of foreign losses against domestic income. We feel it is wiser to maintain this over-all limitation as it prevents the credit from reducing the domestic tax on domestic income.
4. It will be helpful to start the exemption under section 116 (a), Internal Revenue Code, for income earned abroad from the time the individual begins his bona fide residence abroad, but it is also important to limit the concept of bona fide residence which has been construed by the Bureau of Internal Revenue to mean, generally speaking, residence for an indefinite period, which decided cases indicate must be of at least 3 years. This is a longer period than many technicians and businessmen expect to remain abroad. Therefore, the Treasury proposal should be adopted for the benefit of those who go abroad for an indefinite period and supplemented by another provision which would allow the exemption if the citizen lives abroad for professional or business reasons for a minimum of 12 consecutive months beginning at any time in one taxable year, and ending during the course of a subsequent taxable year. In either case, the individual should not be deprived of the exemption if he comes to the United States for a visit to consult with his employer or for reasons of health and returns to his post abroad.

Criterion for relief for foreign business and investment income

The insufficiency of the Treasury's program outlined above is primarily due to the fact that it starts from the premise of tax equality from a United States viewpoint. That is to say, a United States citizen or corporation should bear the same tax whether the income is derived from activities in (*a*) the United States, where one can work under perhaps the most favorable economic conditions, or (*b*) in the most primitive of underdeveloped areas where an enterprise has to face the greatest variety of risks.

In practice this concept will not help spread American industry and technology around the world, because it conflicts with the need of assuring American enterprises competitive equality in the foreign countries where they operate. The criterion should be that an American corporation carrying on business in any foreign country should not have to bear a heavier tax burden than an enterprise of that foreign country. In its treaties of friendship, commerce and economic development, the United States insists on the other government giving American enterprises the treatment of the latter's nationals, yet the United States itself may violate that principle by in effect subjecting American enterprises to higher taxes on their operations in the foreign country than the latter imposes on them.

The unfairness of American policy is especially evident when one takes into account the fact that so many third countries do not attempt to tax income realized by a national enterprise through a permanent establishment in another country. Some governments do not tax even dividends, interest, royalties or other income from foreign sources.

Exemptions granted by foreign tax laws to encourage trade abroad

A number of important countries recognize the prior and exclusive right of the foreign country where income arises to tax such income, and accordingly exempt

their resident taxpayers in respect of income from business carried on abroad, if not in respect of other categories of income. The business enterprises of such countries are accordingly placed in a more advantageous position from a tax viewpoint than are American enterprises operating in the same foreign markets.

Great Britain exempts nonresident citizens' foreign income

As our principal competitors abroad at the present time are the British, attention will first be given to the provisions in the United Kingdom tax laws which have been designed to encourage the development of business in foreign countries. The first basic difference between the British income tax act and our own is that liability to British income tax is based on residence and not on nationality, with the consequence that when British nationals leave England to reside abroad as employees or owners of enterprises, they are completely exempt from the United Kingdom tax on remuneration or profits which they earn abroad, or on dividends, interest, royalties and rents from foreign sources. On the contrary, United States citizens resident abroad are exempt only in respect of their earned income, and then under conditions which often wholly or partially deprive them of the exemption.

United States should adopt general rule of exempting nonresident citizens' foreign income

If the United States Government wishes to encourage the normal expansion abroad of American private enterprise or to induce American individuals or corporations to participate abroad in realizing the objectives of the point 4 program, it should realize the need of making a basic change in its tax policy. Foreign countries almost universally give up tax jurisdiction over nationals who become resident abroad, except in respect of income from sources in their territory. On the contrary, the United States persists, with one exception, in endeavoring to subject its nonresident citizens to a national tax just as if they were enjoying all the benefits of residence in the United States.

In other words, the United States in effect superimposes its fiscal sovereignty over all the foreign countries in which United States citizens or corporations carry on the income-producing activities. Even if the foreign country is so underdeveloped that it has no income tax or can support only a low rate of income tax, the United States nevertheless invades, so to speak, the territory of the other country and collects the same tax from its nonresident citizen or corporation established there as it would in the United States.

Practically all the other countries in the world, however, treat their nationals, individuals or companies, which become resident abroad, in a manner similar to their treatment of aliens, and therefore tax them only on income from sources within their own territories.

On the contrary, if a citizen of the United States is sent by his company to any foreign country, he remains subject to the United States tax on his earned income unless he can show that as of January 1 of the taxable year he has become a bona fide resident of the foreign country, not merely for the one taxable year (as sec. 116 (a), I. R. C., apparently provides) but for an indefinite period, in accordance with the interpretation of the Bureau as upheld by various court decisions. Apparently this means a minimum of at least 3 years. The citizen of the United Kingdom, France, Italy, the Netherlands, or of practically any other nation who is in the same foreign country competing with the American citizen, bears only whatever tax that country imposes. This situation is obviously not conducive for Americans to accept employment abroad as technicians in connection with projects under the point 4 program, especially where, by reason of the lack of suitable living conditions and of educational institutions for their children in the country or countries to which their missions may carry them, they are forced to leave their wives and children at home in the United States, thereby often incurring the cost of maintaining two dwelling places.

One of the reasons for the success of British business abroad prior to World War I was that if the British subject, as an individual or in partnership, established a distributorship for British goods in a foreign country where he resided, he was, and still is, entirely free from the United Kingdom tax on income earned in the foreign country. On the contrary, his American competitor residing abroad, who invests capital and devotes his efforts to a similar enterprise, is exempt only to the extent of 20 percent of his net income, the law thus presuming that only one-fifth of the net earnings may be treated as a reward for his personal services, although the personal effort may have contributed much more to the earning of profits than the amount of capital involved (see sec. 116 (a), I. R. C.).

United Kingdom taxes certain foreign income only when remitted

Under British law, a company is regarded as a person and consequently when a British company becomes resident abroad it is not taxable in England except to the extent that profits are remitted to England. The test of residence in this case is that the company's operations are managed and controlled in the foreign country through a board of directors established there.[4] There is no doubt that this opportunity to plow back profits in the expansion of business in high-risk areas without having to pay the United Kingdom tax was a very important factor in building up important enterprises in numerous foreign countries, as well as in accumulating company reserves which could be drawn on when England became involved in war. This British rule provides a precedent for the United States Treasury proposals, supra, to treat foreign branches as subsidiaries.

Canada exempts foreign business corporations

The Canadian law contains probably the most liberal treatment for a domestic corporation carrying on business entirely abroad, in that it exempts the income of a so-called foreign business corporation which is devoted exclusively to trade or industry in a foreign country or countries. This provision was introduced as section 4 (k) of the Income War Tax Act which has been superseded by section 64 (1) [5] of the Income Tax Act of June 30, 1948, effective for 1949 and subsequent taxation years. Under paragraph (i) exemption is given to industrial, mining, commercial, public utility, or public service corporations, whose business and whose assets (except securities and bank deposits) during the whole of the taxation year were situate entirely outside Canada. The term "assets" means property, machines, current capital, assets, etc. used in the business and not securities and bank deposits. The company may hold shares in other Canadian companies, or Canadian bonds, and still qualify as a "foreign business corporation."

The term "foreign business corporation" also includes (ii) the wholly owned subsidiary of a corporation that complied with the foregoing conditions and was wholly engaged in carrying on business outside Canada, or (iii) a corporation engaged in business of an investment or financial nature which was carried on entirely outside Canada, and the shares of which had been offered for public subscription and were listed on a recognized stock exchange in Canada or elsewhere, and the property of which (except bank deposits and shares of other corporations that were entitled to exemption under this section) was situate entirely outside Canada.

To qualify as a foreign business corporation, the corporation has to meet two other conditions, namely: (*a*) that during the whole of the taxation year it was not a personal corporation, and (*b*) that it filed a return for the year in a prescribed form and paid an annual fee of $100 within 120 days from the end of the year.

Because of the more favorable nature of the foregoing provisions of the Canadian law than any provisions in the United States law, many American corporations have organized Canadian subsidiaries to carry on their business abroad. As an open invitation to organize Canadian subsidiaries, Canada not only exempts the above companies from the Canadian tax, but, when the income is distributed to the American parent corporation, Canada applies instead of the general withholding rate of 15 percent applicable to nonresidents, only a rate of 5 percent when dividends are paid by such a subsidiary corporation to the American parent corporation.

This regime is embodied in section 96 (3) (b) of the Canadian Income Tax Act and is subject thereunder to the limitations that all the voting stock of the

[4] United Kingdom Income Tax Act 1918, as amended, rule 2, case V, schedule D; *Mitchell* v. *Egyptian Hotels, Ltd.*, 6 tax cases 542; Konstam, The Law of Income Tax, 1950, p. 116, vol. 1.

[5] "*Exemptions.*—No tax is payable under this part upon the taxable income of a corporation for a taxation year when it was a foreign business corporation. (Sec 64 (1))

"*Definition.*—In this part, unless the context otherwise requires, a 'foreign business corporation' is a corporation that during the whole of the taxation year in respect of which the expression is being applied—

"(a) was not a personal corporation,

"(b) has filed a return for the year in prescribed form and has paid an annual fee of $100 within 120 days from the end of the year, and

"(c) complied with one of the following conditions:

"(i) its business operations were of an industrial, mining, commercial, public utility or public service nature and were, except for management and the designing, purchasing, and transportation of goods, carried on entirely outside Canada either directly or through ownership of shares in or control of subsidiary or affiliated corporations and its property, except securities and bank deposits, was situate entirely outside Canada,

"(ii) it was the wholly owned subsidiary of a corporation that complied with the conditions in subparagraph (i) and was wholly engaged in carrying on business outside Canada, or

"(iii) its business was of an investment or financial nature and was carried on entirely outside Canada, its shares had been offered for public subscription or were listed on a recognized stock exchange in Canada or elsewhere and its property (except bank deposits and shares of other corporations that were entitled to exemption under this section) were situate entirely outside Canada. (Sec 64 (2).)"

Canadian company (except directors' qualifying shares) belongs to the American corporation, and that either the chief business of the Canadian corporation is the making of loans or that not more than one-quarter of the gross revenue of the subsidiary corporation, for the taxation year in which the dividend was paid, was derived from interest and dividends other than interest or dividends received from a wholly owned subsidiary corporation. It is further restricted by article XI of the convention between the United States and Canada of March 4, 1942, which, after placing a limit of 15 percent of the withholding rate applicable by each country to the income of nonresidents, adds that the rate shall be limited to 5 percent on the dividends paid by a subsidiary corporation organized in one of the contracting states to a parent corporation in the other contracting state, provided the former state is satisfied that the corporate relationship between the two corporations has not been arranged or maintained primarily with the intention of taking advantage of this paragraph.

The very existence of this favorable regime under the laws of our northern neighbor emphasizes how little attention is paid in the formulation of the American tax policy to the tax advantages given by other countries to their nationals, which places them in a more favorable competitive position than nationals of the United States.

Other British Commonwealth countries exempt certain or all foreign income

Other countries in the British Commonwealth of Nations, though they may not have reached the same economic or industrial development as Great Britain or Canada, nevertheless embody provisions in their tax legislation which encourage extension of business and investments to third countries. Thus, South Africa clearly limits its tax to income from domestic sources.[6]

Australia exempts a resident of Australia on income (except dividends) derived in another country if it is not exempt from income tax there.[7] As regards dividends paid by a nonresident company out of foreign income, resident taxpayers receiving such dividends may credit income tax paid thereon to a foreign country against their Australian income tax.[8]

New Zealand law exempts income derived and chargeable with tax in other British Dominions.[9]

British India excludes from tax under certain conditions income derived abroad by residents and not received in British India.[10]

European exemption of foreign permanent establishments

Recognition that, because of the keen competition of business, similar establishments in the same country should be subject to the same tax burden has been specifically embodied in the laws of France and Italy. Thus, France imposes its tax on industrial and commercial profits on the basis of the profits earned in France by a permanent establishment and exempts a French enterprise from this tax on profits allocable to an establishment in another country.[11]

Italian tax law also specifically exempts from its profits tax income attributable to a branch in another country if such branch maintains separate accounts.[12]

In Switzerland, income from foreign business operations is generally excluded from the income-tax base, although included for the determination of the tax rate on other income.[13]

As will be mentioned, infra, this principle has been embodied in a large number of bilateral agreements between European countries, with the result that it may be said that it is the fairly general rule for the taxation of European enterprises operating in two or more countries. Hence, American corporations operating through branches in the same countries would be subjected to this competitive disadvantage where the rate in the given European country is less than the United States rate.

Spain and Latin American countries exempt branch profits abroad

The principle of taxing a domestic enterprise only on income from domestic sources is embodied in Spanish law and is followed fairly generally throughout

[6] Union Income Tax Act, No 31 of 1941, as amended, sec 17.

[7] Australian Income Tax Assessment Act, 1936–47, sec. 23 (q); Gunn, pars. 264–265.

[8] Australian Income Tax Assessment Act, 1936–47, new sec. 45, introduced by Australian Amending Act of 1947.

[9] New Zealand Land and Income Tax Act, 1923, as amended, sec. 89.

[10] Indian Income Tax Act, 1922, sec. 4.

[11] League of Nations, Taxation of Foreign and National Enterprises, vol. IV, par. 570. Decree on Tax Reform, December 9, 1948, art. 8.

[12] League of Nations, Taxation of Foreign and National Enterprises, vol. IV, par. 569.

[13] Act of December 9, 1940, arts. 19 and 44, United Nations, The Effects of Taxation on Foreign Trade and Investment, p 52.

the countries of Latin America. Thus, Spanish companies operating in any Latin American country and taxed there are allowed to deduct from their entire profits the proportion thereof which corresponds to the business done and taxed in the other country, and a like proportion is excluded from the taxable amount of dividends distributed.[14]

Argentina,[15] Brazil,[16] Panama,[17] Paraguay,[18] Uruguay,[19] Venezuela,[20] and Colombia,[21] in regard to domestic companies, follow the principle of territoriality in their laws, and thus a domestic company pays tax only on income from sources within its home state.

Netherlands gives full credit for income from certain foreign areas

Whereas the foregoing provisions are generally applicable to all foreign countries, the law of the Netherlands provides a system of relief which could be used as an example in liberalizing the United States credit for foreign taxes. Briefly, the Netherlands law provides for reducing the Netherlands tax on entire net income of a Dutch company by the amount of its own tax applicable to income from, and taxed in, Indonesia, Surinam, or Curacao.[22] This same provision has been extended to other countries through tax conventions, e. g., Belgium, February 20, 1923;[23] Sweden, March 21, 1935;[24] the United States, April 29, 1948.[25]

Belgium reduces rate on foreign income

Belgium is much interested in foreign trade and has facilitated operations and investments abroad by subjecting its residents to only a low rate of approximately 7 percent on business income from foreign sources, which is less than one-fifth of the 36 percent rate applicable to undistributed profits from Belgian sources.[26] This compares with the 24-percent rate applied by the United States under very strict conditions to Western Hemisphere trade corporations which derive practically all their income from sources outside the United States but in the Western Hemisphere.

Exemption for foreign dividends

It is to be noted that a number of the countries mentioned above exempt dividends from all or certain foreign sources. Thus, France exempts from its tax on income from securities dividends (and even interest) on securities issued by enterprises located in one of the territories of the French union outside metropolitan France.[27]

Italy does not subject foreign dividends, or even domestic dividends, to its tax on movable wealth.

Belgium applies to foreign dividends the reduced rate of 12 percent, and it is proposed to reduce this rate to 6 percent, as compared with the tax on distributed income of domestic companies of 45 percent. Currently, interest from bonds issued in foreign countries by Belgian companies for the needs of their foreign establishments is only taxed at the rate of 6 percent.

The Union of South Africa and various Latin American countries mentioned above tax corporations, and in many cases individuals, only on income from domestic sources, thereby exempting dividends from foreign sources.

Exemption by treaty of profits of permanent establishment abroad

Especially during the period between World Wars I and II, most of the countries of Europe concluded one or more bilateral treaties for the avoidance of double taxation, in the field of direct taxes on income and sometimes property, with the other countries to which the flow of the trade and investments of its nationals was most active. There is a large degree of uniformity in these conventions, especially because of recourse to model conventions drafted by committees of technical experts of the League of Nations.

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[14] Law of September 22, 1922, Disposition 9, par. 2 of part A of tariff 3; Del Olmo y Reviriego, Contribucion sobre Utilidades, 1929, p. 409.
[15] Decree No. 14, 338/46 of May 20, 1946, art. 1.
[16] Decree Law No. 5,844 of September 23, 1943, art. 35.
[17] Law No. 52 of May 23, 1941, art. I.
[18] Decree Law No. 18,190 of April 27, 1943.
[19] Law No. 10,597 of (D.O., January 26, 1945) and Regulatory Decree No. 674,944 of July 11, 1945, art. I.
[20] Ley del Impuesto de la Renta of July 17, 1942, art. I.
[21] Law No. 78 of December 23, 1935, as amended, arts. 4 and 5.
[22] Netherlands Corporation Tax Law, No. 51/1942, art. 28.
[23] League of Nations, Collection of International Agreements and Internal Legal Provisions for the Prevention of Double Taxation and Tax Evasion, vol. VI, p. 9.
[24] Ibid., vol. VI, p. 23.
[25] Treaties and Other International Acts Series, 1855.
[26] Belgium, Coordinated Laws of January 15, 1948.
[27] Tax Reform Decree of December 9, 1948, art. 49 (it appears that in some instances France taxes 10 percent of such income).

In regard to industrial and commercial profits, these conventions embody the principle that if an enterprise of one contracting state extends its activities into the other without having there a permanent establishment, it will be taxable only in the first state, but if it has a permanent establishment in the second state then each state will tax only the profits allocable to the permanent establishment in its territory. The term "permanent establishment" is generally defined to include any fixed place of business, such as an office, factory, assembly plant, sales office, mine, oil well or plantation. It does not include business dealings through a bona fide commission agent or broker, or a subsidiary company. It does include dealings through an agent who regularly makes deliveries out of a stock of goods, or who has authority regularly to conclude contracts.

Frequently the article adds that the competent authorities may agree on rules for the allocation of profits to the permanent establishments in their respective territories. By way of exception, the treaties usually provide that enterprises engaged in maritime shipping and air transportation will be taxable only by the state in which the enterprise is resident from a tax viewpoint, or where the ships or aircraft were documented.

Because of the iron curtain that divides western Europe from eastern Europe, it is convenient to mention first the countries in the former area which are members of the Organization of European Economic Cooperation, the OEEC, as most of these conventions are probably still in effect.

Thus, Belgium has income-tax conventions embodying such a clause with France, Luxemburg, Italy, the Netherlands and even Germany. Denmark applies the principle in conventions with Iceland, Germany, Sweden, Finland, and Norway. France concluded an income-tax agreement with the Saar in 1922 and subsequently entered into such conventions with Italy, Belgium, Germany, Sweden, Switzerland, and Rumania. Italy was a pioneer in the field of tax treaties, starting out in 1922 with a multilateral convention with the former members of the Austro-Hungarian Empire, which however came into effect only in the case of Austria, and following it by treaties with Czechoslovakia, Germany, Hungary, France, Belgum and Rumania.

In addition to its above-mentioned convention with Belgium, the Netherlands also has a similar treaty with Sweden.

Norway has such pacts with Denmark and Sweden. Germany, being perhaps the most active industrial and commercial country of western Europe, had the largest number of tax treaties. To those already mentioned with Belgium, Denmark, France, and Italy, there may be added essentially similar accords with Austria, Czechoslovakia, Hungary, Sweden, Switzerland, Finland, Rumania, and Yugoslavia. Although its treaties with members of the United Nations were abrogated on the outbreak of war, Germany is said to apply in practice the principles embodied therein.

Countries now in the U. S. S. R. sphere of influence had numerous treaties with neighboring countries, such as Czechoslovakia, Hungary, Poland, Rumania, and Yugoslavia.

While there are numerous gaps in the network of treaties between the countries in western Europe where American citizens and corporations may operate, it may be said that in general the American enterprise will find itself competing with permanent establishments of enterprises of third countries of continental Europe which bear the tax on their industrial and commercial profits at only the rate applicable in the country where the establishment is situated. Examples of low taxes on the profits of branches are: Italy, 22.5 percent;[28] the Netherlands, 33⅓ percent; Switzerland, 3–12 percent plus cantonal and communal taxes (e. g., Berne, 20.5 percent). France's rate on industrial and commercial profits of companies is 24 percent.[29]

The United Kingdom has not concluded treaties with any continental European countries embodying this principle, but has incorporated the American-type credit for foreign taxes in treaties with the United States, Australia, Canada, New Zealand, the Union of South Africa, Rhodesia, and many of its colonies or possessions.

However, by far the great majority of countries have in their tax treaties recognized this basic principle that profits should be taxed only in the country of the permanent establishment which produces them.

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[28] Plus additional percentages for the communes.

[29] However, under art. 15, of the United States-France income-tax convention of July 25, 1939, there must be added to this tax the dividend tax of 18 percent on three-fourths of the branch profits, or 13.5 percent.

United States in treaties taxes income of permanent establishments abroad

In the income-tax conventions which the United States has concluded with various European countries, such as France, Sweden, the United Kingdom, the Netherlands, Denmark, Belgium, Greece, and Norway, the same concept of a permanent establishment is found, but it is applied so as to limit the amount of profits that are to be subject to tax as the result of activities carried on in one country by a permanent establishment of an enterprise of the other country. In all cases, the United States reserves the right to subject American enterprises to its tax in respect of profits allocable to a permanent establishment in the other contracting state, but allows a credit for the income tax imposed by the other State against (in effect) its tax on net income from the other State (sec. 131, Internal Revenue Code).

Proposed treaty exemption for foreign branch profits

In other words, the basis has been laid for applying by treaty the same basic principle that is applied by so many foreign countries under their laws and treaties, namely, that of permitting the other party to the tax convention to exercise the exclusive right to tax income attributable to a permanent establishment in its territory. All that is necessary on the part of the United States is to forego by treaty its presently reserved right to include all the profit attributable to the establishment in the other contracting state in the income taxable in the United States. As will be shown, infra, the National Foreign Trade Council has recommended that the United States follow the example of the numerous foreign countries mentioned above whose nationals or enterprises have a competitive tax handicap over Americans.

Inadequacy of present tax conventions

As shown above, the present United States tax conventions do not, in cases where the foreign rate is lower than the United States rate, accomplish the desired purpose of placing American citizens and corporations operating or investing in a particular foreign country in a position of competitive equality with the nationals of that country. This is due to the fact that in such conventions the United States has reserved the right to tax its citizens and corporations at the same rates whether their income is derived from foreign or domestic sources.

Nevertheless, the United States has embodied in its Internal Revenue Code several provisions to place its taxpayers on a basis of equality with competitors abroad:

1. For citizens, the exemption for earned income of those who become bona fide residents of a foreign country under section 116 (a), Internal Revenue Code.
2. For citizens and corporations, the exclusion from gross income (or exemption) of income earned in a possession of the United States, as provided in section 251, Internal Revenue Code.
3. For domestic corporations qualifying under the China Trade Act, the credit against net income (or exemption) provided in section 261, Internal Revenue Code.
4. For citizens and corporations, where the foreign tax rate is at least as high as the United States rate, the credit under section 131, Internal Revenue Code, is equivalent to an exemption of the foreign income from the United States tax.

However, as domestic corporations qualifying under sections 251 and 261, Internal Revenue Code, are treated as foreign for the purposes of the credit granted under section 131 (f), Internal Revenue Code to a domestic parent company in respect of taxes paid by a foreign subsidary which correspond to dividends paid to the parent, and as the parent is not entitled to the dividends-received credit under section 26 (b), Internal Revenue Code, but pays the full 38 percent tax on such dividends, the benefit of the exemptions granted to corporations under sections 251 and 261 is in effect nullified. This is perhaps the principal reason why not as many domestic corporations have qualified under these relief provisions as might be expected.

In other words, if a domestic corporation organized one domestic subsidiary as a China Trade Act corporation to enjoy the exemption under section 261, Internal Revenue Code, and another domestic subsidiary to qualify under section 251, Internal Revenue Code and thereby escape the United States tax on profits from a business carried on in a United States possession, the advantage of the exemptions was lost when each subsidiary distributed its earnings, because the parent corporation was fully taxable on dividends received from either subsidiary, except for the credit for the taxes paid by either subsidiary under section 131 (f), Internal Revenue Code.

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If the China Trade Act subsidiary paid a rate of, say, 20 percent in China, and the other subsidiary paid a rate of, say 12 percent in the United States possession, the parent corporation paid 38 percent on dividends received from either and credited against such tax the respective rates of 20 and 12 percent, leaving margins of 18 and 26 percent, respectively, in excess of the tax an indigenous enterprise in either country would bear. Hence, if the domestic corporation, after the initial period of development, wished to bring home most of the profits, there was little if any advantage in going to the trouble of setting up a special subsidiary to qualify for the special exempt status under either section 251 or 261, Internal Revenue Code.

Advantage of lower tax for Western Hemisphere trade corporations

In the case of Western Hemisphere trade corporations (where no consolidated return is filed), the parent corporation may take the dividends-received credit (under sec. 26 (b), Internal Revenue Code) for dividends from a subsidiary qualifying as a Western Hemisphere trade corporation. Hence, under the present law it pays 38 percent on only 15 percent of the dividends distributed after payment of the United States rate of 24 percent making an effective rate of 38 percent×15 percent×76=4.3 percent+24 percent=28.3 percent. The foreign tax would be credited against the United States rate of 24 percent and in many cases would offset it, but in other cases where the rate is only 24 percent or lower the differential of 9.7 percent (38 percent—28.3 percent) given up by the United States would be an appreciable incentive. It would be more advantageous, from the viewpoint of giving an incentive, not to reduce the initial concession of 14 percent by the intercorporate dividend of 4.3 percent. Section 218 of H. R. 8920 would present similar considerations.

Lower rate for foreign income should be generalized

The United States normal tax rate is by itself about as high a rate as a business enterprise should bear especially in foreign countries where the rate is no higher, and it would be good policy for the United States to adopt it as a ceiling for income-tax rates on income from international business carried on in any foreign country or possession of the United States. This might have the effect of dissuading some foreign governments, particularly in Latin America, from adopting progressive scales of rates which are very moderate in the lower brackets applicable to most national enterpsises but increase rapidly in the upper brackets so as to subject most of the income of larger American-owned enterprises to a top rate approximating the United States rate. This is an effective way of asserting what they consider to be their exclusive right to tax income from their domestic sources derived by American enterprises. If foreign governments realize that the United States normal tax rate is all that is imposed on income from foreign business and that their imposition of a higher rate will curb the inflow of investments, they are more likely to keep their top rates under the United States normal tax rate.

The normal tax rate would equal or exceed the rates on business income in a number of the underdeveloped countries that presumably are within the purview of the point 4 program.

Lower rate should apply to any permanent establishment abroad

Inasmuch as any permanent establishment abroad with an adequate separate accounting of its earnings can meet the same tests as to sources of income as those prescribed under section 109, Internal Revenue Code for a Western Hemisphere trade corporation, the exemption from surtax should be applied to the net income from such an establishment.

This would obviate the need of organizing a special domestic corporation to qualify as a Western Hemisphere trade corporation, and would avoid reducing the full concession of 14 percent by the intercorporate dividend tax of 4.3 percent.

Lower rate should apply to dividends of foreign operating subsidiaries

Furthermore, either because of the laws or administrative requirements of foreign countries, or in order to avoid prejudice, it is frequently necessary to organize a local corporation in which the American corporation may hold a majority, or perhaps only a minority, interest. Therefore, the lower rate should be applied as well to dividends from a foreign corporation which meets the same conditions as to sources of income as those prescribed in section 109, Internal Revenue Code.

Section 131 (f), Internal Revenue Code, should be amended, as proposed by the Secretary of the Treasury, so as to apply in the case of a domestic corporation

receiving dividends from a foreign corporation in which it holds a minority interest, and also when the first-degree foreign corporation holds a minority interest in a second-degree foreign corporation, and the lower rate in respect of dividends received from the first-degree foreign corporation should apply when both foreign corporations meet the tests of section 109, Internal Revenue Code.

Provisions such as the foregoing would offer real incentives for investing in foreign enterprises.

Foreign tax credit should be clarified

The above suggestions presuppose that the foreign country imposes on the permanent establishment or subsidiary operating in its territory an income tax allowable as a credit under section 131, Internal Revenue Code. Unfortunately, numerous foreign countries have taxes which were introduced, in some cases, years ago, as income taxes but have been applied in a practical or empirical manner so as to obviate difficulties in administration.

In some countries the administration of an income tax has been so difficult that empirical methods have been prescribed for levying the tax on practically all taxpayers, with the consequence that no income tax is otherwise generally imposed as required by section 131 (h), Internal Revenue Code, and the regulations. In other cases, taxes intended to reach income are applied in a practical manner, such as by determining gross income by the local market price for sugar or a foreign market price for metals, and in some cases arriving at net income by allowing as a deduction a fixed percentage to cover costs and expenses. Governments sometimes take a short cut and levy, instead of an income tax, a tax of so many cents per unit produced, such as 5 cents per case of soft drinks or 27 cents per bag of sugar. Such taxes should be regarded as allowable credits under section 131 (h), Internal Revenue Code, whether such taxes wholly or partially replace the income tax otherwise generally imposed or reduce it by being allowed as a deduction in computing the net income subject thereto. This frequently occurs where the old income tax is retained after a new one along American lines is introduced, and it serves as a minimum income tax which cannot be avoided. Some countries have as an integral part of their income tax a tax on capital or property which assures the payment of a minimum tax. All such taxes are generally allowed as deductions and thus reduce the tax on net income.

However, if credit is allowed for the tax so reduced and not also for the empirical taxes, the corporation is not fully relieved of the burden of double taxation, with the consequence that the American corporation may have to bear a heavier tax burden as the result of doing business in such foreign country than if it operated only at home.

All such levies should be included in the credit under section 131, Internal Revenue Code, especially since the enactment of section 131 (h) to allow a credit for taxes in lieu of income taxes. However, this provision has been so narrowly construed by the regulations and the Bureau that its purpose has been largely frustrated and therefore a clarifying amendment should be enacted along the lines suggested infra.

Summary of proposed regime to encourage investments abroad

It is evident from the foregoing that, if the United States Government wishes to encourage its taxpayers to make substantial investments abroad, our enterprises carrying business abroad must not have to bear more taxes than their competitors abroad.

The National Foreign Trade Council recommends that, in addition to the Treasury proposals amended as suggested above, the following program of incentives be brought into effect as rapidly as possible by tax treaties and by amendments to the Internal Revenue Code:

1. The system that would give the most complete incentive would of course be to recognize that the country where income arises should have the exclusive right to tax such income by whatever means it finds practicable. Such a rule would provide relief from double taxation in cases where foreign countries have empirical income taxes or other taxes not now allowed as credits against the United States tax. The National Foreign Trade Council has recommended that the United States should follow the example of European countries which exempt income attributable to a permanent establishment abroad, and at least embody this principle in tax conventions;

2. Insofar as the foregoing principle is not applied, the exemption from surtax now granted Western Hemisphere trade corporations should be extended on a world-wide basis.

3. Wherever a United States corporation maintains a permanent establishment in a foreign country with which it carries on relations on the same basis as it would with an independent third enterprise, so that its profits are as accurately reflected by a separate accounting as they would be in the case of an independent company, then the profits of such an establishment should also enjoy the exemption from surtax under the same conditions.

4. As it is often necessary to form a corporation to operate in a foreign country, in which corporation the American corporation may own a majority, but frequently only a minority, interest, the same exemption from surtax should be extended to cover dividends from such a corporation which meets the requirements of section 109, Internal Revenue Code, as to sources of income;

5. Section 131 (h), Internal Revenue Code, which was intended to liberalize the credit for foreign taxes, so as to include foreign taxes in lieu of income taxes, has been so narrowly construed in many cases as to defeat its purpose. Therefore, Congress should adopt a clarifying amendment which would remove any doubt that this subsection when introduced was intended to include taxes based on empirical determinations of net or gross income, such as by using market prices or a certain rate per unit produced, especially where the law declares its intention to reach profits, or taxes on property that are an integral part of the imposing country's income tax, or taxes imposed on any of the above or other bases which serve as minimum income taxes.

Annex I

General conventions for avoidance of the double taxation of income and property or estates concluded by governments participating in the European recovery program

Parties to the convention	Date of signature	Citation
Italy and Austria, Hungary, Poland, Rumania, and the Kingdom of the Serbs, Croats, and Slovenes.	Apr. 6, 1922	Coll.,[1] vol. I, p. 73.
Germany and Austria	May 23, 1922	Coll., vol. I, p. 15.
Germany and Austria (death duties)	May 28, 1922	Coll., vol. I, p. 97.
Germany and Switzerland (with respect to earned income).	Mar. 24, 1923	Coll., vol. I, p. 138.
Germany and Italy	Oct. 31, 1925	Coll., vol. I, p. 80.
United Kingdom and Irish Free State	Apr. 14, 1926	Coll., vol. I, p. 56.
Denmark and Iceland	Aug. 11, 1927	Coll., vol. I, p. 60.
Austria and Switzerland	Oct. 24, 1927	Coll., vol. I, p. 61.
Denmark and Germany (provisional agreement)	Feb. 14, 1928	Coll., vol. I, p. 109.
Germany and Sweden	Apr. 25, 1928	Coll., vol. I, p. 64.
United Kingdom and Irish Free State (amending convention, Apr. 14, 1926).	do	Coll., vol. I, p. 58.
Italy and France	June 16, 1930	Coll., vol. III, p. 24.
Belgium and Luxemburg	Mar. 9, 1931	Coll., vol. V, p. 7.
France and Belgium	May 16, 1931	Coll., vol. V, p. 58.
United Kingdom and Sweden (sales through certain agents).	July 6, 1931	Coll., vol. IV, p. 15.
Italy and Belgium	July 11, 1931	Coll., vol. V, p. 64.
Denmark and Iceland (communal taxes)	do	Coll., vol. V, p. 42.
Switzerland and Germany	July 15, 1931	Coll., vol. V, p. 11.
United Kingdom and Switzerland (sales through certain agents).	Oct. 17, 1931	Coll., vol. V, p. 31.
Italy and France (limiting application of law of June 29, 1872).	Nov 16, 1931	Coll., vol. V, p. 69.
France and United States of America	Apr. 27, 1932	Coll., vol. V, p. 48; United States Treaty Series, 885.
Sweden and Denmark	May 6, 1932	Coll., vol. V, p. 52.
Denmark and Iceland (extending agreements of Aug. 11, 1927, and July 11, 1931).	June 15, 1932	Coll., vol. V, p. 43.
Belgium and the Netherlands	Feb. 20, 1933	Coll., vol. VI, p. 9.
Germany and Switzerland (addition to convention of July 15, 1931).	Jan. 11, 1934	Coll., vol. VI, p. 22.
France and Germany	Nov. 9, 1934	Coll., vol. VI, p. 14.
Sweden and the Netherlands	Mar. 21, 1935	Coll., vol. VI, p. 23.
Germany with Sweden (succession duties)	May 14, 1935	Coll., vol. VI, p. 36.
United Kingdom and the Netherlands (sales through certain agents).	June 6, 1935	Coll., vol. VI, p. 49.
United Kingdom and Greece (sales through certain agents).	Sept. 17, 1936	I. T. A.,[2] 263.
Sweden and France	Dec. 24, 1936	I. T. A., p. 14.
Sweden and France (estate taxes)	do	I. T. A., p. 337.

[1] League of Nations, Collection of International Agreements and Internal Legal Provisions for the Prevention of Double Taxation and Fiscal Evasion.

[2] International Tax Agreements, published by the Department of Economic Affairs, Fiscal Division, United Nations, 1948.

General conventions for avoidance of the double taxation of income and property or estates concluded by governments participating in the European recovery program—Continued

Parties to the convention	Date of signature	Citation
Iceland and Sweden	Sept. 8, 1937	I. T. A., p. 30.
France and Switzerland	Oct. 13, 1937	I. T. A., p 31.
Belgium and Germany	Dec. 1, 1938	I. T. A., p. 59.
Denmark and Germany	Dec. 16, 1938	I. T. A., p. 72.
Norway and United Kingdom (agency gains and property tax).	Dec. 21, 1938	I. T. A., p. 266.
Denmark and Iceland	Jan. 24, 1939	I T. A , 79
United States of America and Sweden	Mar. 23, 1939	I. T. A , 81, United States Treaty Series, 958.
Sweden and France (supplementing convention of Dec. 24, 1936).	May 5, 1939	I. T. A., 89.
France and United States of America	July 25, 1939	I. T. A , p. 90, United States Treaty Series, 988.
United States of America and the United Kingdom.	Apr. 16, 1945	I. T. A., p. 118, United States Treaty Series, 1546.
United States of America and the United Kingdom (amending convention of Apr. 16, 1945).	June 6, 1946	I. T. A., p. 118.
United States of America and the United Kingdom (estate taxes).	Apr. 16, 1945	I. T. A., p. 351, United States Treaty Series, 1547.
United Kingdom and France	Oct. 19, 1945	I. T A., p. 127, United Kingdom Treaty Series, France No. 3 (1945).
France and United States of America.		
Income and estate taxes	Oct. 18, 1946	I. T. A., p. 366, United States Treaty Series, 1982.
Supplementary protocol	May 17, 1948	
Denmark and Norway	Dec 30, 1946	I T. A , p. 165.
Norway and Sweden	June 21, 1947	I. T. A., p. 178.
United Kingdom and Eire (amending convention of Apr. 14, 1926).	July 21, 1947	I. T. A., p. 183.
United States of America and the Netherlands	Apr. 29, 1948	I. T. A., p. 239, United States Treaty Series, 1855.
United States of America and Denmark	May 6, 1948	I. T. A , p. 248, United States Treaty Series, 1854.
United States of America and Belgium	Oct. 28, 1948	Executive I, U. S. Senate, 81st Cong., 1st sess.
United States of America and Norway	June 13, 1949	Executive Q, U. S. Senate, 81st Cong., 1st sess.
United States of America and Norway (estate taxes).	do	Executive R, U. S Senate, 81st Cong., 1st sess.
United States of America and Ireland	Sept. 13, 1949	Executive F, U. S. Senate, 81st Cong., 2d sess.
United States of America and Ireland (estate taxes)	do	Executive E, U. S. Senate, 81st Cong., 2d sess.
United States of America and Greece	Feb. 20, 1950	Executive L, U. S. Senate, 81st Cong., 2d sess.
United States of America and Greece (estate taxes).	do	Executive K, U. S Senate, 81st Cong., 2d sess.

Mr. CARROLL. The second thing, if you will permit me, is that I would like to high light what appears in my statement.

I must say that most of our proposals were prepared before this trouble in Korea, and we feel that we should nevertheless go ahead with our suggestions, presupposing that commerce must go on, that the program of encouraging activities in underdeveloped countries must be continued, in order to raise their standard of living, and thus carry on the so-called cold war against communism, in order to prevent, if possible, its becoming a hot war.

What we have to offer does not involve much in the way of revenues, but it does mean a lot to enterprises that are engaged in foreign commerce or have to make investments abroad, in carrying out the objectives of the point 4 program. As you know, the legislation offered to Congress in connection with the point 4 program deals only with the part that the Government is to do. But that is supposed to be supplemented by the aid of private enterprise, and it is expected in the long run that it will be American private capital, American initiative, that will do the major job in building up the economy of these so-called underdeveloped areas.

In this brief statement which I have here, I touch very quickly upon the proposals which the Secretary of the Treasury has offered, and I hope that you will give consideration to them, because they are very good as far as they go. In our opinion, some of them do not go far enough. There is no doubt about it that especially in countries where you have exchange restrictions and there are difficulties in bringing back your income from foreign investments, the proposal of the Treasury to treat a foreign branch as a subsidiary, so that the tax on the income would be deferred until the income is brought home, would be a very helpful thing.

The proposal to extend the credit in section 131 (f) for the part of the taxes paid by a foreign subsidiary that correspond to the dividends paid by a parent should be extended to an American country with a minority interest, as the Secretary of the Treasury proposes, because it frequently happens that two or three corporations get together and form a foreign corporation in order to carry on a joint venture. However, that provision should be carried through one step further, to make it coextensive with the provisions in section 131 (f) of the existing law, which allows the same credit where the foreign corporation has for business reasons to form a second subsidiary. That isn't a difficult question. It is worked out under the credit now, where you have a first corporation owned to the extent of a majority of the stock by the American company, and in the case of a corporation which exercises its control right through it would be perfectly possible to work out the credit for the foreign taxes.

The third proposal is that regarding the treatment of the income of businessmen and technicians who go abroad. As you know, with this war scare, it will be all the more difficult to get men to go abroad and to carry on our business, but we must carry on. The Treasury has proposed to permit this exemption for the income earned in foreign countries to begin from the time the individual takes up his residence in the foreign country, rather than from the beginning of the taxable year, January 1. Unfortunately, the Treasury construes "bona fide residence abroad" to mean something tantamount to domicile. I believe you will recall that in 1942, when we went into this question very thoroughly before this very committee in regard to this section 116 (a), we used the term "bona fide residence during the entire taxable year." And when we proposed that, we thought that just meant 1 year. But the Treasury has construed it to mean, apparently, an indefinite period of at least three or more years.

We feel that in order to encourage these technicians to go into very primitive and undeveloped areas, there should be a limitation of, say, 12 consecutive months, or something to show that you don't have to really establish yourself for life in the foreign country.

Another proposal is apparently to eliminate the so-called per country limitation on the foreign tax credit; that is to say, the credit for tax in a given country shall not exceed the ratio of the income from that particular country to the entire net income of the corporation. We feel that it is far more important to eliminate that provision rather than maintain it, as the Secretary of the Treasury apparently proposes, and instead to maintain the so-called over-all limitation, so that your foreign business would be treated as a whole, and your taxes in high tax countries could be averaged with taxes in low tax countries. In that way, there would be more encouragement to the expanding de-

velopment abroad of foreign commerce, because the rates in high tax countries like England could in effect be spread over the income of low tax countries, which you will find to be the case in many underdeveloped areas.

Then, the provision for allowing a credit for foreign estate taxes should be adopted.

After a careful examination of the effect of taxes upon the expansion of business abroad, the National Foreign Trade Council has come to the conclusion that it would be desirable for the Congress to, in effect, take cognizance of what other countries are doing, and especially in the laws of many countries, in Latin America and the Union of South Africa and to a large extent India and other places, and in the treaties to which European countries are parties, and adopt the same principle, namely, that of recognizing that the country where income is earned should have the exclusive right to tax that income.

This is very important in order to assure American corporations operating in the same country competitive equality. It is recommended that this be done wherever possible by treaties. That has been the medium which many European countries have adopted to bring into effect this principle.

Where it is not possible, either because of indisposition of the other country to conclude a treaty or because there hasn't been time to conclude a treaty, we recognize that it is necessary to extend on a world-wide basis the treatment provided for so-called Western Hemisphere trade corporations, domestic corporations operating almost entirely within countries of Latin America.

As you will recall, in 1942 this very committee adopted the proposition that they should be exempt from surtax and subject only to the normal tax. In the House bill, a very complicated provision has been substituted for what appears in the existing law. And we would urge that a way be found to return to the way it is done in the existing law and to extend that on a world-wide basis.

Now, it is true that it won't have any advantage vis-à-vis a country like England or Australia or Canada, where the rate is as high as our rate; but there are many areas, especially the underdeveloped ones, where the rate is as low as our normal rate, or even lower, and it would be exceedingly helpful to grant that concession to encourage commerce in those areas.

We have found that there is no advantage for foreign countries to impose a lower rate than ours or to grant exemptions for plow-backs into the business, and that sort of thing, if we continue to impose our full rate and do not take cognizance of what the foreign country does. For example, Brazil has a provision in its law whereby it first collects a tax of 15 percent on the profits and then it imposes a tax of 15 percent, an additional 15 percent, on profits remitted to the head office in the United States. But if that American country uses its profits in developing its business in Brazil, it is exempt from that second 15 percent tax. However, that doesn't do any good in the case of the American corporation, because we impose today 38 percent, if the corporation is not a Western Hemisphere trade corporation and if it is we impose 24 percent; in any case much more than the local rate. So there is no advantage in Brazil offering this inducement to develop business in Brazil when we kill it by subjecting that income to our tax.

So therefore we urge that this committee give very serious consideration to extending and even liberalizing the provision for proposing a low rate on income from abroad.

As you will see in this larger study, many countries exempt outright the income earned abroad, and another country like Belgium applies a much lower rate.

There is another provision that was adopted in 1942, namely, the credit for taxes in lieu of income taxes otherwise generally imposed. We took into consideration in 1942, and this committee in its wisdom adopted it, that many of these Latin American countries do not have as competent tax administrations as we have in the United States, nor do they have as honest taxpayers. Therefore they adopt what we call an empirical method of determining income, such as basing income on the prevailing market price for the products produced and sold. Or they sometimes take even a shorter cut and determine a rate of so much per unit produced, that stands in lieu of the tax that would otherwise be collected as an income tax.

Because of the very narrow construction of the Treasury, largely due to the fact that whereas in the Senate report you refer to taxes that would otherwise be imposed, in the law was inserted the phrase "otherwise generally imposed." In other words, the tax in question must be in lieu of a tax otherwise generally imposed.

There has to be a condition precedent of first determining whether there is a tax otherwise generally imposed, and that this is specifically in lieu thereof.

Now, it frequently happens that in these Latin American countries these empirical taxes came before the income tax, in our sense. It was the primitive income tax, the predecessor of the present income tax. And so the present income tax is levied on top of that tax. Such a levy doesn't fit within this narrow definition of the Bureau.

In other cases, as I say, where the income tax is broken down, they determine a fixed amount, like so much per bag of sugar or so much per case of soft drinks, and collect that as a rough and ready method of getting a taxable income. In some cases that is declared to be, as in the case of one Cuban tax, a tax on extraordinary war profits. In other cases the companies subject to that tax are exempt from the general income tax.

Our contention is that levies such as these should clearly come within the purview of section 131 (h) that was adopted in 1942 by this committee; and it would be very helpful if either an amendment or perhaps just clarifying language in the report could be resorted to, in order to show this broader intent of the original scope of section 131 (h).

Senator BUTLER. Mr. Carroll, if I get the story correctly as you tell it, the empirical taxes take the place of what we would call an income tax?

Mr. CARROLL. Yes, that is true in many of these places. For example, way back in 1867, in Cuba, they adopted what was for the Cubans a general income tax, which was supposed to be a tax on the general return of agricultural enterprises or of property. And subsequently that has become a municipal tax, and a national income tax tax has been imposed on top.

But in the case of these sugar companies down there, for example, they adopt the empirical method of basing the tax on the average mar-

ket price of sugar produced in the area, and they allow a deduction of a fixed amount, of, say, 60 or 80 percent, representing the cost. Now, that is clearly intended to be an income tax. It was a precursor of the present income tax, and it is still levied in addition to the income tax.

Senator BUTLER. Is it not so considered?

Mr. CARROLL. Hitherto I am afraid they haven't considered it that way.

In Cuba, which provides many such examples, there was a tax adopted in 1917, when they needed revenue, and they imposed it at the rate of so much per bag of sugar. And as a matter of fact, that was the successor to what they called at that time an extraordinary war profits tax, a tax by reason of extraordinary war profits. That was similar to other taxes that were imposed in Cuba on various products produced that were introduced back in 1903 to finance the Speyer loan. They imposed taxes of so much per unit produced, like so much per case of beer or soft drinks, and so forth, and when the income tax was reimposed they specifically exempted these companies from that tax.

In the case of Mexico, that country takes cognizance of the fact that the minerals produced in Mexico are sold mostly in New York. Therefore, they base one of their taxes, which was the precursor of the present income tax in Mexico, and it is still applied, on the price at which the metal is sold in the market of New York, as measuring the gross profits realized in Mexico. And, in various laws that have been enacted, they have referred to this tax as being intended to reach the profits of the enterprise.

One could go on and cite instance after instance where in these less-developed countries they resort to these, you might say, foolproof methods of determining the basis of the tax, which is intended to reach the profits of the enterprise.

Senator BUTLER. Have our tax methods been directed to the extension of our foreign trade?

Mr. CARROLL. There is no doubt that where our rate is much higher than the foreign rate, so that in addition to the local income taxes you have to bear these other empirical levies that are not allowed as credits, it means that you have to pay more tax as a result of doing business abroad than you would if you did it at home.

Take for example some of these impirical taxes based on market prices. They may amount to, say, 50 percent of your income. Then, on top of that, they may have an income tax that represents, say, 20 percent of the income.

Now, against our tax there is allowed as a credit today only the 20 percent pure income tax, but not the 50-percent tax based on this empirical method of determination.

The United States allows as a credit only the 20 percent, which means that under the present rate of 38 percent, or the proposed rate of 41 percent, an additional 18 or 21 percent would have to be paid to the United States; so that you have, through the disallowance of this heavy empirical tax as a credit, a greater total effective burden as a result of doing business in the foreign country than you would have if you did business only in the United States.

It is true that in many of these cases these countries got started in the foreign country a long while ago, when our rates were very low, and little by little this cumulative burden has been developed, and they just carry on and do the best they can. But it certainly is a

definite deterrent to any new enterprise going in and doing the same thing, especially in these underdeveloped areas, where, in addition to taxes, you have all other kinds of risks that have to be taken into consideration.

Senator BUTLER. Do you think our firms that are engagd in foreign trade should get the benefit of all those empirical taxes?

Mr. CARROLL. Yes; I do, sir. Because we regard them as being effectively taxes on the income of the enterprise; and, furthermore, as you know, Senator, the credit is very carefully limited, especially if you keep this over-all limitation on the credit. That limitation was put in to prevent the credit from foreign taxes from cutting into the Federal tax on domestic income. In other words, the way the credit is set up now, you get your relief only against the part of your foreign tax that corresponds to the foreign income and not against the part of the foreign tax that corresponds to domestic income. Therefore, we feel that with this limitation of the credit, protecting the domestic revenues from domestic activities, Congress can afford to be a little more liberal in dealing with purely foreign taxes on foreign income.

Thank you very much, Mr. Chairman.

Mr. CHAIRMAN. You have given the reporter all the statements that you wish to have go into the record?

Mr. CARROLL. I have, Senator.

The CHAIRMAN. Thank you very much, Mr. Carroll.

Mr. CARROLL. Thank you, sir.

The CHAIRMAN. Mr. Baggett? You may be seated sir, and identify yourself, if you will, for the record.

STATEMENT OF SAM G. BAGGETT, BOSTON, MASS., APPEARING IN BEHALF OF THE LATIN-AMERICAN COMMITTEE OF THE BUSINESS ADVISORY COUNCIL

Mr. BAGGETT. Mr. Chairman, I am Sam G. Baggett, of Boston, Mass. I am vice president and general counsel of the United Fruit Co. I am a director of the National Foreign Trade Council and a member of the tax and law committees of that organization. I am also a member of the tax committee of the United States Council of the International Chamber of Commerce. I am chairman of the division of trade of the section of corporation, banking, and business law of the American Bar Association, and a member of the Latin-American Committee set up by the Business Advisory Council of the Department of Commerce. In 1948, in an unofficial capacity as the representative of the National Foreign Trade Council, I attended the Ninth International Conference of American States at Bogotá, Colombia, which, as you will recall, was interrupted by the burning and sacking of the city directed by communistic agitators. I also served with a committee of the National Foreign Trade Council which gave extended study to the President's point 4 program and made recommendations for legislative implementation. Various conferences between groups of business men and representatives of the Department of State in which I participated culminated in a nonpartisan bill on point 4 which was enacted into law.

I have given this statement for identity and background, because this is my first appearance before this committee, but I am appearing

here in behalf of the Latin-American Committee. The Business Advisory Council is a statutory board which was set up to advise the Department of Commerce, as the Senator knows, and they organized, a short time ago, a Latin-American Committee to advise with the Department of Commerce and the Department of State on matters particularly affecting Latin America.

On behalf of the Latin-American Committee, I wish to elaborate on one of the recommendations of the National Foreign Trade Council mentioned by Mr. Carroll and its relation to the point-4 program. I refer to the recommendation that Congress authorize the inclusion in treaties for the elimination of double taxation of a reciprocal provision that the income of business establishments of the nationals of one contracting country located in the other shall be subject to income tax only in the country where the income is earned. Thie proposal has been endorsed in principle by the members of the Latin-American Committee and submitted to the membership of the Business Advisory Council.

In the field of extraterritorial taxation we are, in my opinion, one of the principal offenders. The long arm of the United States Treasury reaches out all over the world and taps the income of railways, power plants, factories, banks, and other enterprises that belong to the citizens and corporations of the United States. An American citizen living in a foreign country who owns a dairy, a radio shop, or any other business, can take out only a maximum of 20 percent of the profits as earned income and the balance is subject to tax here. A railroad in Central America, for example, is subject to income tax here if it is owned by an American corporation even though part of the capital may have been furnished by British investors. It is the same with other American enterprises. We do allow a credit for the foreign tax that meets our standards of an income tax, but if the foreign rate is lower than our rate, the difference must be paid to the United States Treasury. As our courts have said, this does not eliminate double taxation; it merely mitigates the evils thereof.

Our policy is contrary to the policy generally followed by other countries. A large number of countries by law limit their income tax to income from domestic sources. France, Italy, Switzerland, Spain, South Africa, Australia, British India, and generally the various countries of Latin America do not tax the income of business establishments of their nationals located in other countries. Belgium taxes such income at less than one-fifth of the rate applicable to domestic income. Canada allows a complete exemption to so-called 4-K companies which are organized for the express purpose of conducting business abroad. England does not tax the foreign income of its citizens residing abroad nor does it tax the income of British corporations whose operations and management are located abroad except to the extent the profits are remitted to England.

In addition, most of the countries of Europe have from time to time entered into tax treaties of the type here recommended which provide specifically that the income of the business establishments of the nationals of one contracting country operating in the other shall be subject to income tax only in the country where earned.

Senator CONNALLY. If that would apply to Central and South America, we would lose lots of revenue, would we not?

Mr. BAGGETT. I don't think so, Senator. I touch on the cost of it a little later in my statement. We haven't been able to get any accurate figures, of course.

Senator CONNALLY. All right.

Mr. BAGGETT. The countries that have entered into one or more of this type of treaty are as follows: Austria, Belgium, Czechoslovakia, Denmark, Finland, France, Germany, Hungary, Iceland, Ireland, Italy, Netherlands, Norway, Poland, Rumania, Russia, Sweden, Switzerland, and Yugoslavia.

You will see that that covers most of the countries of Europe and some of Asia.

Many countries, and particularly countries of Latin America, are resentful of our extraterritorial tax policy. They say that we are siphoning off the wealth of their countries because the money paid to the United States Government by American enterprises located in their countries could be used to provide for expansion of facilities and otherwise increase the financial strength of the business. There is a coast-to-coast railroad in Central America, for example, that was built by American and British capital under a franchise issued many years ago when the construction and operation of such railroad was extremely hazardous, and I might say that it is still hazardous. Under its franchise it pays no income taxes to the Government. It has never been able to pay a common dividend and is in arrears on its preferred stock. Its roadway and equipment are badly in need of repairs and replacements, and it is unable to make them. Yet through the past years that company has paid out large sums in income taxes to the United States Government merely because it is an American corporation, although it has no operations whatsoever outside of the country where the railroad is located.

It is pointed out also that our tax policy is a deterrent to the flow of American capital to underdeveloped areas. Many of the underdeveloped countries maintain lower income-tax rates because their economy will not support higher taxes. But American corporations operating in such countries are subject to income tax at the high United States rate. Many countries have established, and others have offered to establish, tax incentives to attract American capital for their development, but such measures are not attractive to investors of the United States which is the principal source of capital. At a recent Town Meeting of the Air the representative of Brazil explained in detail the tax measures which his country proposed to enact in order to attract the investment of American capital, but it had to be pointed out that such measures would not be effective for this purpose because of the income-tax policy of the United States.

Our income-tax policy is a deterrent to the execution of treaties for the elimination of double taxation. Some countries are willing to define and limit their taxing power to provide assurances to American investors but they are unwilling to do so as long as the United States retains the power through its income tax to nullify these measures. They know that any income-tax concessions they make will merely be for the benefit of the United States Treasury. Our tax policy is, therefore, an open invitation to other countries to tax American corporations up to the full United States rate. We say to them, in effect, if you do not impose income tax equal to ours, we will collect the difference from all American corporations operating in your country.

The business establishments of American corporations are at a disadvantage in their competition with the nationals of the country and the nationals of other countries that do not impose income tax on income from foreign sources. For example, a national company or a company of a country that does not impose income tax extraterritorially which operates a public utility in country A where the income-tax rate is lower than ours would be able to pay a dividend of 6 percent on its stock if this amount is earned over the local income tax. An American company in order to pay the same dividend would have to earn an additional amount sufficient to pay the difference between the local tax and the United States tax.

This subject has been a vital issue at international conferences. It was raised at Habana. It was also raised at Bogotá. At that conference General Marshall, after explaining the heavy burdens already existing on the United States Government and that the bulk of the development of Latin-American countries would have to be financed by private capital, pointed out the desirability of other countries creating a favorable climate for private investments and indicated the action the United States Government would take on its part to encourage the flow of capital. He stated:

> The United States has studied the proposals regarding the taxation of foreign investments with a view to avoiding double taxation and to encouraging the flow of private capital into other countries desiring it. I am glad to report that the President has under consideration measures to liberalize taxes on capital invested in foreign countries.

The United States was able to obtain the inclusion in chapter IV of the Economic Agreement of Bogota of various provisions for the protection of foreign investments, and in regard to taxes it was provided in article 27 as follows:

> Each state, in order to stimulate private investment for the purpose of economic development, shall, within the framework of its own institutions, seek to liberalize its tax laws so as progressively to reduce or eliminate double taxation as regards income from foreign sources and to avoid unduly burdensome and discriminatory taxation, without, however, creating international avenues for tax avoidance.
>
> The states shall also seek to conclude as soon as possible agreements to prevent double taxation.

Although because of various reservations filed by the many countries the Bogota Agreement has not been submitted for ratification, the statement of General Marshall and the provision on the liberalization of tax laws so as to reduce or eliminate double taxation should, in my opinion, be adhered to as the policy of this country. Since over 2 years have elapsed since that conference, it seems high time that some action is taken.

Although it is true that a tax treaty ratified by the Senate would override the provisions of our local tax laws, I am convinced from my discussions with Government officials over a period of years that they will not make any substantial departure from the present pattern of tax treaties without congressional authorization in advance. It has, therefore, been recommended that a simple provision be inserted in the laws authorizing the inclusion in tax treaties of an agreement that the income from the business establishments of the nationals of one country located in the other shall be subject to taxation only in the country where earned. In other words, a provision exactly like the provision in those 48 treaties which have been executed abroad. The treaty would, of course, be signed only in case our officials could get

satisfactory commitments from the other country defining and limiting the tax jurisdictions of the respective countries and eliminating those taxes which are considered discriminatory or unduly burdensome to foreign trade.

The measure would have no effect with respect to countries maintaining income-tax rates equal to or in excess of ours. That of course is because the foreign tax credit would entirely absorb the United States tax. Generally speaking, it is the underdeveloped countries that maintain lower tax rates, and it is precisely those countries which the point 4 program is designed to aid.

We have not been able to ascertain, in spite of our efforts, just what the cost of the program would be, but it is believed that the direct loss of revenue would be relatively small even if all of the low tax countries signed up. The new policy would be in effect only with respect to the treaty countries, and since the execution of tax treaties necessarily involves rather extended negotiations, the proposed measure would give us an opportunity to observe the program for a few years with very small, if any, loss of revenue. It is, of course, impossible to say to what extent any direct loss in revenue will be offset by gains. For example, if the measure resulted in increased investments abroad and increased corporate earnings, the income when declared in dividends to American stockholders would be subject to tax at the full normal and surtax rates. Furthermore, there is a tendency on the part of other countries to impose dividend and remittance taxes and other burdens which are allowed as credits or which reduce the income flowing to the United States. The elimination of such taxes through treaty would mean increased revenue to the United States.

It has been argued that if foreign income of American corporations were not subject to the United States tax, this would be unwarranted discrimination. It should be pointed out that equality of treatment of all taxpayers has never been a characteristic of the Internal Revenue Code of the United States and real discrimination does not exist as long as all taxpayers in the same category are treated equally. Under supplement Q of the Internal Revenue Code regulated investment companies, and under supplement G insurance companies, are given tax treatment that differs in many respects from that accorded the general corporate taxpayer. Nineteen classes of organizations are listed in section 101 of the code which are entirely exempt from income tax including farmers' cooperatives, mutual savings banks, and building and loan associations. Oil and mining companies are given special treatment including an allowance for depletion in excess of cost. Nonresident aliens are generally subject to taxation at the rate of 30 percent on income from sources within the United States, but the code provides that the United States may by treaty reduce the rate to as low as 5 percent. We have made treaties under these provisions and alien citizens of treaty countries are given better tax treatment than alien citizens of nontreaty countries, and our citizens having income from such treaty countries are likewise given concessions that are not made in nontreaty countries. Furthermore, discrimination now exists under our income-tax laws in the treatment of income from sources outside the United States precisely because our policy is fundamentally unsound, and efforts have been made from time to time on a piecemeal basis to eliminate some of these inequities. For

example, we have the China Trade Act, the Western Hemisphere Trade Corporation provsions, and section 251 of the code which exempts income from possessions of the United States provided the taxpayer fulfills the statutory requirements.

We are committed to the policy under the point 4 program of cooperating with other countries by sharing our capital and technical skills for the purpose of developing underdeveloped areas. At this time when we are attempting in our fight against communism to aid the other countries of the world to build up their economies and to strengthen them in their struggle to maintain freedom, we should not follow a tax policy which tends to despoil them. I should hesitate to recommend the use of taxation simply to provide incentives, but when it is found that our tax policy is an obstacle to the flow of international investment, this obstacle should be removed. If we can by a liberal and enlightened tax policy stimulate the flow of investment capital for the development of underdeveloped areas, we will relieve the United States Treasury of a great part of the financial burden it is now carrying. The small loss of revenue, if it occurs, will not be a drop in the bucket compared to the large outlays that are now coming out of the American taxpayer. The fact that the international situation has become more critical and uncertain is not, in my opinion, any reason to delay this tax corrective any longer. As indicated by Mr. Carroll, it would seem that the change in the international situation should make this measure more urgent.

I want to say that that is the record not to this particular tax bill but to this corrective which is here mentioned and which of course could be handled in any measure which might be submitted in carrying out President Truman's recommendations and the recommendations of Secretary Snyder. I would not want that to be considered as a recommendation on my part that this present tax bill should be enacted now in view of the situation.

The CHAIRMAN. We understand your position, Mr. Baggett.

Senator CONNALLY. Is your company particularly interested in this question?

Mr. BAGGETT. My company has taken no position on this. I of course cannot separate myself from my company.

Senator CONNALLY. You are here representing them?

Mr. BAGGETT. No, sir, I am representing the Latin American advisory committee which is the committee organized by the Business Advisory Council, that is, the Latin American committee which is organized by the Business Advisory Council. We are not presenting this for any company. We are presenting it in our opinion as something that is very constructive which we should do and which should fit into the program for the Government in carrying out point 4. We feel that the reasons we have given on this tax matter are very cogent and that they should be impressive.

The CHAIRMAN. The point 4 program will never succeed in a large way unless we do take some steps in this direction. Is that what you mean to say?

Mr. BAGGETT. That is what I mean to say, sir, and I understand also that our negotiations for these tax treaties for the elimination of double taxation and so on have bogged down to some extent and that some countries have taken the position that there is no value in those treaties to them unless they can get assurance that we will not

through our tax policy nullify the provisions they put into effect to attract the investment of our capital.

The CHAIRMAN. I think in general I am in agreement with your view, Mr. Baggett.

Senator Butler, do you have any questions?

Senator BUTLER. I might ask Mr. Baggett this question, if it is not his opinion that if we would adopt a program such as you have suggested here in our tax program, it would to a large extent nullify the necessity of our making cash appropriations from the Treasury of the United States to do the same thing abroad.

Mr. BAGGETT. I think it would tend to have that effect if we could get these treaties executed and if they should be successful in attracting foreign capital to those countries. I think it would relieve the Treasury of considerable expense.

The CHAIRMAN. Thank you very much, Mr. Baggett, for your appearance.

Mr. BAGGETT. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Jacob Kosbie.

STATEMENT OF JACOB KOSBIE, MEMBER OF THE BOARD OF DIRECTORS, TRAILER COACH MANUFACTURERS ASSOCIATION

Mr. KOSBIE. Mr. Chairman and gentlemen of the committee, I am a member of the board of directors of the Trailer Coach Manufacturers Association and a member of the excise tax committee of the association. As an individual I am a manufacturer of trailer coaches and have been closely associated with the industry, its problems and the individuals using our products for more than 12 years. I am quite familiar with the problems of the industry, and also the individuals who purchase house trailers. I would like at this time, gentlemen, to supplement my prepared statement with a few words in view of the present change of conditions. With your permission I will proceed.

The CHAIRMAN. Do you wish to put your statement in the record?

Mr. KOSBIE. I would like to put the statement in the record at this time.

The CHAIRMAN. It will be entered into the record.

(The statement referred to follows:)

STATEMENT PRESENTED BY JACOB KOSBIE, A DIRECTOR OF TRAILER COACH MANUFACTURERS ASSOCIATION AND MEMBER OF ITS EXCISE-TAX COMMITTEE, ON BEHALF OF THE TRAILER COACH INDUSTRY

Mr. Chairman and gentlemen of the committee, my name is Jacob Kosbie. I am a director of Trailer Coach Manufacturers Association and a member of the excise-tax committee of the association. As an individual I am a manufacturer of trailer coaches and have been closely associated with the industry, its problems, and the individuals using our products for more than 12 years.

I am here not to address this committee on behalf of the manufacturers of trailer coaches but actually and primarily on behalf of the 500,000 owners of trailer coaches who will gradually purchase new coaches to replace their present ones and also to speak for the 60,000 to 70,000 citizens who will, within the next year, purchase trailer coaches for their housing needs. These groups are unorganized and cannot present their plea to your committee. It is purchasers of the trailer coaches upon whom the burden of the 7-percent excise tax falls since the manufacturer who pays the excise tax passes this tax on to the ultimate consumer.

Under interpretation of the Revenue Act passed in 1941, section 3403 (subsection "B") the words, "trailers and semitrailers suitable for use in connection with passenger automobiles and motorcycles (including in each case parts or accessories thereof)—except tractors, 7 percent," have been construed to apply to a 7-percent excise tax on trailer coaches known to many as house trailers.

On February 20, we stated our case accurately, we believe, before the Committee on Ways and Means of the House of Representatives. Our statement before that committee has, we understand, been available to your group. We explained to that committee that a recent survey has shown 94.5 percent of all trailer coaches sold during 1949 are being used specifically for some form of housing either by service personnel of our military services, construction workers who may be working on road or Government dam projects and so require mobile housing, retired couples who are seeking an economical way of life, veterans and their families and young married couples.

This honorable committee of the House treated us with courtesy and we appreciated the opportunity to appear before them. However, their recommendation in the current tax bill provides for the reduction of excise taxes on many luxury and pleasurable items such as furs, jewelry, cabarets and numerous others but the bill specifically ignored our plea for relief to the many thousands seeking our particular form of low-cost mobile housing.

We are, therefore, coming before you gentlemen with new arguments we believe to be specifically in our favor. It is pointless for us to remind you of the national situation brought on by affairs in Korea. Nevertheless this situation is definitely affecting our industry we feel, in an increased demand for trailer coach homes. Families are already being uprooted and moved from one location to another due to changes in our military operations and stepped-up industrial activities due to Army and Navy contracts. Such movements immediately cause housing problems and as our National Government learned during the recent conflict, trailer coach homes are the answer to such housing projects.

Virtually every Army and Navy base in the United States has by now established its own trailer park for the relief of men with families who of necessity are using this type of mobile living. Is it fair, gentlemen, that these military men who, due to circumstances, find this their necessary way of life should have to pay a 7 percent excise tax on their homes when they read in the newspapers that a pending tax bill would remove or reduce an excise tax on fur coats?

Is it fair that factory workers who are suddenly now being moved from one plant to another in order to step up production to meet the demands of our high command should be forced to pay a 7 percent excise tax on their mobile homes when they read such taxes are being reduced on cosmetics?

We realize that in the minds of many in 1941 when the revenue act was originally passed the trailer coach was considered a luxury but it is impossible for us to understand how people of wisdom in a government which is almost weekly contracting for trailer coach homes for its own personnel working on field projects apparently fail to realize that a trailer coach is not a plaything but is a home in the same sense as any home constructed free of such taxation.

Once again we are here before you in a final plea for the 60,000 to 70,000 families who this year because trailer coaches happen to suit their way of life or meet their needs for mobile living should not be unjustly discriminated against when the man who is able to buy a house on a foundation for any place from $10,000 to $100,000 faces no such excise taxation.

Again we earnestly request Congress to rectify this unjust situation and exempt house trailers from the excise tax as listed in section 3403 (subsection "B") of the Internal Revenue Code under the revenue act passed in 1941.

Thank you gentlemen, for your courtesy.

Mr. KOSBIE. It would seem slightly selfish on my part to come before you at this time and ask for an exemption of any taxes. However, we feel that the provision of the revenue act, that is section 3403, subsection B, is quite discriminatory as far as our industry is concerned. I am here not to address the committee on behalf of the manufacturers of trailer coaches but actually and primarily on behalf of the 500,000 owners of house trailers who will purchase new coaches to replace their present ones, and also to speak for the 60,000 or 70,000 families who now own house trailers and will make purchases within the next year for their housing needs.

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We are the only form of housing that is directly taxed by the Federal Government. The Federal Government has recently purchased approximately $3,000,000 of mobile housing units for construction workers in various areas of this country and has paid itself an excise tax for the purchase of those units. We are paying a 7 percent excise tax under the 1941 amendment to the revenue act on a three-, or possibly four-room house that no other housing industry is paying on.

We would say that a construction company should pay a tax on housing. That is impractical at this time because a large number of sections of the country are still in a critical housing situation and to tax housing would be impractical. However, we are passing on a 7 percent excise tax to a man who buys a mobile housing unit.

We are the only housing industry that has ever asked this Government for any assistance of any kind either during the war for materials or since the war for subsidies or lending assistance. We manufacture, sell, and finance our own products and the ultimate purchaser is the one who pays the 7 percent tax.

Now a person purchasing a mobile housing unit is subject to a 7 percent excise tax. If he purchased a permanent home, he would be subject to no direct Federal tax. If he purchased a temporary home, he would be subject to no tax. The use to which our product is put we feel should exempt us from the tax as embodied under the 1941 revenue act.

We are at this time building units for tuberculosis research, cancer research, dental and medical research; various subsidiaries are purchasing the units for that purpose. Those societies are being subjected to the 7 percent excise tax.

Now if those same people had set up a temporary cottage, let us say, anywhere in the United States and used that for research, demolished it at the time they were through with it and moved it to another area, they would not be subject to any direct Federal tax.

We feel that the industry is being discriminated against by keeping that tax against us.

We have set up a complete story in our prepared statement.

If there are any questions at this time, gentlemen, I would be pleased to answer them.

Senator CONNALLY. How large do you build these trailers? How many rooms do they have?

Mr. KOSBIE. Four rooms; they run 40 feet long.

The CHAIRMAN. What is the cost to the user or consumer?

Mr. KOSBIE. Not exceeding $4,500.

The CHAIRMAN. That is your maximum?

Mr. KOSBIE. That is the maximum fully furnished, including sanitary facilities, refrigeration, that is, electrical refrigeration, beds, cabinets; all except their wearing apparel and linens.

Senator BUTLER. Are many of them occupied in a way that you could call them permanent homes or are they for temporary use?

Mr. KOSBIE. Ninety percent of them are occupied as permanent homes. They are mobile for anywhere from 6- to 12-month periods. A person will buy a house trailer, live in it for 6 months in one area, and then his job may require him to move to another area. Or if he is a member of the military personnel, he may be required to move to another area. He then moves it. But 90 percent of them today are used for permanent housing.

The CHAIRMAN. Mr. Stam, what is it estimated that this trailer tax produces in revenue to the Treasury? Do you recall?

Mr. STAM. I do not recall the figure. I do not believe it was very large.

The CHAIRMAN. Would you happen to know, Mr. Kosbie, how much excise tax this produces in your industry?

Mr. KOSBIE. Our industry's business is approximately $100,000,000 and I doubt whether the tax exceeds between $5,000,000 and $7,000,000 annually.

The CHAIRMAN. Are there any other questions? If not, we thank you very much for your appearance.

Mr. KOSBIE. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Roy W. Johnson.

STATEMENT OF ROY W. JOHNSON, VICE PRESIDENT, ALASKA INDUSTRIAL CORP., NEW YORK 17, N. Y.

Mr. JOHNSON. Mr. Chairman and gentlement of the committee, my name is Roy W. Johnson, vice president of the Alaska Industrial Corp. We have offices in Seattle and in New York City.

I would like to speak briefly about the subject of Alaska which is now recognized as one of the most acute and urgent matters for consideration from the view of national defense and national economic development. The statehood bill may be on the floor of the Senate very shortly and we feel that even if no general tax bill is enacted the necessity of taking a specific step, such as I am going to give here, for Alaska is imperative, perhaps even more so for Alaska than even for our point 4 countries.

The Alaska Industrial Corp. is one of a few groups which have been engaged over the past few years in tenacious and rather costly efforts to launch and operate a pulpmill in Alaska. We have, of course, in that connection, dealt repeatedly with the various Federal and Territorial departments concerned, both in Washington and in Juneau, and have, at all times, received their fullest cooperation and assistance.

However, as a result of our repeated and persistent efforts to interest venture capital in Alaska, we have learned it to be a fact that, in view of the unusual risks and higher costs in an undeveloped and concontiguous area such as Alaska, it is practically impossible to finance therein a pulpmill, or any other sizable enterprise, without some special incentive provided by the proper authorities to offset those greater risks.

We have, after careful study and consideration, devised a practical proposal which we think would solve the problem, and we have reason to believe that the principle involved has the approval of public and private organizations and companies in Alaska and in the State of Washington.

President Truman and Secretary Snyder have recommended that, to implement and make effective the point 4 program, private American investments in underdeveloped foreign countries be encouraged by deferring Federal taxability of such foreign income until and unless it be repatriated to the United States. This recommendation is predicated upon the recognition that the special risks and problems of investments in underdeveloped areas must be met and compensated by deferring taxation to some extent.

While it is commonly stated that it is to the national interest to develop Alaska, it has become apparent that the problems of developing its considerable resources are typically those of an underdeveloped area—not foreign, but our own.

The solution recommended for foreign countries by our policy makers should be equally valid for Alaska—only more so.

Furthermore, under section 251 of the Internal Revenue Code, we have given, since 1921, even more liberal tax treatment to Puerto Rico and our other possessions by providing that income derived by American business investments in the possessions may enjoy full exemption from Federal income taxation. Alaska, on the other hand, being a Territory, but actually an undeveloped area, has the same over-all tax structure as any highly developed State in the country.

It is not proposed to extend the complete Puerto Rico type exemption to Alaska, but it is proposed, if the resources of Alaska are to be at long last and effectively unlocked, that Alaska be considered by way of amendment to the point-4 proposal—exempting, thereby, Alaskan enterprises from Federal income tax, at the corporate level only, as long as those profits remain invested in Alaska.

1. We state, on the basis of considerable experience, that the resources of Alaska will not be developed in a system of free enterprise, unless some effective incentive be provided to compensate for the greater risks inherent in an underdeveloped area.

The two basic undeveloped resources of Alaska are timber, on the one hand, and minerals and oil on the other. It has been hoped and announced for many years that the tremendous timber resources of Alaska would result in an important and badly needed pulp supply. But, in spite of extremely low stumpage rates offered by the United States Forest Service, no pulp mill has been constructed in Alaska. On the other hand, many pulp mills exist in British Columbia, right next to Alaska, and several new pulp mills have just been completed or are under construction there by American corporations, some very close to the Alaskan border. Alaska is thus being consistently passed up, and the reason is, we know, due largely to incentives being conceded to new enterprise by the Canadian Government. Similarly, the mining industry in Alaska is deteriorating at an alarming rate. There was testimony here that the mining industry in the United States fails to progress, to a point dangerous to national defense. We feel that the immense undeveloped mining resources of Alaska should be opened up; and this, too, requires the incentive.

2. This particular proposal, limited in scope and concrete in nature, involves no appropriation of public funds and no additional burdens of any kind on any person or institution, public or private. On the contrary, if it accomplishes its purpose—the creation of new enterprise in Alaska—it will benefit not only Alaska, but the country at large through the developing of resources and the creating of new revenues, both public and private, which are subject to all the other taxes. (These other taxes would include, for instance, income taxes on salaries, wages, and dividends, and all indirect or excise taxes such as sales tax, transportation tax, et cetera, and, of course, Territorial and other local taxes.)

It cannot be argued that the taxes, thus deferred for the benefit of new enterprise, would be borne by other existing business, because it

is now plain, 5 years after the war, that without an incentive of this scope, there will be no sizable new business at all, and, consequently, no new sources of tax revenues.

3. It could be argued that it is not permissible to do this for Alaska, and that other States in the Union could claim similar privileges. The basic difference, however, is that, as is commonly recognized by responsible Government officials, Alaska is underdeveloped to a degree that does not compare with any State in the Union. Alaska is, in fact, one of the least-developed areas in the world, and economically speaking, is a frontier. On the other hand, it is a recognized policy that Alaska must be developed in the national interest.

Congress, in the past, has exempted from all Federal income tax specific groups and industries (sec. 101, Internal Revenue Code, exempts mutual savings banks, farmers' associations, labor organizations, and numerous other groups) because such exemptions are believed to be in the public interest. It has for many years provided special tax incentives for income derived from Puerto Rico (under sec. 251, Internal Revenue Code, income of United States corporations, the greatest part of which is derived from United States possessions, is not subject to Federal income tax), from China (under secs. 261–262, Internal Revenue Code, income of so-called China Trade Act corporations are subject to more liberal credits), and since 1942, from trade in any country in the Western Hemisphere. (So-called Western Hemisphere trade corporations, defined under sec. 109, Internal Revenue Code, as United States corporations, all of whose trade is done in any country in North, Central or South America, the West Indies, or Newfoundland, are subject only to ordinary rates, not to the surtax.) Congress, therefore, certainly can take a similar sensible and reasonable step to assist the development of its own Territory or State. Various States of the Union, both after World War I and in recent years (for instance, in Louisiana and Mississippi), granted tax incentives to new industries and, on the European Continent, such policies have consistently been carried out to develop overseas or noncontiguous territories.

4. Far from interfering with statehood plans, this proposal should make it easier for the new State to increase its financial resources and to thus decrease, correspondingly, the costs which might initially still have to be borne by the Federal Government. In the course of recent hearings on Alaska statehood before the Senate Committee on Interior and Insular Affairs, it was apparent that, while nobody opposed statehood as such, the Senators were concerned with the question of whether the new State would be able to support itself. This question could be answered in a constructive manner if the Congress, by this progressive measure, should lay now the ground work for the economic development of the proposed State. The important and urgent step to be taken, if Alaska is to become developed and contribute its share of resources to the national economy and national defense, is to enact the incentive into law now.

The CHAIRMAN. Are there any questions?

Have you had the legal question here thoroughly examined as to the power of the Congress of the United States to propose nonuniform tax burdens?

Senator BUTLER. Mr. Chairman, that was the question I was going to propound to the witness. If we could do this in the instance

that he suggests, why it might be that Texas, Nebraska, or Georgia might come in and ask for a special Federal income-tax rate.

The CHAIRMAN. Of course we can do it with regard to possessions but Alaska is a part of the United States. A possession is different. Of course, the constitutional requirement for uniformity of taxation is not applicable to possessions. Otherwise, you have a very meritorious plea here. I wondered if you had had that examined by capable counsel.

Mr. JOHNSON. We have our counsel here in the room at this time. He has examined it and it is his opinion that it is constitutional to give such consideration based on the discriminations that have been going on before and that the sixteenth amendment is based on making it without apportionment among the several States and so on.

The CHAIRMAN. I understand it is not the apportionment; it is the uniformity rule. However, if your counsel has prepared a statement on it, I suggest that he file that as a supplement to your statement.

Mr. JOHNSON. We can do that.

(The statement referred to follows Mr. Johnson's testimony.)

Senator CONNALLY. You do not contend that we could pass a tax law here in Congress and say that if a man lives in Chicago he should pay 20 percent and if he lives in Rhode Island he should pay 10 percent.?

Mr. JOHNSON. No, that would not be fair. But Alaska is a Territory and is incorporated into the United States as such. Actually from the economical standpoint it is on a par with our possessions. It has a small population, it is entirely undeveloped, and the risks inherent in going to a noncontiguous area, the threat of maritime tie-ups every year or two, just makes it impossible for people to compete in Alaska for the money against projects in the interior of the United States.

The CHAIRMAN. On the basis of facts and on the general economic question which you raise, you probably would have a very good case but how we could have a nonuniformity, a provision that did not apply uniformly, in Alaska, since it is a part of the United States, is difficult to see. However, if your counsel has a brief on that subject, he may file it in connection with your statement.

Mr. JOHNSON. Thank you.

Senator BUTLER. I might ask Mr. Johnson if it is the fear of the Federal income tax that is a deterrent or if it is the fear of local Territorial or State tax as the case might be. Which one is the greater fear?

Mr. JOHNSON. Any kind of tax incentive which might be provided for Alaska must be on the Federal level because while the local taxes are sizable, by having relief on that level they would not provide anywhere near sufficient incentive for a new industry to come. It must first be worked out on a Federal level and a just program can be worked out on the Territorial or State level.

The CHAIRMAN. Congress could undoubtedly apply a special treatment to the development of timber resources in Alaska because Congress would be acting as the legislative authority over that particular area. It would be comparable to a legislative power vested in any State. They could give such treatment as they saw fit, but this proposal is that the income tax be suspended until the profits are actually brought within the United States. They are in the United States to start with, but until they are brought out of Alaska is the meaning of your suggestion?

Mr. JOHNSON. That is right, taken out of Alaska.

The CHAIRMAN. Thank you for your appearance, Mr. Johnson.

Mr. JOHNSON. Thank you, Senators.

(The following telegram and statement were submitted for the record:)

JUNEAU, ALASKA, *July 12, 1950.*

Delegate E. L. BARTLETT,
New House Office Building, Washington, D. C.:

Local chamber advises you have endorsed Roy Johnson proposal for tax relief as incentive to establishment of industry in Territory and hearings to be held on subject in morning. If this is so, you may add our strong endorsement.

RALPH BROWNE,
Alaska Development Board.

MEMORANDUM OF LAW RE CONSTITUTIONALITY OF A LEGISLATIVE TAX INCENTIVE FOR ALASKA, BY SIMON J. NUSBAUM, COUNSELOR AT LAW

I. LEGISLATIVE PRECEDENTS

In considering the question whether it would be constitutional for Congress, under the uniformity clause of the Federal Constitution (art. I, sec. 8) to provide a special tax incentive for new enterprises in Alaska, it is no doubt relevant to point out that such an incentive would by no means be a novelty in fiscal legislation, and to review similar existing enactments.

While tax exemptions and tax incentives have frequently and successfully been resorted to by European countries to develop their overseas territories, they have also frequently been granted in our own Federal tax legislation, not only to specific classes, but to specific areas. Congress, of course, has at all times relieved from all Federal income tax numerous groups and industries whose exemption was believed to be in the public interest.[1] But various classifications, or "discriminations", have been made on a geographical basis as well. Ever since 1921, complete exemption has existed for United States citizens and corporations on income derived from United States possessions (Puerto Rico, the Philippines, etc.),[2] and while the reasons given in 1921 for that exemption could of course not be expected to be the same as those which in 1950 speak for a tax incentive for Alaska, some of these policy considerations would apply to Alaska as well.[3] In 1942, Congress gave preferential tax treatment to income derived from trade with the entire Western Hemisphere,[4] and corresponding advantages have existed ever since 1924 for trade with China.[5] And the most recent and spectacular development is undoubtedly the Treasury's sweeping recommendation to Congress that, for the purpose of encouraging investments abroad under the President's point 4 program (assistance to underdeveloped foreign countries), income from American investments in any foreign country be completely exempted from Federal income tax until brought back to the United States.[6] Similar policies, it should be noted in passing, have been adopted by various States of the Union, both after World War I and in recent years.[7].

With respect particularly to Alaska, specific fiscal measures either in favor of the Territory, or discriminating against it, are also far from being unknown. Refer-

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[1] Sec. 101 I R. C. exempts mutual savings banks, farmers' associations, labor organizations, and numerous other groups. It was held at an early date that such exemptions were within the power of Congress, and not invalid under the uniformity clause of art. I, sec. 8, nor under the due process clause of the fifth amendment. *Brushaber* v. *Union Pacific R. R.* (240 U. S. 1 (1915), at pp. 24–25).

[2] Sec. 251 I. R. C. provides in effect that income of United States citizens and domestic corporations derived from such possessions, is not subject to Federal income tax, if at least 80 percent of their total gross income was derived from sources within such possessions, and if at least 50 percent of such income was derived from the active conduct of a trade or business there Sec 217 of the 1950 revenue bill (H. R. 8920), as passed by the House and now pending before the Senate, would somewhat limit the scope of the exemption for individuals, but leaves it intact for corporations.

[3] While the committee reports do not seem to explain the purpose of the exemption, explanations were furnished on the floor of the House (Congressional Record, vol. 61, p 6540) and of the Senate (id., p 6998) cf. *Raussermann* v. *Commissioner* (23 B. T. A. 378 (1923), aff'd 63 F. (2d) 124, cert den 289 U. S. 729 (1933)).

[4] So-called Western Hemisphere Trade Corp., defined under sec. 109 I. R. C as United States corporations, all of whose trade is done in any country in North, Central, or South America, the West Indies, or Newfoundland, are under sec. 15 (b) I. R C., subject only to the normal tax, not to the surtax. Under sec. 218 (d) of the 1950 revenue bill (H R 8920), the rate, although somewhat increased (34 percent), would still be substantially less than the full combined normal and surtax (41 percent).

[5] Secs. 261-263, I. R. C., applying to so-called China Trade Act Corporations

[6] Testimony by Secretary of the Treasury Snyder before House Ways and Means Committee, hearings on 1950 revenue bill (H R. 8920), pp. 27–28. Similar testimony was presented by the Secretary before the Senate Finance Committee on July 5, 1950.

[7] For instance, Louisiana and Mississippi.

ence could be made to the numberous special appropriations which Congress has at all times passed in favor of Alaska. But limiting this inquiry to taxes as such, as distinguished from appropriations, the cases hereafter to be discussed involve acts of Congress imposing a special burden on the Territory, or on the other hand discriminating in favor of its residents. Attention should further be called, for instance, to sections 1300–1301 of the Internal Revenue Code, expressly applying a special tax rate to Alaskan railroads, as distinguished from railroads elsewhere in the United States, and providing further for the specific earmarking of the proceeds of such tax. Finally, it is noteworthy that the Alaska statehood bill itself (H. R. 331, 81st Cong., 2d sess.) contains several exceptional, "discriminatory" fiscal measures, all in favor of the proposed State, and none of which seems to have given rise to any doubt as to their constitutionality.[8]

Before going into the question of constitutionality proper, it should be also stated that while the specific proposal submitted to the Senate Finance Committee by Alaska Industrial Corp. purports to follow the pattern of the Treasury's recommendation as to investments in underdeveloped foreign countries, this particular proposal does not by any means purport to be the only form of tax incentive which could be suggested to solve the problem of developing Alaska. Any number of proposals could be advanced, either of the types summarized hereabove, used in the past for other areas or classes of income, or by devising a new formula specifically adapted to the economic conditions and resources of Alaska. It should be noted, in this connection, that at the hearing of July 13, 1950, the chairman of the committee stated that Congress could "undoubtedly apply a special treatment to the development of timber resources in Alaska."

II. THE ISSUE OF CONSTITUTIONAL LAW

The precise question of law involved is whether a proposal to provide a tax incentive for new enterprises in Alaska would be unconstitutional as violating the uniformity requirement of article I, section 8, clause 1 of the Federal Constitution. That provision reads as follows:

"The Congress shall have the power to lay and collect taxes, duties, imposts and excises, to pay the debts and provide for the common defense and the general welfare of the United States, but all duties, imposts and excises shall be uniform throughout the United States."

1. Before examining the applicability of that provision, and of the uniformity requirement contained therein, to the Territory of Alaska, it is proper to define first its scope and construction in general, as evolved by the courts.

First, it has been noticed that while the first sentence of the clause, which constitutes the source of the general taxing power of the Congress and states the permissible purposes of taxation, refers to "taxes, duties, imposts and excises," the second sentence, which limits this power by the requirement of uniformity, does not include "taxes." The question therefore arose whether the Federal income tax was subject to the requirement of uniformity. Although *Pollock* v. *Farmer's Loan and Trust Co.* (157 U. S. 429 (1895)) had invalidated the then effective income tax law on the ground that it was a direct tax which should, therefore, have been apportioned amongst the States (art. I, secs. 2 and 9, U. S. Constitution), it was decided, after the adoption of the sixteenth amendment, that the income tax law of 1913 was an excise and, therefore, subject to the uniformity requirement. *Brushaber* v. *Union Pacific R. R. Co.* (240 U. S. 1 (1916)); Rottschaeffer, Constitutional Law (1939) (p. 190).

Second, it was settled a long time ago, and has been consistently held since, that the uniformity clause requires merely geographical, not intrinsic uniformity, and that it does not, therefore, require that a tax have an equal effect in each State, but merely that it operate with the same force and effect in every place where the

[8] The special fiscal measures contained in the statehood bill, as amended by the Senate Committee on Interior and Insular Affairs, are the following

(1) On all minerals granted or sold by the future State of Alaska on certain lands, the State is to receive a 12½ percent royalty (sec. 5 (b))

(2) The income from, and proceeds of said lands, when sold by the State of Alaska, shall be held by it "as a public trust for the support of the public schools and other public educational institutions" (sec. 3 (b)).

(3) The State shall receive, "in addition to payments made under the provisions of 16 U. S. C. 500," 12½ percent of the moneys received by the Secretary of the Treasury from the national forests of Alaska (sec. 5 (c))

(4) The State shall receive from the Secretary of the Treasury 50 percent of the net proceeds, as determined by the Secretary of the Interior, derived from all sales of sealskins or sea otter skins by the Federal Government (sec. 5 (g)).

(5) Any proceeds of the sales of public lands, or of seal or sea otter skins or from oil royalties, and certain other Federal revenues, which are not paid over to the State by the Federal Government, or not otherwise appropriated by Congress, shall be "deposited in the Treasury of the United States in a special fund and shall be devoted only to the retirement of the public debt of the United States" (sec. 5 (k)).

subject of it is found; and consequently, numerous classifications, rate differences, total or partial exemptions, etc., with which the Federal Tax law is replete, have been upheld by the courts almost without exception.[9] (*Knowlton* v. *Moore*, 178, U. S. 41; *Flint* v. *Stone Fray Co.*, 220 U. S. 108 (1910); *Brushaber* v. *Union Pacific R. Co.*, 240 U. S. 1 (1916); *Florida* v. *Mellon*, 273 U. S. 12 (1927); *Fernandez* v. *Wiener*, 326 U. S. 341 (1945).)

2. The view that the uniformity clause applies to Alaska, because it is a Territory, incorporated in the United States (*Rasmussen* v. *U. S.*, 197 U. S. 516 (1905); sec. 1, Organic Act of 1912, 48 U. S. C. 21) seems to be predicated, basically, on one of the Insular cases, the celebrated case of *Downes* v. *Bidwell* (182 U. S. 244 (1901)). But it is submitted that a close analysis not only of *Downes* v. *Bidwell*, but principally of several subsequent Supreme Court cases, leads to the inescapable conclusion that article I, section 8, actually never did, and does not, prevent special congressional tax treatment for Alaska.[10]

In *Downes* v. *Bidwell*, there was involved the validity, under article I, section 8, of an act of Congress imposing on goods imported from Puerto Rico a duty of only 15 percent of the normal duty on goods coming from foreign countries. It was argued that Congress had violated the uniformity clause with respect to Puerto Rico, which, as had just been decided in *De Lima* v. *Bidwell* (182 U. S. 1), had ceased to be a foreign country, and become subject to the jurisdiction of the United States. While the minority thought that the Constitution as a whole did apply to newly acquired areas, the tax was upheld by a majority of five Justices, but on grounds so different and inconsistent between each other, that it has often been stated that the case has created considerable confusion and settled nothing.[11]

It is that case, however, in which the Court for the first time formulated the so-called doctrine of incorporation, which in later years became the basis for the legal differentiation between Territories and possessions. This observation makes it possible to distinguish between the holding and the dicta of the case, a matter of considerable importance for our problem. The actual holding of the case is that the uniformity clause did not apply to Puerto Rico, an unincorporated possession. While Mr. Justice Brown, delivering the opinion of the Court, reached that result on the ground that the constitutional altogether did not apply to newly acquired territories (except, perhaps, certain fundamental rules for the protection of life and liberty), the four other Justices who, with Mr. Justice Brown, made up the majority which upheld the tax, based their conclusion on the difference between incorporated Territories and unincorporated possessions. Whatever these differences of opinion, however, and whatever the divergent consequences with respect to other problems, it remains certain, at any rate, that the decision of the case only deals with Puerto Rico, which was then, and still is today, a possession. Therefore, any considerations expressed by the various Justices as to the applicability of the uniformity clause (and of the Constitution in general) to Territories, are mere dicta, and as Mr. Justice Gray said in his concurring opinion (at page 345):

"The cases now before the Court do not touch the authority of the United States over the Territories * * * Territories of Alaska and Hawaii."

However, even taking the dicta of *Downes* v. *Bidwell*, with respect to Territories at their face value, a close reading thereof discloses that, in spite of the differences of opinion amongst the majority, the various Justices supported, and even expressed, the view that the uniformity clause is not a limitation on Congress even with respect applying to incorporated Territories. As previously stated, Mr. Justice Brown, in announcing the opinion of the Court, held as a general proposition that in congressional legislation relating to any newly acquired areas, the Constitution in general, and at any rate the revenue clauses thereof, and amongst them the uniformity requirement of article I, section 8, did not apply. Reviewing many prior decisions of the Court, he showed that in enacting revenue measures for such Territories, Congress was acting not under the general taxing power of article I, section 8, but under the Territorial power to "make all needful rules

[9] Similar rules have of course been applied within Alaska, under sec 9 of the Organic Act of 1912 (48 U S C. 78) which provides that "all taxes shall be levied upon the same class of subjects and shall be levied and collected under general laws." *Alaska Pacific Fisheries* v. *Alaska* (236 Fed 52 (1916)) (Alaska license taxes on fishing industry held reasonable classification), *Alaska Fisheries Co.* v *Smith*, (255 U. S 44 (1920)) (same); *Alaska Steamship Co* v *Mullaney* (84 Fed Supp 561) (D C. Alaska, 1949) (Territorial income tax of 1949 upheld in spite of certain alleged inequalities).

[10] A text writer of the stature of Willoughby in his treatise on the Constitution (1929), vol. 2, p. 687, is of the opinion that the uniformity clause does not prevent Congress from applying a revenue measure to Territories only. In F. R. Black, Tax Uniformity and the Incorporated Territories, 26 Georgetown, L. J. 343 (1938), it is argued more generally that the uniformity clause does not apply to Territories in any manner.

[11] See Cooley, Taxation (4th ed. 1924) par. 111; Gray, Limitations of the Taxing Power (1906) 359, Coudert, the Evolution of the Doctrine of Territorial Incorporation, 26 Col. L. Rev. 823 (1926); F. R Black, Tax Uniformity and the Incorporated Territories 26 Georgetown L. J. (343 (1938) at p. 348).

and regulations respecting the Territory or other property belonging to the United States" of article IV, section 3, and that, in exercising the latter power, Congress was not limited by the uniformity requirement. While the four other Justices violently disagreed with that reasoning, the opinion of Mr. Justice White, in which two other Justices concurred, in referring to incorporated Territories, stated that in exercising this Territorial power, the limitations of the Constitution "which are applicable to the Territories" are controlling (p. 291), but that with respect to taxes:

"As Congress derives its authority to levy local taxes for local purposes within the Territories, not from the general grant of power to tax as expressed in the Constitution, it follows that its right to locally tax is not to be measured by the provision empowering Congress 'To lay and collect Taxes, Duties, Imposts, and Excises,' *and is not restrained by the requirement of uniformity throughout the United States*" (p. 292).

And, while Mr. Justice White then added that the uniformity requirement would prevent Congress from imposing an impost duty on goods coming into the United States from an incorporated Territory (p. 292), he did not further qualify the general rule hereabove quoted. It may therefore be justifiably advanced that nowhere in *Downes* v. *Bidwell* is there either a holding, or a dictum, that the uniformity clause would prevent Congress from imposing an income tax measure discriminating either against or in favor of a Territory. The only prohibition of this kind to which Mr. Justice White did actually refer in this connection, with respect to Territories, relates to impost duties, the only kind of tax which was involved in the case altogether.

Once *Downes* v. *Bidwell* has thus been properly focused and anlayzed, it becomes apparent that far from supporting the proposition that no particular tax treatment could be applied by Congress to the Territories as such, the case actually indicates a contrary belief on the part of the majority. The way is, therefore, now clear for an analysis of the subsequent Supreme Court cases which have actually dealt with the subject at hand.

3. The first important case on the subject is *Binns* v. *U. S.* (194 U. S. 486 (1904)). The case involved the constitutionality, under the uniformity clause of articles I, section 8, of the license taxes imposed on businesses in Alaska by an act of Congress of 1899, which provided further that the proceeds of the tax be covered in the United States Treasury. It was alleged that this was an excise tax which, under article I, section 8, it was unconstitutional to impose on Alaska alone, and which should under that clause, be uniformly applied throughout the United States. The same Court which, 3 years earlier, in the Insular cases, had been so dramatically divided, now was unanimous in all respects. The Court first stated that, since Alaska is an incorporated and organized Territory, it was unnecessary to consider the decisions in the Insular cases. The Court then went on to hold that, in administering the Territories, and specifically in establishing a revenue system therein, Congress is not acting under the general taxing power of article I, section 8, but acts, as would a local legislature, under article IV, section 3, paragraph 2 giving it the power to make "needful rules and regulations" for the government of the Territories. It was thus held in effect that the uniformity requirement, which is a condition of, and limitation upon, the exercise of the taxing power granted by article I, section 8, does not limit Congress in exercising the territorial power granted by article IV, section 3. The Court further found that the fact that the proceeds of these taxes were not earmarked for Territorial use, but were to be covered in the United States Treasury at large, did not invalidate the tax either, since it satisfactorily appeared that the purpose of these taxes was to raise revenue for use in Alaska, that the total revenues derived from Alaska were inadequate to the expenses of the Territory and that Congress had, therefore, to draw upon the general funds of the Nation to support the Territory.

Thus, in *Binns* v. *U. S.*, the Court in effect found that when a tax is imposed by the Congress on Alaska only, i. e., when in effect, the Congress discriminates against Alaska, this constitutes no violation of the uniformity clause, because, when Congress levies such revenues, it is not acting under the taxing power of article I, section 8, but under the Territorial power of article IV, section 3.

Neither has the Binns case been the only instance of discriminatory legislation specifically directed against Alaska, which has been held to be constitutional. In *Alaska* v. *Troy* (258 U. S. 101 (1921)), there was involved the constitutionality of section 27 of the Merchant Marine Act of 1920, which discriminated against Alaska in providing, in effect, that whereas inhabitants of the continental United States could under certain circumstances ship their goods in vessels which offer the lowest rates, residents of Alaska could only ship in vessels of American registry. In

the suit brought by the Territory against the United States collector of customs to challenge the constitutionality of such a provision, it was held that this was a provision regulating commerce, not a revenue measure, and that the uniformity clause of article I, section 8, did therefore not apply; and that, furthermore, the prohibition of article I, section 9 against preference to be given to ports of one State over those of another, did not apply either because that clause applies only to States, not to Territories.

Forty years after the Binns case, in the recent case of *Mercury Press Inc.* v. *District of Columbia* (173 Fed. 2d 636 (Court of Appeals, D. C., 1948)), a similar question arose in the District of Columbia, and the same result was reached, on the same grounds. Congress voted a personal-property tax for the District of Columbia, and petitioner, an importer of newsprint from Canada, alleged that that tax, as applied to him, was a duty on imports which, under article I, section 8, should be uniformly imposed throughout the United States. The Court held, as it had done for Alaska in the Binns case, that when the Congress legislates for the District of Columbia, it acts not under the general taxing power of article I, section 8, but under the Territorial power of clause 17 of that same article (the provision which, for the District of Columbia, corresponds to the Territorial clause of art. IV, sec. 3); and, acknowledging the fact that the uniformity requirement of article I, section 8, had never been mentioned in the numerous cases upholding taxes established by the Congress for the District, the Court stated that "this omission seems to indicate that it was deemed a settled question." And the Court, not limiting itself to the District of Columbia, but indicating, by citing the Binns case, that it was also referring to Alaska, stated the rule, in general terms, as follows (p. 637):

"It has long been established (*Binns* v. *U. S.*, 194 U. S. 486) that Congress may constitutionally impose excises in the Territories which it governs directly, without making such excises generally applicable to the country at large."

3. The above cases, as can be seen, deal with measures discriminating against the Territory, and yet, the Supreme Court found no difficulty in overruliug the contention of unconstitutionality based on lack of uniformity, and held that a tax directed exclusively against Alaska or its residents, and not made applicable throughout the United States, did not violate the uniformity clause because that clause has no application to legislation passed by the Congress for the Territories.

The question then arises whether the Court would apply, or has applied, the same rule when the discrimination would go not against the Territory, but in its favor. That, indeed, would be the precise question involved if Congress should find it good policy to enact some tax incentive of the kind which has been proposed or could be otherwise devised.

Clearly, on logical grounds only, there seems to be no reason, if the uniformity clause was held inapplicable to render invalid a tax applying only in the Territory, why it would have any more validity or cogency if the Congress should now, for once, reverse the trend. But as it happens, that question has not been left to logic alone either, and in several cases it was either held or stated that such preferential treatment of a Territory would, too, be perfectly constitutional, and not in violation of article I, section 8.

To begin with, in the Binns case itself, this question did not go unnoticed. In discussing its reasons for upholding the tax which discriminated against Alaska, and against Alaska only, the Court, at page 429, quoted the following passage from *Gibbons* v. *District of Columbia* (116 U. S. 404):

"In the exercise of this power (i. e., the power to levy taxes as a local legislature for purposes of the District of Columbia) Congress, like any State legislature unrestricted by constitutional provisions, may at its discretion *wholly exempt certain classes of property from taxation, or may tax them at a lower rate than other property.*"

The question however presented itself squarely in *Haavik* v. *Alaska Packers Association* (263 U. S. 510 (1924)). That case involved the constitutionality of an act of 1919 of the Alaska Legislature, imposing a head tax of $5 on each male person within the Territory, and an annual license tax of the same amount on nonresident fishermen only. The Court stated first that the Territorial legislature undoubtedly had authority, under the terms of the Organic Act of 1912, to impose both of these taxes, unless Congress itself would not have had the power to do so by direct action, and cited *Binns* v. *U. S.*; in making that statement, the Court thus recognized that the constitutional question involved was the same as if the taxes had been imposed by an act of Congress. The Court then held, first, that the taxes in question were not arbitrary or capricious with respect to petitioner, a nonresident fisherman living in California but who came to Alaska for the season—

since he made his livelihood in Alaska, was within the jurisdiction of the Territory for several months of the year, and, said the Court, might therefore well be required "to contribute something to its support." And with respect to the tax on nonresidents only, the Court made the following statement, which may be considered as good a foundation as any to support a tax measure favoring Alaskan individuals and corporations attempting to create new business in the Territory.

"Citizens of every State are treated alike. Only residents of the Territory are are preferred. This is not wholly arbitrary or unreasonable, and *we find nothing in the Constitution which prohibits Congress from favoring those who have acquired a local residence and upon whose efforts the future development of the Territyor must largely depend.*"

The Haavick case, then, may be considered as the counterpart of the Binns case, and indicates that the Supreme Court will not hold unconstitutional a reasonable tax measure passed by the Congress for the purpose of helping the Territory.

Furthermore, while the Haavik case merely involved a license tax, the constitutionality of general exemptions from the Federal income tax has also been raised and passed upon by the courts. True, the question presented itself in connection with United States possessions, but, as will be seen, the courts did not limit their pronouncements to possessions, but extended them to the Territories.

In *Lawrence* v. *Wardwell* (273 Fed. 405, C. C. A. 9th, 1921), a question of construction arose under the 1916 Revenue Act, by which the Philippines were excluded from the Federal income tax, while under the 1918 act, they were included, with the proviso however that the tax so collected was to be earmarked and paid to the Philippine authorities. The Court said, at page 408:

"The power of Congress in the imposition of taxes and providing for the collection thereof in the possessions of the United States, is not restricted by constitutional provision (sec. 8, art. I) which may limit its general power of taxation as to uniformity and apportionment when legislating for the mainland or the United States proper, for it acts in the premises under the authority of clause 2, section 3, article IV, of the Constitution which clothes Congress with power to make all needful rules and regulations repsecting the Territories or other property belonging to the United States *Binns* v. *U. S.* (194 U. S. 486); *Downes* v. *Bidwell* (182 U. S. 244)."

While the sentence, in terms, refers to "possessions" without clearly indicating whether the word was used in its technical or in its broader sense, it is reasonable to argue that the broad language used, coupled with the express reference to *Binns* v. *U. S.*, which involved Alaska, as well as to *Downes* v. *Bidwell*, which involved Puerto Rico, clearly indicates that the Court considered the rule stated as applicable to incorporated Territories as well as to possessions.

Any doubt which might remain in this connection can be further dispelled by referring now to *Neuss Hesslein & Co.* v. *Edwards* (30 Fed. 2d 620 (C. C. A. 2d 1929); certiorari denied 279 U. S. 872). In that case, a New York corporation engaged in the export business with foreign countries claimed that the fact that it should pay income taxes on its income from sales abroad, while Puerto Rico corporations conducting identical sales were completely exempted under the act, constituted an unconstitutional discrimination. It was held, by a court composed of Judges Manton, Learned Hand, and Augustus Hand, that in distributing the tax burden Congress has the widest latitude; that it is notoriously difficult to lay taxes equally, but that, even if the exemption for Puerto Rico were unreasonable, there was little recourse—and, under some older decisions, none at all—before the courts. Dealing with the constitutionality point, which in this case was based on the fifth amendment (the argument derived from the uniformity clause was not even presented), the Court first restated the rule that, as to Puerto Rico and the Philippines, the Constitution, or the whole of it, did not automatically apply, but the Court then extended its remarks to the Territories as well, by saying that, just like Puerto Rico and the Philippines, Alaska and Hawaii, although incorporated, "do not share politically in the Government," and "govern themselves by Congress under article IV, section 3." And the Court then proclaimed the following general rule, which seems decisively to answer the question discussed in the present memorandum:

"As a purely fiscal policy, there is no doubt that Congress may prefer the Territories, imposing the resulting burdens on the States at large, just as it may directly tax them and cover the proceeds into the Treasury (*Binns* v. *U. S.*, 194 U. S. 486). The fifth amendment does not reach such inequalities, for the preference granted is to a community which has no voice in the result; the States cannot oppress themselves, and may grant favors to those dependent on their will, if the resulting deficit is equally distributed."

Finally, the important case of *Cincinnati Soap Co.* v. *U. S.* (301 U. S. 308 (1937)) should now be considered. While the case involved a revenue measure for the Philippines—then a possession of the United States—the Supreme Court, in that case, stated the rules without making any distinction between possessions and Territories, and the case seems to leave no further room for doubt as to the question of constitutionality discussed in this memorandum.

Section 602 1/2 of the Revenue Act of 1934 imposed a tax of 3 cents per pound on domestic processing of coconut oil, and provided that with respect to coconut oil coming from the Philippines the proceeds of the tax should be held as a separate fund and paid to the Treasury of the Philippine Islands (Cf. secs. 2470, 2483, I. R. C.). Petitioners, domestic soap manufacturers who used large quantities of Philippine coconut oil, challenged the constitutionality of the tax on the ground of article I, section 8, as well as the due-process clause of the fifth amendment. The Court overruled both contentions by holding that since the Philippines have always constituted a dependency over which we have exercised supreme power of legislation and administration, "limited only by the terms of the treaty of cession and those principles of the Constitution which by their nature are inherently inviolable" (p. 314), such broad power "carries with it obligations" (id.), amongst which is that of "protecting, defending, and providing for the general welfare of the inhabitants" (id.). The Court went on to say that this tax, and the appropriation of its proceeds, might well be justified, under article I, section 8, "as an exercise of the taxing power to provide, in a broad sense, for the public defense or the general welfare of United States," but that it was not necessary to decide that question, since, in any event, the revenue measure involved constituted "an act in discharge of a high moral obligation amounting to a 'debt' under that same section."

Speaking for a unanimous court, Mr. Justice Sutherland, making a clear distinction between revenue measures applying to States and taxes applying to Territories and dependencies, unambiguously laid down the rule that the constitutional limitation upon the former does not apply to the latter. He stated, at page 317:

"It does not follow that because a Federal tax levied for the express purpose of paying the debts of providing for the welfare of a State might be invalid (Passenger cases, 7 How. 283, 446) that such a tax for the uses of a Territory or dependency would likewise be invalid. A State, except as the Federal Constitution otherwise requires, is supreme and independent. It has its own government, with full powers of taxation and full power to appropriate the revenues derived therefrom. A dependency has no government but that of the United States, except insofar as the United States may permit. The National Government may do for one of its dependencies whatever a State might do for itself or one of its political subdivisions, since over such a dependency the Nation possesses the sovereign powers of the General Government plus the powers of a local or a State government in all cases where legislation is possible. Compare *Stoutenburgh* v *Hennick* (129 U. S. 141, 147); *National Bank* v. *County of Yankton* (101 U. S. 129, 133); *Mormon Church* v. *United States* (136 U. S. 1, 42); *Utter* v. *Franklin* (172 U. S. 416, 423)."

And further, at page 323:

"In dealing with the Territories, possessions, and dependencies of the United States, this Nation has all the powers of other sovereign nations, and Congress in legislating is not subject to the same restrictions which are imposed in respect of laws for the United States considered as a political body of States in Union (*Dorr* v. *United States,* 195 U. S. 138, 140, 142)."

The Court further supported its reasoning by referring (pp. 314–315) to the numerous special appropriations by Congress for the uses of the Territories, and, quoting from an earlier decision (*U. S.* v. *Curtiss Wright Corp.*, 299 U. S. 304), remarked in this connection that a practice of such long standing went a long way to support its constitutionality (at p. 315).

There can be no doubt that both in its reasoning and in the broad language quoted, the Cincinnati Soap case goes further in several respects than any of the earlier cases, discussed here above. First of all, as the above quotations show, the Court not only failed to distinguish between possessions and Territories, but stated the rules in language specifically covering Territories as well. Second, the Supreme Court now apparently feels that in legislating for Territories and possessions, and particularly in the field of revenues and appropriations, Congress may not be acting necessarily under the territorial power of article IV, section 3, as had been held in the other cases, but also under the general taxing power of article I, section 8 itself, and that, with respect to Territories and possessions, the

latter provision, far from imposing the uniformity requirement, does on the contrary impose on Congress an obligation to help Territories and possessions by giving them preferential tax treatment. In other words, the argument has now been advanced by the Supreme Court, as a matter of constitutional law itself, and not merely as one of policy for Congress, that article I, section 8, instead of preventing specific tax exemptions or incentives to Territories and possessions, might be the very foundation of their permissibility.

There is a further holding in the Cincinnati Soap case which is of immediate relevance with respect to the now pending Alaska statehood bill (H. R. 331, 81st Cong., 2d sess.). The case was decided 3 years after the passage by Congress of the Philippine Independence Act of March 24, 1934, and even after the adoption and approval by it of the Philippine Constitution; and, furthermore, the Revenue Act of 1934, involved in the case, was itself passed after the Independence Act. The further contention was therefore made that, whatever the rules otherwise applicable to Territories and possessions, the provision in question was certainly unconstitutional in view of the fact that the Philippines would, under the Independence Act, soon cease to be a possession. But the Court expressly held (p. 319) that, far from interfering with the rules laid down by it, this sequence of events and the proposed independence of the Philippines had by no means terminated the duty of the United States toward these islands. The Court acknowledged that, under this enactment, the status of the Philippines and their relation to the United States had profoundly changed, but found, in fact, that this proposed independence not only did not terminate but might well increase the responsibilities of Congress. The Court said (pp. 319–320):

"Thus, while the power of the United States has been modified, it has not been abolished. Moral responsibilities well may accompany the process of separation from this country; and, indeed, they may have been intensified by the new and perplexing problems which the Philippine people now will be called upon to meet as one of its results. The existence and character of the consequent obligations and the extent of the relief, if any, which should be afforded by the United States in respect of them, are matters, not for judicial but for congressional consideration and determination."

There can be no doubt that the transitional period of 1934–46 for the Philippines, with the difficulties which accompany any such change from apprenticeship into fully adult status, is strikingly similar to what will be the status of the Territory of Alaska in the period between passage of the statehood bill and actual proclamation of statehood under that bill.

CONCLUSIONS

On the basis of the above considerations, and principally of the rulings of the Supreme Court between 1901 and 1950, the following conclusions may be stated:

1. It would not be a violation of the uniformity clause (art. I, sec. 8, United States Constitution) to grant preferential tax treatment to Alaska to encourage its economic development.

2. The reason is that, while Alaska is an incorporated Territory, and therefore part of the United States, revenue legislation passed by Congress for the Territory is not necessarily based on the general taxing power (art. I, sec. 8), but on the Territorial power (art. IV, sec. 3). In *Cincinnati Soap Co.* v. *U. S.* (301 U. S. 308 (1937)), the Supreme Court even indicated that even under the general tax clause (art. I, sec. 8) preferential tax treatment to Territories is entirely permissible.

2. The case of *Downes* v. *Bidwell* (182 U. S. 244 (1901)) holds nothing to the contrary, and rather supports our view. All subsequent pertinent Supreme Court cases and several text writers do support our view.

4. The principle of preferential tax treatment for Alaska being entirely constitutional, the specific form of tax incentive is a matter for Congress to decide in the light of economic conditions and resources of Alaska.

The CHAIRMAN. I believe there is just one other witness here, Mr. R. M. Lovelady.

STATEMENT OF R. M. LOVELADY, PRESIDENT AND LEGISLATIVE REPRESENTATIVE OF LODGE 14, AMERICAN FEDERATION OF GOVERNMENT EMPLOYEES, BALBOA, C. Z.

Mr. LOVELADY. Mr. Chairman, I have quite a lengthy statement which I wish to file.

The CHAIRMAN. You wish to make a brief statement?

Mr. LOVELADY. If I may, sir.

My name is R. M. Lovelady, president and legislative representative of Lodge 14 of the American Federation of Government Employees, located at Balboa, C. Z.

My statement, Mr. Chairman, was prepared before the present Korean situation arose, and my brief statement in supplementing my prepared statement is on the basis of the present world situation.

We found that during the past war it was practically impossible to recruit competent personnel to come to the Isthmus to carry on the war effort. We had to have them there in connection with putting ships through the Canal and maintaining a fleet of tankers at the Pacific entrance to keep oil flowing to the Pacific areas. At the present time our inducements are barely adequate to get competent employees to sever their ties in the United States and go to the Canal Zone and make it their home. We believe that it will be a certainty that during an emergency, when employment would be plentiful in this country, it would be difficult to get them to break away and go to the Canal Zone where, as a general rule, they cannot take their families because of inadequate housing. For that reason, we do not believe the enactment of section 216 of H. R. 8920 will be a wise course to follow, particularly at this time.

There is one other thing that is not pointed out in my statement, which is very important, and that is the fact that most employees in foreign countries and other areas overseas rotate every 3 or 4 years, whereas on the Panama Canal Zone it is a career service. They cannot acquire property, build homes, and maintain them, but at the end of their service of anywhere from 20 to 30 years or more they must sever their ties there, leave the Isthmus within 30 days ordinarily, come back to the States and reestablish themselves in places that they have been away from for many, many years.

More than that, our educational facilities down there are not such that we can send our children to college after they have their high-school education without sending them to the United States, and maintaining them here during their 4 years of college.

The savings that we can effect at the present time by being exempt from the income-tax laws are barely enough to allow us to accumulate sufficient money for us to send our children to the States and to take periodic vacations that the health authorities advise us to take in order to recuperate from the enervating effects of the Tropics.

Senator CONNALLY. How are the rates of wages compared to those here?

Mr. LOVELADY. Senator, as a general rule the wages for skilled positions are based on those prevailing in the United States plus a differential not to exceed 25 percent.

Senator CONNALLY. In other words, the Americans living in Panama get a higher rate?

Mr. LOVELADY. Yes, sir.

Senator CONNALLY. They get more than they would get in the United States?

Mr. LOVELADY. Generally speaking, that is true.

Senator CONNALLY. It runs as high as 25 percent more?

Mr. LOVELADY. It could run as high as 25 percent.

Senator CONNALLY. Does it not?

Mr. LOVELADY. Yes, sir; it does, but not in all cases.

Senator CONNALLY. That is what I am getting at. You fellows keep punching and pushing until you get the 25 percent. You want to keep it and not pay any tax on it.

Mr. LOVELADY. We want to keep the 25 percent.

Senator CONNALLY. You do not want to pay any income tax?

Mr. LOVELADY. That is right.

Senator CONNALLY. A man up here gets 25 percent less than you get and then he pays the tax. Your man gets 25 percent more and he does not want to pay any tax. Is that right?

Mr. LOVELADY. Senator, we have other areas overseas.

Senator CONNALLY. I am talking of that area.

Mr. LOVELADY. That is right.

Senator CONNALLY. You are a professional representative here of the Americans living in the zone; are you not?

Mr. LOVELADY. I am the representative; not a professional.

Senator CONNALLY. Do you stay here all the time?

Mr. LOVELADY. No, sir.

Senator CONNALLY. Where is your office?

Mr. LOVELADY. In the Panama Canal Zone.

Senator CONNALLY. You get a salary, too?

Mr. LOVELADY. Yes, sir.

Senator CONNALLY. All right, that is all I wanted to ask.

The CHAIRMAN. Are there any further questions? If not, we thank you very much for your appearance.

Mr. LOVELADY. Thank you, Mr. Chairman.

(The prepared statement follows:)

STATEMENT OF R. M. LOVELADY, PRESIDENT AND LEGISLATIVE REPRESENTATIVE OF LODGE 14, AMERICAN FEDERATION OF GOVERNMENT EMPLOYEES

Mr. Chairman, my name is R. M. Lovelady, president and legislative representative of Lodge 14, American Federation of Government Employees, at Balboa, C. Z. I appear before your committee specifically in opposition to section 216 of H. R. 8920, which would remove the exemption from payment of income tax certain Federal employees in possessions now enjoyed under section 251 of the Internal Revenue Code. I submit the following in justification of our position.

On February 6, 1950, the Secretary of the Treasury presented testimony to the Ways and Means Committee concerning miscellaneous loopholes in the Internal Revenue Code. His testimony contained many specific recommendations for remedial legislation, among which was one that individual citizens of the United States who reside in possessions be given the same treatment with respect to income tax as is accorded citizens who reside in foreign countries. This is similar to the recommendation which he submitted on February 26, 1948, and which is embodied in section 145 of H. R. 990.

The Secretary also drew attention to the difference in treatment between citizens of the possessions under section 251 and citizens in other parts of the world under section 116 (a). I should like to point out, however, that most citizens in possessions remain there for prolonged periods, very often extending throughout their entire career as Federal employees, while most of those in foreign countries are reassigned to another locality upon the expiration of their tour of duty, which is seldom longer than 3 years.

We believe a careful scrutiny of the conditions of employment between these two groups of employees, their relative tours of duty outside the United States, compensation and other emoluments, particularly with respect to those in the Panama Canal Zone, will convince you that the Congress did not err when it enacted section 251 in the Revenue Act of 1921 and has not permitted it to remain in effect for more than 28 years without good and sufficient reasons for considering it in the interest of the service.

We believe also that continuation of the benefits of section 251 is fully justified under the special circumstances which are set forth in the following pages. Our argument is based upon what we consider is in the best interest of the service in general as well as fair treatment for the employees residing in areas now exempt under section 251. Among the many reasons outlined herein, perhaps the most important is the health hazards and effects of prolonged residence in the Tropics on the white man. Appended to this brief are excerpts from an address delivered by Dr. George Eugene, who was an eminent authority on tropical diseases, and which we think should lend considerable emphasis to our contention that to remove the tax exemption would not only be an injustice to these employees but detrimental to the defense of our country, particularly in these times of world unrest.

The Revenue Act of October 3, 1913, appears to be the first legislation which required residents of the possessions to pay a Federal income tax. Section 2 of that act required every citizen, whether residing at home or abroad, to pay a normal tax of 1 percent per annum upon the entire net income of such citizen in excess of $3,000 in the case of a single person or $4,000 in the case of a married man or woman with wife or husband living with him or her. It defined income as any gains or profits derived by a person and in whatever form paid. Allowances for quarters, heat, lights, water, and similar utilities and the money equivalent or services furnished in kind were required to be reported as income.

Section 7 of the act of September 8, 1916, exempted nonresident aliens and citizens of the United States if they received less than $3,000 per annum. The War Revenue Act of October 3, 1917, required that every individual who was the head of a family and who received an income of $2,000 or more during the year of 1917 and every individual who was not the head of a family who received $1,000 or more during that year to file an income-tax return. Later, by Treasury Decision No. 2242, it was ruled that amounts paid to nonresident aliens for services rendered wholly outside the United States were not subject to Federal income tax and that, accordingly, aliens resident in the Canal Zone were not taxable under the act of September 8, 1916, as amended by the act of October 3, 1917.

Section 262 of the Revenue Act of 1921, approved November 23, 1921 (42 Stat. 227, 271), changed to section 251 by the Revenue Act of May 29, 1928, provided for exemption from payment of income tax, with slight exceptions, on the income of United States citizens derived from sources within a possession of the United States. This section now provides in pertinent part that—

"SEC. 251. INCOME FROM SOURCES WITHIN A POSSESSION OF THE UNITED STATES.—(a) GENERAL RULE.—In the case of citizens of the United States or domestic corporations, satisfying the following conditions, gross income means only gross income from sources within the United States.

"(1) If 80 per centum or more of the gross income of such citizen or domestic corporation (computed without the benefit of this section) for the three-year period immediately preceding the close of the taxable year (or for such part of the period immediately preceding the close of such taxable year as may be applicable) was derived from sources within a possession of the United States; and

"(2) * * *

"(3) If, in such case of such citizen, 50 per centum or more of his gross income (computed without the benefit of this section) for such period or such part thereof was derived from the active conduct of a trade or business within a possession of the United States either on his own account or as an employee or agent of another."

In the light of this section, the Deputy Commissioner of Internal Revenue made the following decision on May 23, 1922:

"A citizen of the United States entitled to the benefits of section 262 will not be required to file returns of income to the United States unless he is in receipt of income from sources within the United States or unless he receives within the United States income from sources without the United States.

"Employees of the Panama Canal who receive no other income than the compensation received for services in the Canal Zone and who do not receive any portion of such compensation within the United States will not be liable for returns."

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As a result of the enactment of section 262 (now 251), and the ruling quoted next above, the income of practically all employees in the Canal Zone (and other specified possessions) has been exempt from Federal income tax since 1921.

From the above, it will be observed that section 251 of the Internal Revenue Code excludes generally from gross income for tax purposes the income derived from sources within a possession of the United States by citizens of the United States who meet certian percentage and other requirements concerning the nature and source of their income. Section 145 of H. R. 990, entitled "A bill to provide for revenue revision, to correct tax inequities, and for other purposes," would amend section 251 by adding at the end thereof the following new subsection:

"(j) *Employees of the United States:* For the purposes of this section, amounts paid after December 31, 1947, for services performed by a citizen of the United States as an employee of the United States or any agency thereof shall be deemed to be derived from sources within the United States." (Italics supplied.)

Under section 251 and similar provisions of all revenue acts passed since 1921, The Canal Zone income of nearly all United States citizens receiving their income in the Canal Zone has been exempt from Federal income tax because the Canal Zone is a "possession" of the United States within the meaning of section 251 and such persons have qualified for the benefits of the section. The great majority of persons receiving income in the Canal Zone are in the service of Government agencies. Consequently, the effect of section 216 of H. R. 8920 would be to withdraw the benefits of section 251 from all but a relatively few of the United States citizens in the Canal Zone.

The proposed amendment would extend the Federal income tax for the first time to the great majority of United States citizens earning income in the Canal Zone. For reasons stated hereafter, it is considered inappropriate, inequitable, and contrary to what we consider is in the best interest of the service, both as a matter of principle and as a practical one because of (1) the discriminatory result that citizen employees of the Government would pay the tax while the much more numerous alien employees of the same Government agencies in the Canal Zone would be exempt; (2) the discriminatory result that citizen employees of the Government would pay the tax while United States citizens employed in the Cnal Zone by private business enterprises or Government contractors, or those with an income from private sources, would be exempt; and (3) the further undesirable result that the long-established conditions of employment in the Canal Zone would be seriously disrupted to the detriment of effective recruitment of competent personnel to man Government organizations operating there.

It is realized that on its face the proposed amendment corresponds to a similar provision in section 116 (a) of the Internal Revenue Code which exempts from income tax the earned income of United States citizens resident in foreign countries but which concludes from that exemption amounts paid by the United States or any agency thereof. However, it is submitted that the reasons stated above and discussed in more detail later in this brief establish that the unique situation in the Canal Zone is not comparable to that in foreign countries, and refute the otherwise acceptiable general principle that citizen employees of the Government in possessions may properly be subject to income tax.

As a result of restrictions established by treaty between the United States and Panama upon residence and private business enterprise in the Canal Zone, nearly all persons employed there are necessarily engaged in activities related to the care, maintenance, sanitation of operation, government, and protection of the Canal and the Canal Zone. Of a total of some 8,000 United States citizens employed in the Canal Zone, about 95 percent are employees of the Panama Canal or other Government agencies. About 3 percent are employees of quasi-Government agencies and contractors, and the remaining 2 percent are employed in the private commercial or industrial enterprises such as oil companies, banks, and shipping agencies.

The approximately 8,000 United States citizens represent only about one-fifth of the total number of persons employed in the Canal Zone, the remainder of the about 40,000 being made up of citizens of Panama and other nationalities. Of these aliens, about 85 percent are employed by Government agencies, 65 percent of whom are citizens of Panama, the others being for the most part Jamaicans and other West Indians and natives of Central and South American countries of the Caribbean area. More than half of the aliens employed in the Canal Zone reside in the Republic of Panama.

The Canal Zone has since 1921 been treated as a possession of the United States and as not being within the term "United States" within the meaning of the law for income-tax purposes. Aliens living or working there do not work or reside in the

United States and their Canal Zone income is therefore not from a source within the United States. Consequently, their income has properly never been subject to United States income tax. Because of this, citizen employees of Government agencies in the Canal Zone have always been treated substantially the same as the alien employees of such agencies in this respect.

From the foregoing it will be observed that the proposed amendment would discriminate against all the United States citizens employed by the Government on the Canal Zone by taxing their salaries, with the aliens and citizens who are not employed by the Government remaining exempt. It is important to bear in mind that these aliens are fellow employees of the United States citizens who would be taxed, working with them on the same Government projects. Many of the aliens work at lower rates of pay but some, and their number is rapidly increasing, work on exactly the same pay scales as the United States citizens.

The discrimination noted above may not properly be avoided by also extending the income tax to the alien employees. Considering the special nature of the Canal enterprise and the close relations existing between the United States and Panama, it would appear to be wholly inappropriate to apply the United States income tax to the Canal Zone income of Panamanians and other aliens. Under article X of the 1903 convention between Panama and the United States, Panama is obligated not to impose any income tax or other contributions or charges of a personal character of any kind upon officers, employees, laborers, and other individuals in the service of the Canal and Railroad and auxiliary works, notwithstanding they may be citizens or residents of Panama. Apart from the sovereign right of the United States to extend the income tax to the aliens in question, it seems clear that as a matter of comity and general policy in reference to relations with the Republic of Panama, including the treaty exemption of United States Government employees from taxation by Panama, the enactment of the proposed legislation is inappropriate, and not in the best interest of the service or conducive to harmonious relations with the Republic of Panama.

A further discrimination is involved in the proposed amendment in that United States citizen employees of private business enterprises and of Government contractors in the Canal Zone would continue to be exempt. This result not only would seem unfair to the citizens in Government service in the Canal Zone, but also would put the Government at competitive disadvantage in recruiting and retaining competent civilian personnel to carry on important work essential to the Canal enterprise.

A further practical objection of substantial importance to the Government agencies operating in the Canal Zone is that the proposed amendment is certain to seriously disturb the long-established conditions of employment in the zone and would have a disrupting effect upon the effective maintenance of the Government organizations operation there. The benefits of section 251 for which nearly all Canal and other Government employees in the Canal Zone have qualified since 1921 are necessarily closely related to and reflected in the salary and wage scales which in the last analysis must be fixed on the basis of sufficiency to attract and hold United States citizen employees necessary for the work to be done.

It should likewise be borne in mind that the vast majority of the citizens affected are recruited by the Panama Canal and other Government agencies from the continental United States for service in a relatively small area situated approximately at sea level and only 9° north of the Equator. The tropical climate in the Canal Zone has uniform high temperature, high relative humidity, and excessive sunlight. The enervating climate and its depressing effects on the white man plus the many other ever-present hazards to health have long been recognized by health authorities, and they have consistently advocated that employees take vacation trips to a temperate climate at least every 2 years. Housing conditions are generally unfavorable, and treaty restrictions and other extenuating considerations do no permit employees to acquire and improve permanent homes or residence in the Canal Zone, notwithstanding that to a great extent employment with the Panama Canal is a career service; and that after termination of employment the employee and his family must leave the Canal Zone, usually to reestablish a home and occupation in the United States. Transportation and other expenses for health vacations and other trips are, of course, high and are greatly in excess of those normally incurred by persons in the United States with comparable income.

These conditions and many others slightly less tangible, but equally as real, such as remoteness from relatives and friends in the employee's home community in the States and from other desirable features of his former place of residence, add to and complicate the very real problem of inducing competent personnel to sever their ties here, go to the Canal Zone, and remain there as career employees.

Despite the present inducement of a tax-exempt salary, it is extremely difficult to recruit highly qualified or professional personnel for duty on the Isthmus. The turn-over in personnel among organizations in the Canal Zone is still inordinately high, and recruitment is expensive.

Another point for consideration in connection with our case against the proposed amendment is that the total number of new taxpayers in the tax exempt possessions would be comparatively small. The aggregate revenue to be derived from that source would not be substantial, particularly in view of the almost certain increase in turn-over among qualified personnel and the resulting expense of recruiting and training replacements. It is illogical to assume that the more competent personnel will remain in employment in areas outside the United States with no greater benefits than they can command in the continental United States.

Citizens employed in the Canal Zone are subject not only to the ordinary disadvantages of employment in the enervating tropical climate, but to numerous other disadvantages normally enjoyed by residents of the continental United States. Among the advantages not enjoyed by residents of the Canal Zone are (1) the privilege of owning their own home and living wherever they please without being assigned to such living quarters as they may be able to obtain on the basis of length of service; (2) the privilege of shopping for groceries, clothing, and incidentals at the place of their choice rather than in Government-owned commissaries or in the Republic of Panama where retail prices are from 25 to 200 percent above those in the commissaries or in the United States; (3) cost of water or air transportation from the Isthmus to the United States, especially in the case of employee with large families, an item which even now makes it impossible for most of them to take the biannual recuperative vacation recommended by eminent authorities on the Tropics; and (4) the inescapable necessity for regimentation of employees to an extent not conducive to high morale.

Still another argument against extending the income-tax laws to the Canal Zone is the fact that employees there are now paying what in effect amounts to Federal taxes. Most employees residing in the United States either own their home or rent from private owners. As a consequence, they do not pay anything to the Government for rent, lights, water, care of grounds, rental for furniture, etc.; they do not pay to the Government the actual cost plus an overhead surcharge of from 25 to 100 percent for repairs to furniture, electrical equipment, automobiles, etc.; they do not pay any sales profits on goods sold by Government-owned commissaries, clubhouses, theaters, storehouses, etc. The amounts now paid by Federal employees in the Canal Zone toward the support of Government functions in the zone are considerably more than is paid as Federal income tax by the average Government employee in the United States.

It is estimated that the average citizen employee in the Canal Zone will pay to the United States Government during 1950 the following: (1) for rent and home utilities, $500; (2) food, clothing and similar necessities for family use, $360 as gross profit (based on a gross profit of 20 percent times $1,800 per employee—the Commissary Division alone has been ordered to make a net profit of $600,000 this year); (3) for repairs to electrical equipment, automobiles, furniture, and other miscellaneous jobs, $150. This means that each of the 8,000 United States citizen employees in the Canal Zone will pay toward the support of a Government enterprise during 1950 about $1,010, or a grand total of $8,080,000. It is also estimated that extension of income tax to the Canal Zone would produce about $2,000,000 per year. This added to their present contributions means that each of the 8,000 citizen employees would be required to pay $1,350 toward the support of his Government, a share which we consider out of all proportion to that borne by his counterpart in the United States.

Earlier in this brief, I drew attention to the recommendation of health authorities that citizen employees take recuperative vacations in a temperate climate every 2 years. Let us provide the Canal Zone employee with his automobile while in the United States so that he will have transportation facilities equal that of the employee here. The additional cost for Canal Zone employees among families of varying sizes will be substantially as follows:

Canal Zone, family	Man and wife	Man, wife, 1 child	Man, wife, 2 children	Man, wife, 3 children	Man, wife, 4 children
Round-trip ship fares for	$220	$320	$420	$520	$620
Automobile	180	180	180	180	180
Total	400	500	600	700	800

Thus, the employee on the Canal Zone must pay for his much-needed vacation an amount ranging from $400 to $800 more than his counterpart here just to put himself and family at a port of entry (usually New York) in the United States and get back to the Canal Zone at the end of his vacation. Added to the extra vacation costs set forth above, are almost always some undetermined expenses due to the Canal Zone's geographical remoteness from the United States which, in a large number of instances, results in vacation expenses that would otherwise not be necessary. Some are such as seasonal clothing, long distances to travel from New York before reaching their home and relatives, lodging, and subsistence en route. Even now, the average Canal Zone employee with a wife and one or more children can seldom accumulate enough savings to afford a vacation each 3 years, and if he were saddled with the extra burden of income tax, it is very doubtful that he could save enough to afford a vacation each 10 years, even if then.

There are many other valid reasons, perhaps less tangible, but equally as compelling as those enumerated in the foregoing why the proposal to tax the salaries and income of citizen employees of the Government residing in possessions should not be enacted into law. It is certain no change should be made without affording the Governor of the Panama Canal Zone, military and naval officials there, as well as all other responsible officials and employee representatives a full opportunity to present their views as to the effects this proposal will have on employee morale so that this committee may have the benefit of such views in reaching a conclusion that will serve the best interest of the Federal service.

For the foregoing reasons, I respectfully recommend this committee not favorably consider the proposed section 216 of this bill on the grounds that the proposed amendment is inappropriate, discriminatory, and undesirable as a matter of principle. Most important of all, however, is the certainty that it would react detrimentally to the defense of this country should we unfortunately be forced into another war. The present war in Korea and the attendant threat to the peace of the world gives reason to pause before taking any step that might tend to impair the security of this Nation.

I thank you, Mr. Chairman, for giving me this opportunity to appear before your committee and present our views on this matter which is of such importance to citizen employees on the Canal Zone.

The Effects of the Tropics on the White Man

(Excerpts from an address delivered by Dr. George Eugene, an eminent authority on health in the Tropics, before the Natural History Society, Gorgas Memorial Institute, Panama, Republic of Panama)

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As far as the Isthmus is concerned, the first great enemy to white colonization has been completely, almost completely, eliminated. What remains is climate itself—the tropical climate with its highly uniform temperature, its high relative humidity, its excess sunlight, and its lack of variability.

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I will analyze our own local climate. First, as regards the excess of sunlight; second, as to the effects of excess heat and humidity; and third, as to uniformity. Major Woodruff of the United States Army when on duty in the Philippine Islands evolved the theory that the most destructive element in the tropical climate was the actinic rays. It was a clever theory which appealed to many people, but experiments and later work by men like Colonel Chamberlain, formerly chief health officer here, Colonel Phalen, Dr. Shattuck, Dr. Huntington, and Dr. Fleming have shown that the effect of the actinic rays is not so important, but that the excess of total sunlight is deleterious and harmful. Too much sunlight will kill a living cell; it will kill superficial cells and will harm the blood. The protection against too much sunlight is pigment in the deeper layers of the skin. Where there is a lack of sunlight there is a decrease in pigment. The lightest blondes come from the cloudiest and coolest climates, around the Baltic Sea where there are less than 1,250 hours of sunlight annually. The races with the heaviest and darkest pigment are in the hottest and in the most glaring, sunniest countries where there is a great amount of surface reflection or glare. The blackest races are where it is sunniest and where there is the most glare from the earth. As we travel from the Scandinavian countries south we find an increasing amount of pigment. The Mediterranean people are olive-skinned. Farther south they are brown, and in the extreme sunny countries they are black. The Eskimos are

pigmented also, on account of the glare from the snow and ice. The Eskimos have a yellow pigment, the same as the Chinese, and are of Mongolian extraction.

The white man is handicapped in the Tropics by his lack of pigment and protection against the sunlight. The tendency of blondes migrating to a sunnier country is to become darker. The English in England are a blonder race than their descendents in the United States because of the greater amount of sunlight and the greater intensity of the heat in the United States.

Experiments in the Philippines, undertaken by Colonel Chamberlain, prove that there is very little difference between the condition of blonde soldiers and brunett soldiers after a year in the Tropics. These experiments were carried on very carefully and very thoroughly. However, a year, which is a short time in a lifetime, may not be sufficiently conclusive.

The Negro is better adapted to the Tropics than the white man, not only because of greater pigmentation but in other respects. His air passages are more direct. The white man's nostrils are narrow and are adapted to warm the cool air before it enters the lungs; the Negro's nostrils are wider and more open, his larynx and trachea are larger in proportion. This accounts for his bass voice. The Negro is built also to conduct heat away from himself more easily; he is leaner and less bulky than the average white man.

The next effect of the Tropics, and, I believe, the most important, is the combined effect of heat and humidity. I believe that the greatest amount of injury to the white man in the Tropics is due to this combined effect of high heat and high relative humidity. One of the constants of human life is a constant body temperature. It remains at 98.6, or a little more, under almost all conditions of health. Any deviation of this body temperature, even of a few degrees upward or downward, produces disfunction and death. It is one of the most uniform conditions. Body metabolism depends upon it. There is a mechanism of heat production, heat control, and heat dissipation. We must have heat and energy to live. Our metabolism depends on it. The action of the lungs and heart requires energy. Energy is also required for work. The production and dissipation of heat goes on at a certain pace and that pace differs somewhat in different climates.

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We have here in the Tropics a constant race between heat production and heat dissipation. The white man's mechanism is taxed all the year around, instead of 20 days a year as in the States. This continual stress will produce certain effects. One of these effects is that of a lowered rate of combustion. In other words, the body will slow up its oxidation processes. The oxidation processes of the body are intimately connected with the process of elimination. Before the wastes of the body are eliminated in the form of carbon dioxide from the lungs, or water from the skin, or urea from the urine and skin, it must be split up from a highly complex molecule to a simple molecule. The process of oxidation does this splitting. If this oxidation is incomplete and slowed up, we have an increase of the unburned wastes of the body—toxins; not only in the blood, but in the cells and in the intercellular spaces. I believe that this slow and gradual accumulation of toxins which are not completely eliminated and burned up is the prime cause of what we complain of most in the Tropics. Most of the patients coming to the dispensary complain of being tired, of being headachy, feeling languid; even after a good night's sleep they are tired; tired all the time. This condition of chronic fatigue, I believe, is one of the main results of this suboxidation in the effort of the body to adapt itself to retarded heat dissipation and the consequent imperfect splitting up of the waste products for elimination.

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The next factor in keeping us below par here in the Tropics is the lack of muscle tone. There is no question that in the Tropics our muscles and our general tissue structure have less tone than in the States. People coming down here from the States complain about their feet swelling. One wears smaller shoes in the States, smaller collars. There is more tone to the muscles in the States in every way. Muscle tone is important, not only for physical work but it is important in intercellular elimination. Most of the preliminary elimination processes of the body occur in the cells and between the cells. The blood simply picks up the prepared article. The living cell is surrounded by liquid; there is no real systolic circulation in the liquid around the cells. It is the action of the thousands of muscle fibers in our body, of movements and adjustments that keep on pushing forward toward the blood stream all this intercellular fluid. If this fluid is kept stagnant by loss of muscle tone, as it is in the Tropics, we have another cause of

faulty elimination. We have an intercellular accumulation of toxins. The human body has a wonderfully adaptive mechanism which enables it to stand this intercellular intoxication for many years with only the effect of headache and fatigue. Eventually this mechanism, after many years in some, sooner in others, will weaken, and there will be an organic deterioration and sclerosis of the various tissues. This combined with the effects of the suboxidation contributes to our earlier deterioration and shorter life.

We have no adequate statistics regarding our expectancy of life here. Many sick men are weeded out of the service here long before it is time to retire, either voluntarily or by order of the health department. Before the depression, especially, but even now many a man has voluntarily resigned on account of his health or that of his family; his death in the States does not affect our statistics. Death records here are of those who died before they could get away to a better climate. It is only now that the first-comers of the Americans are reaching retirement age; they represent only a small percentage of the horde that came originally and have left or died. Better statistics should be available in the future. However, insurance companies do not insure white Americans on the Canal Zone without a considerable increase in the rates. In other words, their statistics indicate a lessened expectancy of life here.

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EFFECT ON WOMEN

Women suffer more than men from the effects of the climate. Women as a rule show more anemia and are more neurasthenic than the men. Men are more resistant to the effects of the Tropics. The climate disturbs the menstrual rhythm in many cases; usually there is an increased menstrual flow in the first years of a woman's residence here; later there is a decrease. This disturbance of a primitive rhythm shows how strong the effect of climate can be. The menopause in many cases comes a little earlier. The premonitory signals of the approach of menopause, such as mental depression and vasomotor changes appear earlier, and the effects of the menopause last longer. There is an increase of pyelitis among women here. This, I believe, is due to lack of muscle tone. In many cases where careful X-ray examinations have been made it has been found that the cause of the pyelitis is a sagging kidney, in a climate where everything sags.

TUBERCULOSIS

This is an unfavorable climate for tuberculosis—they should get out of here and go where they can rebuild themselves. I think this climate is favorable for rheumatic conditions, although in the fifties there is quite a lot of chronic arthritis. It is a favorable climate for chronic nephritis.

The skin here is soggy and constantly damp. It furnishes an ideal soil for the innumerable parasitic fungi indigenous to the Tropics. As a consequence, almost everybody on the zone is suffering or has suffered from disagreeable and sometimes dangerous skin conditions.

After a decade or two in the tropics there is a tendency for the white man to lose immunity to Temperate Zone diseases. On returning to the United States he is more susceptible to many infections, especially those involving the respiratory tract.

A variable climate that is cool has a stimulating effect on the white man. In the absence of this natural stimuli in the Tropics many a white man has resorted to alcohol and other vices so that they became helplessly addicted. I can recall many cases of normal Americans who broke down and finally reached a hopeless stage of alcoholism here. Return to the Temperate Zone has restored most of these men to a useful state, free from their addictions.

* * * * * * *

VACATIONS

I think there should be compulsory vacation. Of course, it is hard to take a vacation when you have a big family and economically you cannot. But I think vacations should be taken at least every 2 years. The difference between zonites coming back from vacation and before they left is plain and unmistakable; you see a man go up "all in" and come back full of life and health. I think there have been too many men down here who stayed without vacations for too long a period to their eventual harm. Vacations should be taken at a time like October or November when the temperatures are dropping in the States. A rising tem-

perature brings disease. Going up in February or March is not as safe as going up in October—the temperature is dry and dropping in October—it is cold, damp, and rising in March, and there is more pneumonia, more contagion. Vacations also can be taken to advantage in the mountains—there is an anemia down here in most people and the mountains will raise your red blood count faster than lower altitudes. It will improve faster at a moderate altitude than it will at the seashore.

* * * * * * *

CONCLUSION

In conclusion, rubber rots, wood decays, iron rusts, and men deteriorate and die faster in the Tropics than in the Temperate Zone.

The CHAIRMAN. Senator Butler, did you have a statement you wished to put into the record?

Senator BUTLER. No, Mr. Chairman.

The CHAIRMAN. If there are no further witnesses present to be heard at this time, the oral hearings on H. R. 8920 will be formally closed, and further consideration of the bill is recessed until the committee by appropriate action resumes consideration of the matter. The clerk of the committtee will have the record printed.

(The following material was submitted for the record:)

ROPES, GRAY, BEST, COOLIDGE & RUGG,
Boston 10, July 13, 1950.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee,
United States Senate, Washington, D. C.

DEAR SENATOR GEORGE: For many years the necessity of a general revenue revision act to correct technical defects in the Internal Revenue Code has been generally recognized. It is unfortunate that Congress has not been in a position to have full and orderly hearings and to adopt such an act. One of the crying needs is for a legislative correction of the interpretation of section 113 (b) (1) (B) of the Internal Revenue Code which was enunciated by the Supreme Court in the case of *Virginian Hotel Corporation* v. *Helvering* (319 U. S. 523 (1943)), a five to four decision with Chief Justice Stone and Justices Roberts, Murphy, and Jackson dissenting. That interpretation was carried to its logical and absurd conclusion in *Commerce Company* v. *United States* (171 F. 2d 189 (C. A. 5th 1948) cert. denied 336 U. S. 972 (1949)). As there interpreted, section 113 (b) (1) (B) has the effect of binding a taxpayer by erroneous depreciation figures shown on earlier tax returns even though the figures were clearly erroneous at the time the returns were made in the light of facts then available and even though taxes were not reduced and the Government was not harmed in any way by the error. The incorrectness and unfairness of such an interpretation and the need for legislative correction has been widely recognized by students of taxation. Following the Virginian Hotel decision the American Bar Association and the American Institute of Certified Public Accountants promptly passed resolutions calling for an amendment to section 113 (b) of the Internal Revenue Code to relieve against the effect of the decision.

We would have appeared before in behalf of such an amendment but we have been awaiting a suitable opportunity for such presentation when Congress was considering a bill to embody a number of such technical provisions. We are presenting the matter now to your committee to record our belief that the error should be corrected now or later. We realize that the present bill being considered by your committee (H. R. 8920) is primarily a revenue measure with a few loophole-closing provisions inserted to increase the revenue.

We sincerely trust that the delay in securing an appropriate opportunity for full presentation of the problem to your committee will not be prejudicial to the securing of proper relief. Legislative correction of the erroneous holding of the Virginian Hotel decision is urgently needed and we hope that you can request the staff of the Joint Committee on Internal Revenue Taxation to give immediate study to the problem as soon as the present bill is disposed of. Then at the very first appropriate opportunity we hope that your committee can give the matter full consideration.

Much of the confusion in the Government's discussion of the effect of the Virginian Hotel decision has been due to the fact that there has always been a tendency to suggest—if it was not urged—that the decision in the Virginian Hotel case did not involve an error which could have been determined to be an error in the light of the facts existing at the time the returns for the loss years were filed but that the excessiveness of the depreciation claimed in the loss years was determinable only in the light of later events. The Commerce Co. case, supra, finally disposed of by the Supreme Court in 1949, fully disposes of this contention. That decision makes it clear beyond question that the Virginian Hotel decision binds the taxpayer to an error which was an error at the time the return was filed in the light of facts then existing. The facts in the Commerce Co. case were that the taxpayer constructed a building in 1929. From 1929 through 1931 the company made profits, for 1932 to 1935 there were losses, and thereafter again there were profits. The Commissioner investigated the years 1929–31 and adjusted downward to the correct amount the depreciation claimed for those years and collected additional taxes. He did not investigate the loss years 1932–35 and made no change in the excessive depreciation claimed. In the profit years following 1935 the Commissioner, while using the lower and correct depreciation rates for 1929–31 in computing the depreciation reserve, refused to correct downward to the correct amount the additions to the reserve for the years 1932 to 1935, although the correction in the earlier years was made on his own initiative and although the same erroneous figures were used in all of the years 1929 to 1935 and although the use of the erroneous figures in the loss years resulted in no harm to the Government. This interpretation of the statute seems unrealistic and unfair and wholly unnecessary.

So far as we are aware, this is the only instance since the first income tax statute was enacted where any effort has ever been made to bind a taxpayer to an erroneous computation of income in one year because of an error made in a return for another year where the error has had no effect on the revenue. A striking feature of the situation is that section 113 (b) (1) (B) was amended to its present form at the Treasury's request to protect the Government against an unscrupulous taxpayer deducting depreciation a second time when he had once deducted it and had secured a tax benefit from the deduction and the statute of limitations had run on the collection of the tax which would be due if the error were corrected. This is entirely clear from the legislative history. There was no suggestion that the amendment requested would ever be used as it is now used by the Treasury to penalize taxpayers for innocent errors in earlier returns which in no way injured the Government or benefited the taxpayer.

Congressman Daniel A. Reed, as a member of the Ways and Means Committee, became interested in this problem and in January of this year wrote to the Commissioner of Internal Revenue making certain inquiries as to the application of the Virginian Hotel decision with the expectation that he would have the Ways and Means Committee consider the problem with a view to providing a remedy. The Commissioner's reply, which was considerably delayed, answered the questions propounded but suggested still other questions. Thereafter the pressure of other business prevented Congressman Reed from pursuing the inquiry further and from bringing the question actively before the Ways and Means Committee. In view of this, he has kindly consented to have his letter and the Commissioner's reply placed before this committee in the hope that it will be of some assistance in bringing to this committee a full understanding of the issue and in securing an appropriate legislative solution. Copies of Congressman Reed's letter of January 24, 1950, and the Commissioner's reply of March 30, 1950, are attached hereto.

Respectfully submitted.

CHARLES B. RUGG.

JANUARY 24, 1950.

Commissioner GEORGE J. SCHOENEMAN,
Bureau of Internal Revenue, Washington 25, D. C.

DEAR COMMISSIONER: I am most anxious to obtain clarification of the Bureau's position on two questions arising in connection with the rule established in the Virginian Hotel Corp. case. The following two cases of assumed facts raised the questions I have in mind, and I should greatly appreciate your cooperation in advising me of the position of the Bureau on these two points.

1. Assume the following facts:

In a taxable exchange on January 1, 1940, X corporation gets machinery which has a stated value in the contract of $100,000. The corporation puts this

machinery on its books and its tax return at that figure. The machinery actually had a value in 1940 of $37,000, but X corporation sustained a large loss in 1940 so that the overstatement of value was of no importance.

In 1940, 1941, 1942, 1943, and 1944 X corporation deducted on its books and tax returns $10,000 depreciation per year based on the correct rate of 10 percent and the incorrect value of $100,000.

Without deducting any depreciation on this machinery, the correct gross income and the correct deductions for each of the years 1941 through 1944 would balance, so that there would be no net income and no loss. With the deduction of $10,000 per year depreciation on machinery, there would be a net operating loss for each of the years 1941, 1942, 1943, and 1944 of $10,000 per year.

In 1945 there is gross income of $50,000 before deducting any depreciation on machinery or any loss carry-over. These are the only deductions available for that year.

The Commissioner makes a casual check of the returns for 1940 through 1944 and leaves them unchanged. Then after the statute of limitations has run on all years through 1944, the Commissioner investigates the profit year 1945.

How would the Commissioner compute the net income of X corporation for the year 1945?

2. Assume the following facts:

A taxpayer files a return for 1946 in which he includes as a depreciation deduction a figure in excess of the amount "allowable" for that year. The error has no tax result since losses for the year exceed the difference between the excessive figure and the "allowable" depreciation. There is, however, no operating loss carry-forward or carry-back from 1946. The Commissioner checks the return for 1946 and notifies the taxpayer that it is accepted.

Before the statute of limitations has run on the collection of taxes for 1946 the taxpayer files an amended return in which he deducts only the "allowable" depreciation.

Will the Commissioner accept the amended return and will he, for years after 1946, reduce the taxpayer's basis for depreciation only by the amount of depreciation "allowable" for 1946?

Sincerely,

DANIEL A. REED, M. C.

UNITED STATES TREASURY DEPARTMENT,
OFFICE OF COMMISSIONER OF INTERNAL REVENUE,
Washington 25, March 31, 1950.

Hon. DANIEL A. REED,
House of Representatives, Washington, D. C.

MY DEAR MR. REED: Reference is made to your letter dated January 24, 1950, requesting clarification of the Bureau's position with respect to two questions arising in connection with the rule established in the case of *Virginian Hotel Corporation of Lynchburg* v. *Helvering* (319 U. S. 523).

The first question is based on the case of the X corporation which acquired machinery in a taxable exchange on January 1, 1940. The machinery, which had a stated value in the contract of $100,000, was recorded on the corporation's books and reported in its income tax returns in that amount. In each of the years 1940 to 1944, inclusive, depreciation in the amount of $10,000 computed at the correct rate of 10 percent (expected useful life of 10 years) was deducted in the corporation's books and its income tax returns. The actual value of the machinery on January 1, 1940, was $37,000 rather than $100,000.

The X corporation sustained a large loss in 1940 and in each of the years 1941 to 1944, inclusive, it had a correct net income of zero before deducting depreciation so that after deducting depreciation in the amount of $10,000 there would be a net operating loss of $10,000. In 1945 the X corporation realized a gross income of $50,000 before deducting any depreciation or any net operating loss deduction. There are no other deductions available for that year. The returns for the years 1940 to 1944, inclusive, received a casual check and were left unchanged. After the expiration of the statutory periods of limitation for all years through 1944 an investigation of the 1945 return is made and you inquire how the net income for that year would be computed.

Under the stated facts it is indicated that the basis of the machinery on January 1, 1940, and the capital sum to be recovered through depreciation during its expected useful life of 10 years is $37,000. It is assumed that there will be no salvage value at the end of the expected useful life. To the extent that amounts

representing depreciation on the machinery are allowed in the years after its acquisition such amounts reduce the capital sum to be recovered through depreciation in subsequent years.

Under the provisions of section 122 of the Internal Revenue Code any net operating losses in the years 1943 and 1944 are carry-overs to the year 1945 since there is no net income in either of the two preceding taxable years. The term net operating loss is defined in section 122 (a) of the Internal Revenue Code as "the excess of the deductions allowed by this chapter over the gross income" (with certain exceptions not material here). Accordingly, since the net operating losses for the years 1943 and 1944 are carry-overs to the year 1945 and included in the net operating loss deduction for that year, the deductions for depreciation in the years 1943 and 1944 must be corrected to the amounts allowable irrespective of the fact that the losses reported in the returns filed for those years were not changed within the statutory periods of limitation for making assessments or allowing refunds or credits for such years.

Net income for 1945, under the facts assumed as a basis for your first question, would be computed as follows:

Gross income		$50, 000
Deduct:		
Depreciation	$1, 000	
Net operating loss deduction	2, 000	
		3, 000
Net income		47, 000

The depreciation allowable in each of the years 1943, 1944 and 1945 and the net operating loss deduction in 1945 as shown above are computed as follows:

Capital sum to be recovered through depreciation (basis on Jan. 1, 1940)		$37, 000
Less: Depreciation allowed—		
1940	$10, 000	
1941	10, 000	
1942	10, 000	
		30, 000
Adjusted basis Jan. 1, 1943		7, 000
Remaining useful life—7 years depreciation allowable in each of the years 1943, 1944, and 1945		1, 000
Net operating loss carry-overs:		
1943 (depreciation allowable, $1,000)		1, 000
1944 (depreciation allowable, $1,000)		1, 000
Net operating loss deduction		2, 000

It is believed advisable to state here that as to the great majority of income tax cases which were affected by the decision of the Supreme Court in the case of the Virginian Hotel Corp. of Lynchburg, supra, there was no question with respect to the correctness of the cost of the property subject to depreciation such as that involved in your hypothetical case. With few exceptions the problem was confined to cases involving depreciation rates and depreciation deductions which, in an income tax return filed for some year subsequent to the loss years this office found to be excessive in the light of conditions then known to exist, and in which the taxpayer, after agreeing to the reduced rates, sought to apply them retroactively in income tax returns upon which the statute of limitations had run, for the purpose of adjusting the basis under the provisions of section 113 (b) (1) (B) of the Internal Revenue Code.

The assumed facts in the hypothetical case if actually present in the income tax returns of a given taxpayer would represent an unusual situation and not comparable to those in the case of the Virginian Hotel Corp. of Lynchburg and many others, where the question arose solely as a result of estimates of useful lives of depreciable property, which can never be predicted with certainty in advance, and which in later years proved to be erroneous, rather than the use of an erroneous original cost basis. Nevertheless, it is believed that a strict interpretation of the decision of the Supreme Court in the case of the Virginian Hotel Corp. of Lynchburg would require a computation of the adjusted basis and the resulting depreciation as indicated on page 2 of this letter.

The second question relates to a return for the year 1946, in which it is assumed that depreciation in excess of the amount allowable had been deducted but the

error had no tax effect in that year for the reason that the loss for the year was greater than the excess of the depreciation deducted over the amount allowable. It is assumed further that there is no net operating loss carry-over or carry-back from 1946 and that after a check of the 1946 return the taxpayer had been notified that it was accepted. However, before the expiration of the statutory period of limitation for 1946 the taxpayer filed an amended return in which only the depreciation allowable was deducted. You inquire whether the amended return will be accepted so that the taxpayer's basis for depreciation will be reduced only by the depreciation allowable for 1946.

It is the policy of the Bureau to give proper consideration to all facts presented by taxpayers in amended returns filed within the statutory periods provided in the Internal Revenue Code and the acceptance of the original return as filed would not prevent the correction of an error if the issue is raised within the statutory period. On the basis of the facts presented it is the opinion of this office that the rule established in the case of the Virginian Hotel Corp. of Lynchburg, supra, does not require that the taxpayer's base for depreciation be reduced by more than the amount of depreciation found to be allowable for the year 1946.

If further correspondence relative to this matter is necessary, reference should be made to the symbols IT:P:CA-JOT.

Very truly yours,

FRED S. MARTIN,
Acting Commissioner.

NATIONAL LIVE STOCK TAX COMMITTEE,
Denver 2, Colo., July 12, 1950.

Re opposition of livestock industry to proposal that gains on sale of breeding livestock be treated as ordinary income.

Hon. WALTER F. GEORGE,
Chairman, Senate Finance Committee, Washington, D. C.

DEAR SENATOR GEORGE: The livestock industry is deeply concerned with the possibility that, in the controversy over the proposed revision of section 117 of the Internal Revenue Code, the livestock industry might be deprived, intentionally or inadvertently, of the right of treating as capital gains profits on sale of breeding livestock.

As you will not from our letterhead, our committee represents on a very broad basis the livestock producers of the country: The American National Livestock Association, the National Woolgrowers Association, the American Hereford Association, the American Aberdeen-Angus Breeders' Association, the American Shorthorn Breeders' Association, as well as 30 or so State cattle and sheep associations.

The background of our present fears is this. Under section 117 (j) of the Internal Revenue Code, as it stands today, gains on sales of "property used in the trade or business" are treated as capital gains. Obviously, our breeding herds are held for the production of calves and lambs, just as the factory and equipment of a manufacturer are held for the production of his product. Thus the courts have held quite properly that a livestock producer's breeding herd is "property used in the trade or business" and entitled to capital-gains treatment.

The Treasury Department, discriminating against the livestock industry, has proposed that these cases be overruled by legislation. It proposed to the House Ways and Means Committee that section 117 (j) be amended so as to treat gains on sales of livestock regularly culled from a dairy or breeding herd as ordinary gains, whereas gains on sales of the discarded machinery, plant, and production equipment of other industries continue to be treated as capital gains.

The House Ways and Means Committee refused to accede to this discriminatory request, and refused to insert such a provision in H. R. 8920. We are distressed, however, to note that Secretary Snyder's statement to you of July 5 again asks that the code be amended so as to classify our profits on sales of livestock culled from a dairy or breeding herd as ordinary income, regardless of what your committee does with respect to other business profits. The insertion of any such distinction would be an unfair discrimination against the livestock industry, and we earnestly urge you not to adopt it.

As far as the livestock industry is concerned, section 209 of H. R. 8920 is satisfactory. We do not object to the change which it proposes, making section 117 (j) a two-way street with losses on sales of property used in the trade or business treated as capital losses, gains on such assets remaining as capital gains.

The present provisions of section 117 of the Internal Revenue Code are also satisfactory to us, unless present court decisions should be reversed.

We understand, however, that other taxpayers' associations (oil, mining, utilities, and railroads, for instance) are attacking section 209 (d) of H. R. 8920 with respect to the abandonment of capital assets and assets used in the trade or business, and that some of them (the Association of American Railroads, for instance) have proposed as one solution that section 117 (j) be repealed and the code revert to its pre-1942 status, when both gains and losses on sales of property used in the trade or business were treated as ordinary rather than capital transactions. Such amendment, if adopted, would deprive us of the right to treat gains on sales of our breeding herds as capital gains, and they should be capital gains for they are essentially sales of our production plants rather than our inventory or product. It would seem to us that, if the committee chooses to recognize the objection raised as to losses on abandonment, it could do so without hurting the livestock industry, one of the largest industries in the United States, merely by eliminating section 209 (d) of the House bill, or by leaving section 117 (j) as presently existing. It would be unfair, however, to the livestock industry to attempt to correct this situation by eliminating section 209 (b) of the House bill, which is presently in satisfactory form.

Accordingly, we urgently request that the livestock industry be not discriminated against by treating gains on sales of our breeding herds as ordinary income, and that either—

1. Section 209 (b) of H. R. 8920 as presently drafted be permitted to stand; or that
2. Section 117 (j) of the Internal Revenue Code as presently existing be retained; or that
3. A special provision be inserted in the Internal Revenue Code recognizing capital gains on sale of breeding livestock.

Respectfully submitted.

NATIONAL LIVE STOCK TAX COMMITTEE,
By FRANK S. BOICE, *Chairman*,
STEPHEN H. HART, *Attorney*.

(Whereupon, at 12 noon the hearings on H. R. 8920 were closed.)

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