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REVENUE ACT OF 1962

1498—

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

EIGHTY-SEVENTH CONGRESS

SECOND SESSION

ON

H.R. 10650

AN ACT TO AMEND THE REVENUE ACT OF 1954 TO PROVIDE A CREDIT FOR INVESTMENT IN CERTAIN DEPRECIABLE PROPERTY, TO ELIMINATE CERTAIN DEFECTS AND INEQUITIES, AND FOR OTHER PURPOSES

APRIL 6, 9, AND 10, 1962

PART 3

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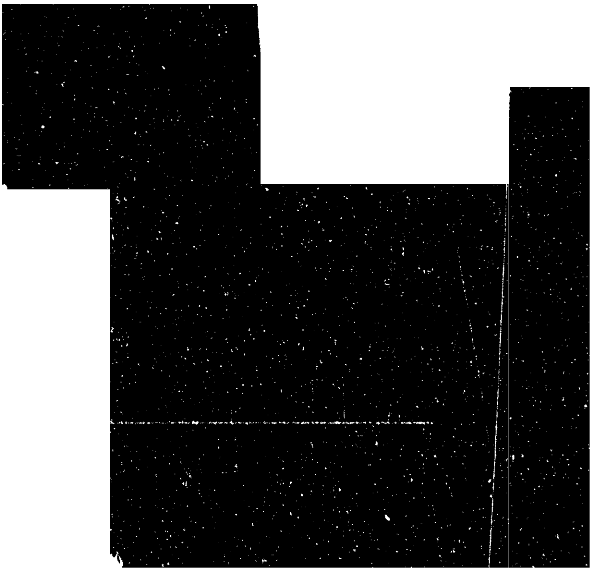


REVENUE ACT OF 1962

FRIDAY, APRIL 6, 1962

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to recess, at 10 a.m., in room 2221, New Senate Office Building, Senator Harry F. Byrd (chairman) presiding.

Present: Senators Byrd, Kerr, Douglas, Gore, Williams, Carlson, and Curtis.

Also present: Elizabeth B. Springer, committee clerk; Colin F. Stam, and Laurence N. Woodworth, Joint Committee on Internal Revenue Taxation.

The CHAIRMAN. The committee will come to order.

Our first witness will be Senator William Proxmire, a very distinguished Senator, and we are very happy to have you.

STATEMENT OF HON. WILLIAM PROXMIRE, A U.S. SENATOR FROM THE STATE OF WISCONSIN

Senator PROXMIRE. Thank you, Mr. Chairman and members of the committee.

I would like to discuss two parts of the tax bill H.R. 10650, the House-passed bill.

These are: Section 2, dealing with a proposed credit for investment in certain depreciable property; and section 3, dealing with appearances and other costs with respect to legislation.

INVESTMENT CREDIT

Regarding the investment credit, I oppose it because it would not work; it is unfair to other taxpayers; it is hypercyclical; and it would result in a huge revenue loss to the Treasury.

(1) One principal disadvantage of the investment credit is its unfortunate equity concept. It will gave a business firm tax benefits which are more than 100 percent of costs.

For a corporation in the 52-percent bracket, the investment credit is equivalent to depreciation of 114 to 116 percent of the cost of newly acquired assets. Other taxpayers—excepting those who receive percentage depletion—are limited to deductions of 100 percent of costs. Granting such an exceptional privilege raises a serious question of tax equity.

I am concerned, therefore, as I am sure you must be, about the potentially dangerous precedent set by the investment credit. It is not unlikely that other groups will request similar tax treatment.

Retailers may request more than 100 percent deductions for the costs of carrying inventory. Construction firms may request more than 100-percent deductions for buildings they own. Teachers could request deductions for more than 100 percent of the costs of advanced courses. Individuals who borrow money to invest in homes may request more than 100-percent deductions of their interest costs incurred in the purchase of homes.

(2) The investment credit is also undesirable because it will tend to accentuate the business cycle. I don't think this has been emphasized sufficiently so far. Far from contributing to business stability, it is in fact hypercyclical. It aggravates the business cycle by encouraging investment during a period of inflation and discouraging it relatively in a recession, when businesses have less income against which to write off new investment.

If the proposed credit stimulates investment—which I doubt—the stimulus will be greater in those periods when investment is likely to be high in any case.

Thus, investment will be stimulated exactly in those periods when there is little or no need for an investment stimulus. Contrariwise, the investment credit will have its least stimulative effect when investment prospects are dim.

Hence, the credit will tend to accentuate present fluctuations in investment. If there is any single goal sought by administration economic policy, it is to increase growth by stabilizing the economy and ironing out fluctuations. This proposal will have exactly the opposite effect: It will be inflationary in boom times; it will increase unemployment in recession periods.

The investment credit is also undesirable from a cyclical standpoint because it serves to reduce Government revenues exactly at those times when Government revenues should be raised to curb private demands for goods and services; namely, in inflationary periods.

If the Federal budget were otherwise in balance during a prosperous period, the effect of the investment credit would be to create budget deficits in the prosperous periods. Certainly, this is fiscal irresponsibility in its purest form.

Moreover, it is bad economics. Almost all economists, regardless of their political persuasion, feel that the Government should run surpluses during periods of high employment. The investment credit will serve to reduce those surpluses, or throw the budget into a deficit position, exactly in those periods when surpluses would be most appropriate.

(3) One basic criticism of the investment credit is that the goals which are sought by this device are inappropriate. Specifically, the credit is designed to stimulate artificially the rate of physical investment in the United States.

Why do we need an artificial stimulus to obtain more investment than the free market deems appropriate? A fundamental tenet of our economic system is that, wherever possible and to the greatest possible extent, we will permit free-market forces to determine the amounts and types of goods to be produced. The investment credit attempts to interfere with the free-market decisions of consumers and producers.

It is also argued that the investment credit is needed to stimulate physical investment to compete with foreign countries. Such competition takes many forms. If standard of living is the area of competition, then we have managed well to date without the investment credit.

If "competition with foreign countries" refers to our balance-of-payments position, then it seems ridiculous to support the investment credit for all industries in the United States simply to aid the relatively few firms that actually compete overseas.

Moreover, there has been remarkable little evidence provided indicating that lack of investment is holding back U.S. firms in foreign competition.

First, it is not clear that U.S. firms are suffering significantly in their competition with foreign industry.

Second, it is not clear that, if such suffering is occurring, it is due to lack of investment. It could just as easily be due to lack of initiative, weakness of new designs, excessive labor costs, insufficient mobility, or many other reasons which would not be affected by the investment credit.

Surely, the burden of proof is on those who support the investment credit to indicate that the problems of foreign competition—which were so heavily stressed by Secretary Dillon on Monday—in fact exist and would be significantly reduced by adoption of the investment credit.

(5) What grounds do we have for doubting the efficacy of the investment credit?

First, the credit will be given to business firms even if they do not change their investment decisions by one jot or tittle. Obviously, business firms are always engaged in making investments. On all of these investments, they will obtain the proposed credit.

But the only justification for the credit is that new investment, over and above what would normally be made by a business firm, will be encouraged as a result of the credit. Nonetheless, business firms receive the cake credit—and can eat it, without taking any new and additional actions to earn it.

Secondly, businessmen themselves are not responding favorably to the proposed credit. A responsible survey by the Wall Street Journal indicates that virtually all the businessmen interviewed would consider the proposed investment credit as a windfall and did not plan to change their investment plans if the investment credit were enacted.

Mr. Chairman, I would like to submit a copy of this Wall Street Journal article for the record, at this point.

The CHAIRMAN. Without objection.

(The article referred to follows:)

[From the Wall Street Journal, Feb. 8, 1962]

TAX BILL'S IMPACT: FIRMS PLAN ONLY SLIGHT CAPITAL SPENDING BOOST IF NEW CREDIT IS VOTED

WITHHOLDING TAX ON INTEREST PROMISES COMPUTER BOON AND DEPOSITOR CONFUSION—WHAT IS A "BUSINESS MEAL"?

Tax changes now being shaped up in Congress probably would have some surprising as well as some predictable effects on business, a Wall Street Journal survey of over 100 executives shows.

A key provision of the tax bill that probably will be voted on by the House of Representatives this month—a tax credit for most companies amounting to 8 percent of what they invest in new machinery—may lead many of them to revive relatively small equipment-buying projects they had shelved. But it also may give what one executive calls windfall savings to companies going ahead with plant expansion programs they would have carried out anyway.

A tax credit for public utilities of 4 percent of their new equipment investments may speed extension of gas mains to some small towns and rural areas where they wouldn't be profitable now. But the disparity between this and the 8-percent credit to most of the utilities' customers may crimp electric utilities' sales by tempting some customers to install their own power-generating plants.

A 20-percent witholding tax on dividends and interest, to be deducted at the source, probably would speed computer sales and subject corporate and bank officers to a barrage of angry phone calls from shareholders and depositors who might think the deduction was the company's idea. It also would deprive some tax-exempt institutions and individuals of the use of sizable sums of cash at least temporarily, and cause them and others headaches figuring out their refund claims.

RESTAURANT BANE OR BOON?

And tighter tax rules on business entertainment may either severely pinch home restaurants or help them snatch expense-account trade away from theaters and nightclubs—depending on which of two conflicting interpretations of the pending changes is correct.

These assessments by businessmen are tentative, of course, as the tax revision bill is a long way from being law, and some of its provisions may be changed in coming congressional votes. Already the House Ways and Means Committee, which is preparing the bill, is considering modifying the dividend withholding provision to put it on a 3-year trial basis, ending in 1965; committee members think this might soften some expected congressional opposition.

But otherwise the committee, which must originate tax legislation, is expected to make only a few changes in a tentative draft of the bill it already has approved for submission first to the full House, then the Senate. So it is clear, at least, what are the main proposals that will be coming to a vote.

MANY COMPLEX RULES

These proposals are both numerous and complex. The bill would increase taxes on mutual savings banks and savings and loan associations, farm and consumer cooperatives, businessmen's earnings from some foreign investments, and some profits of U.S. corporations' foreign subsidiaries. Important as they are, though, these provisions would affect only certain segments of business, while the proposals for tax credits on machinery buying, tax withholding of dividends and some interest, and limitations on businessmen's deductions for entertaining would touch nearly every company in the country.

But the effects, though widespread, may not always be what the lawmakers anticipate—as can be seen best by a look at the provision that would involve the most money, the proposed 8-percent credit on investments in most types of new machinery.

Under this section of the draft bill, a business that invested, say, $1 million in new machinery in any one year could deduct $80,000 from its eventual corporate income tax bill for that year. In effect, it could buy $1 million worth of machinery by paying, in the end, only $920,000 out of the corporate treasury. The Kennedy administration, which proposed this section, has been counting on it to spur much new business spending for plant expansion and modernization, thus giving a lift to the entire economy.

SOME EARLY STARTS

But of 68 companies surveyed on this aspect of the bill, only 1—Radio Corp. of America—thought the 8-percent credit would have a "significant" effect on major expansion programs. Of the rest, 38 said the credit would at most cause them to take a second look at "marginal" projects they had rejected, or start early on projects they eventually would have begun anyway.

And no less than 29 companies reported the credit wouldn't change their capital spending plans at all—though they would use the credit to reduce tax bills anyway. "If we spend $100,000, we're going to get $8,000 more cash," says Donald K. Evans, treasurer of Riegel Textile Corp.

"This program won't alter our construction program one bit; it's nothing more than a windfall," adds the executive vice president of a major chemical concern.

The reasons for this view vary, but underlying all of them is a conviction that an 8-percent credit supply isn't big enough to alter major corporate capital spending programs. This is particularly true of companies which draw up their capital spending programs far in advance. "Plans for 1962 capital spending have already been determined, and we do not believe the proposed tax credit will influence them," says Frank McGrath, financial vice president of United States Rubber Co.

Many other companies emphasize that they plan capital spending on the basis of what they think is needed to keep plants modern and to expand output as fast as the market will support, with tax rules a secondary consideration. A. Lightfoot Walker, president of Rheem Manufacturing Co., puts this view succinctly: "If we needed new equipment to run our business efficiently we would get it. If we did not need it, we would not spend money on it just to get a credit."

And some concerns are worried by excess capacity, which makes spending large sums of money for new machinery seem to them a dubious proposition regardless of tax laws. "The problem now is trying to find markets for our present production, not getting money to make more," says Joe E. Nolan, executive vice president of Weyerhaeuser Co., the big timber and forest products concern in Tacoma, Wash.

This isn't to say, however, that the credit would have no effect. On some less-expensive projects, "it just might be enough to tip the balance in favor of replacing outmoded equipment with modern, efficient machines," says William Brown, vice president for finance of American Viscose Corp., Philadelphia rayon and cellophane maker.

A. J. INDUSTRIES SPEEDUP

The credit also would speed up some projects already in the works. "An extra 8-percent allowance would allow us to accelerate expansion programs at our Jessup Wood Products division, a $2 million to $3 million expansion of our Reynolds metals division foundry, and other smaller programs," asserts Charles Ver Harlen, president of A. J. Industries, Inc., diversified Los Angeles concern. International Business Machines Corp., too, says the credit "in some instances should result in earlier acquisition of new capital equipment," though only to a "quite limited" extent.

And the effects of the credit could grow in coming years, as companies come to the end of programs they have budgeted now and begin shaping new ones. "The tax credit would certainly be welcome; it would not affect our 1962 plans but it would enter into our decisions on equipment spending in the future," says Kendall Co., Boston-based maker of textiles and surgical goods.

The effects of the separate 4-percent tax credit for public utilities investing in new equipment also might fall well short of some congressional hopes. Ways and Means Committee members have said this provision is likely to lower electric, water, and gas rates to consumers, by saving utilities some money which could be passed on to the public through rate cuts.

NO BOOSTS, NO CUTS

Utility executives concede the credit might make some rate increases unnecessary. "A 4-percent credit would give us about $160,000 and would forestall application for a rate increase for 2, possibly 3 years," says the treasurer of a California water utility. But no utility surveyed plans to cut rates voluntarily because of the credit, and most think increases in other costs would make impossible any rate cuts that State regulatory commissions might seek. "None of the utilities I know of are earning even close to an adequate return on their investment," says K. M. Robinson, chairman of Washington Water Power Co., Spokane, Wash.

Utility executives seem to be of two minds about the proposed credit. Many say the savings it would provide would make it possible to extend service on a stepped-up schedule. "It might mean we'd extend gas service to some small towns not now receiving it," says Dean H. Mitchell, president of Northern Indiana Public Service Co., Hammond, Ind. "Some of these projects would be unprofitable now, but the tax credit might make the difference."

These same executives and many others, however, denounce the bill as "discriminatory" and perhaps competitively harmful in giving utilities only half the 8 percent credit other industries would get. "We're competing with coal and oil industries for the fuel market, and they would receive an 8 percent credit," says Marvin Chandler, president of Northern Illinois Gas Co. "It just isn't fair."

ELECTRIC UTILITIES' FEARS

Electric utilities fear intensified competition from another source: Their own customers. Aluminum companies in particular might figure it would be cheaper to put up their own generating plants with the "92-cent dollars" an 8 percent credit would give them than to buy power from a utility that had to spend "96-cent dollars" on new generating capacity, frets Jack Busby, president of Pennsylvania Power & Light Co. Aluminum companies need gigantic quantities of electricity to smelt ores into metal.

The proposed 20 percent withholding tax on dividends and interest probably would affect individual taxpayers more than anything else in the bill, but its impact on many corporations would be slight. Melville Shoe Corp., with 20,000 stockholders, does think dividend withholding would bring a tremendous increase in paperwork costs. But American Telephone & Telegraph Co., with nearly 2 million shareholders, says it could set up a withholding system at purely nominal cost.

For individual taxpayers, however, dividend and interest withholding would complicate the problem of preparing tax returns. Under the draft bill, banks and companies would not be required to prepare annual withholding statements for taxpayers showing how much tax has been withheld from dividends or interest the individuals received. Instead, the taxpayer would record on his tax return the amount of money he actually received and the full amount he would have received without the withholding tax, and file for a tax refund if he is entitled to one.

TAX RETURN PROBLEMS

This raises a problem: How would an individual taxpayer, if he knows only the net amount of dividends or interest he actually got after tax had been withheld, figure out what the pretax payment would have been? For stockholders this may not be too difficult, as the gross amount of corporate dividends per share are announced regularly. But for the bank saver, who knows only the interest figure stamped on his savings account passbook, it may be more troublesome.

Actually, some savings institutions are planning to help the taxpayer even though not required to. First Federal Savings & Loan Association of Pittsburgh will "work out some system to give" savers a breakdown on what their pretax dividends would have been, how much tax has been withheld, and what the net figure after taxes is, every time it pays a dividend, a spokesman says. Savers "are going to demand to know something more than the net dividend after taxes," he explains.

Senator PROXMIRE. It is rare in the area of tax policy to have advance laboratory tests of the potential effectiveness of policy proposals. Such laboratory tests, when available, should certainly be examined closely. In this case we have the example of the accelerated depreciation methods which were introduced in the 1954 Internal Revenue Code. One of the primary purposes of these accelerated methods was to encourage greater business investment in plant and equipment.

Yet, look what happened. Before the enactment of these new methods, the growth in capital stock per worker was roughly 3.5 percent per year. After the adoption of the accelerated depreciation methods, capital stock per worker grew by only 1.9 percent per year from 1954 to 1960.

In other words, instead of acceleration of business investment as a result of the new depreciation methods, there was a very substantial dropoff, so that the rate of increase was only about one-half what it has been in the earlier period.

The effect of this on output per worker was significant. Output per worker in the period from 1947 to 1954 increased by 3.3 percent per year. After the accelerated depreciation methods were enacted, the rate through 1960 was only 2.1 percent.

How can we explain this lack of effectiveness of a tax stimulus to investment so analogous to the investment credit? It seems to me there are several available explanations.

One, while the tax benefits were being given, there was still no corresponding increase in aggregate demand for the goods and services which additional investment could produce. Therefore, while there were cost savings through tax reductions, there was no particular stimulus to obtain more investment to produce more goods and services. The tax stimulus, as I am sure will be the case with the investment credit, was simply reflected in increased profits, rather than increased production.

Two, the period since 1954 has been generally one of excess capacity due to inadequacy of consumer demand. Given this excess capacity, there are relatively few marginal investment decisions which will be encouraged by an investment tax stimulus such as accelerated depreciation or the proposed credit.

Three, there is ample indication that prices of products are sometimes administered prices. When this is the case, prices are less subject to market forces. Such prices tend to stay up under circumstances in which they could be reduced. Returns from increased investment for a business firm come only if the firm reduces its prices to sell the increased quantities that can be produced with the additional investment.

Rather than expanding plant and equipment to produce more goods and then lowering prices in order to sell the additional goods, some firms have been content to maintain prices and sell lesser quantities that require lesser amounts of plant and equipment.

The tax stimuli to investment, therefore, reflect themselves merely in higher after-tax profits at constant price levels, rather than in greater production at lower price levels.

A principal argument for the investment credit is that business firms need additional cash for additional investments. The facts refute this justification.

There is no evidence that the major firms, which do the great amount of investing in the United States, need additional cash flows to finance further investment.

Take General Motors, for example. General Motors set aside depreciation reserves of $1,637 million during the years 1957–60, while it invested only $1,589 million in plant and equipment combined. During those same years, it retained profits after payments of dividends in the amount of $1,017 million, out of which it added $965 million to its cash and security holdings—rather than in physical investment—so that the total of its financial holdings at the end of 1960 was $1,637 million—ironically, the same amount as its depreciation reserves. Surely General Motors has not been in need of an artificial tax advantage to support further physical investment.

The General Motors case is typical of many large firms and reflects the situation in industry generally. Table 1, below, drawn from the recent report of the President's Council of Economic Advisers, indicates that, in the period from 1959 to 1961, funds available from internal sources alone exceeded total plant and equipment outlays for industry generally. This is completely aside from the additional funds that would be available through new debt financing or new equity issues.

TABLE 1.—*Relationship of plant and equipment outlays to internal funds*

[Dollar amounts in billions]

Period	Plant and equipment outlays (1)	Funds available from internal sources [1] (2)	Col. (2) as percent of col. (1) (3)
1950-54	$107.2	$97.1	90.6
1955-58	113.2	108.4	95.8
1959-61	88.9	93.0	104.6

[1] Retained profits and depletion allowances, and depreciation and amortization allowances.

Source: Table B-65, Report of the Council of Economic Advisers, January 1962, p. 283.

It has been alleged that the low level of investment in recent years has been due to a squeeze on corporate profits. Two sets of facts indicate that this reasoning is fallacious. The first set of facts involves the history of the last few years. This history indicates quite clearly that corporate profits are quite sensitive to the rate at which capacity is being utilized.

Corporate profits have been low only when capacity is not being fully utilized. Since the rate of utilization was higher in the early period of this decade, it follows that the ratio of profits to GNP would be higher in the earlier period.

This in turn, suggests that the lack of investment has been due to an inadequacy of final demand, rather than a lack of corporate profits. Lack of investment is a symptom, not a cause.

The second set of facts concerns the relationship between corporate profits and that part of the national income which originates in corporations. If the corporate share of economic activity falls, corporate profits decline as a percentage of GNP, even when corporate profits are a stable percentage of the income flow through corporations.

Table 2 indicates this relationship quite clearly. If a comparison is made simply between corporate profits and GNP, as indicated in line 2 of table 2, this percentage has gone down. However, if corporate profits plus capital consumption allowances are related to national income originating in corporations—which is the more relevant comparison—it is clear that the ratio in recent years has been higher than at the beginning of the decade—even though unemployment rose from 3.7 percent to 6.1 percent during the same period.

TABLE 2.—*Comparative corporate income rates, 1950–53, 1954–57, and 1958–61*

[Percent]

Item	1950-53	1954-57	1958-61
Corporate profits after taxes:			
Percent of gross national product	5.9	5.3	4.5
Percent of national income originating in corporations	12.6	11.4	10.1
Corporate profits after taxes plus capital consumption allowances:			
Percent of gross national product	9.4	10.0	9.7
Percent of national income originating in corporations plus capital consumption allowances	18.8	19.5	19.3
Unemployment as percent of civilian labor force	3.7	4.6	6.1

Source: U.S. Departments of Commerce and Labor.

The investment credit, by providing a windfall tax break for businesses, would cost the Treasury $1.8 billion the first year. At a time when the Federal budget is in precarious balance, such a revenue loss, which will accomplish so little, should not be incurred.

LOBBYING ACTIVITIES

I oppose the tax deduction for lobbying expenses because it would give a thoroughly unjustified tax advantage to special business interests over the public interest.

Contributions to lobbying organizations that fight for their ideals—be they left, right, or center—are not tax deductible. Contributions to groups like the American Civil Liberties Union, the Americans for Constitutional Action, and the League of Women Voters are prohibited by law from tax exemption.

But if this provision is enacted, special interest business groups, whose financial interests may run counter to the public interest, will get a juicy tax break.

This proposed new tax deduction is the one part of the bill that is flatly opposed by the Treasury.

This is one of the very few significant changes made in the law in years on which the House Ways and Means Committee conducted no hearings.

Section 3 of the bill would allow businesses and trade associations, but not the ordinary citizen nor the individual specialist, to deduct costs incurred in connection with promoting or opposing particular legislation. The bill as presently written would allow deductions for not only the expenses of appearances before congressional committees, but also expenses involved in personal contacts with individual Members of the Congress, personal contacts with State and local officials, and all expenses incurred by trade associations in propagandizing a particular point of view with their individual members.

I consider this provision of the bill wholly indefensible on several different grounds. First, as I have mentioned, from a legislative standpoint, the Ways and Means Committee has held no hearings on this particular measure. Certainly there should be an opportunity for the general public to be heard by the Ways and Means Committee on this subject before the legislation is enacted.

Second, from a legal standpoint, section 3 of the bill represents a change in a long-standing principle which has been supported on several occasions by Federal courts, including the Supreme Court.

The Internal Revenue Code provides for deductions only for "ordinary and necessary" expenses. It is far outside the "ordinary and necessary" income-producing procedures of business to attempt to influence legislative decisions. While the Treasury Department has apparently not attempted to enforce fully its present regulations, dereliction of duty should not be a justification for legislative change.

Third, the proposed change can be criticized on equity grounds. It clearly and explicitly discriminates in favor of business lobbying and against lobbying by private citizens or individual specialists.

Thus the provision serves to rig the odds against legislation for the general well-being, and in favor of specialized legislation for the few. It is difficult enough at present for the individual legislator to obtain information on both sides of the questions upon which we must legislate.

In effect the new provision means that some tax funds now coming to Uncle Sam will be returned to businesses and trade associations in order that they can present their case more effectively, while at the same time discouraging individuals, who presumably have less capacity to meet lobbying costs, from incurring those costs. Thus the flow of information to legislators is diverted so that it comes more freely from certain sources and is less available from other sources.

Fourth, the proposed section can be criticized on economic grounds. The Federal Government, through this measure, will be subsidizing the diversion of resources away from productive output for the benefit of the national economy into specialized propagandizing purposes designed solely to benefit the few. These proposed deductions are not equivalent to deductions for advertising. Advertising is intended to disseminate knowledge to the many about products which are available in the market. The proposed deductions are for expenses designed to influence the few for the special benefit of a few.

The proposed provision on lobbying expenses will not only discriminate against certain nonprofit lobbying organizations, such as the League of Women Voters.

These organizations, like industry trade associations, are usually nonprofit and are generally not subject to tax on their own activities.

However, contributions to these organizations, like contributions to industry trade associations, are only deductible by the contributors to the extent that the contributions are not used by the associations to support lobbying activities.

Section 3 of H.R. 10650 would permit contributions to trade associations to be deductible even though the contributions were used by the trade associations for lobbying purposes.

This change would be made on the grounds that the contributions were "ordinary and necessary" business expenses. However, contributions to organizations such as the League of Women Voters would not be deductible to the extent that the league engaged in lobbying activities because the contributions in that case—under the proposed bill—would not be considered as "ordinary and necessary" business expenses.

Therefore, the bill tends to discriminate in favor of lobbying activities by industry trade associations and against lobbying activities by certain other groups which have been of great assistance to legislators in the past.

Mr. Chairman, I stated at the beginning of this statement that I believed there were two sections of the bill before you which were inimical to the best interests of the general public. I believe the case against both these provisions is clear cut and overwhelming.

That completes my statement, Mr. Chairman.

The CHAIRMAN. Senator Proxmire, I want to congratulate you on one of the very ablest statements that has been made to this committee in opposition to the tax investment credit.

I do not know of any other witness to call attention to the fact of the effect it would have on the business cycle. You say investment credit is also undesirable because it would tend to accentuate the business cycle.

It aggravates the business cycle by encouraging investments during a period of inflation and discouraging it relatively in a recession when businesses have less income against which to write off new investments. I don't recall of any other witness who commented on that point.

As I say, I congratulate you on this. This matter will come before the Senate, and I hope that you will then continue, I imagine it will come before the Senate either by amendment or by inclusion of this bill, I am not certain which way it is coming. But it is certain to come before the Senate in some form, because the administration is apparently determined to enact this $1 billion, you said, $800 million; I think Mr. Stam puts the loss at $1.4 billion.

Senator PROXMIRE. I tried to modify this by saying as the Treasury originally requested it with an 8-percent credit and the lesser restriction, 25 percent of net income, I believe, on how much it could be written off was $1.8 billion, as I understand it, but as it was written it was cut down it is $1.3 billion, or $1.4 billion as it appears in the House bill, you are right, Mr. Chairman.

The CHAIRMAN. In the 10-year period Mr. Stam estimated the loss to be $20.99 billion. It has been inserted in the record. I want to call your attention to an itemized statement of the losses in each of the years for 10 years. (See pt. 1, p. 375.)

Another very astonishing part of this bill is the fact that it is retroactive. It goes back to Juanry 1 of this year, and that in itself, assuming that it will not be enacted by Congress before July 1, I don't think it can be, this tax bill, that gives a 6-month windfall to people who could not have been possibly stimulated or influenced to make these investments because there was no law on the books at that time. That is a windfall of at least $600 or $700 million.

I have to my personal knowledge known. I know of people in my community who have made modernizations of their packinghouses and things like that without any thought of any investment credit, and that they will then get 8 percent credit on these modernizations that have already, by July 1, have been installed.

The apple business, for example, we start packing apples around August so whatever we do in a modernization way has to be done before that date, and I brought that to the attention of Mr. Dillon because he has repeatedly, the Treasury has, and I think properly so, opposed retroactive tax legislation.

But he defended this before the committee because he said he thought there was an incentive involved in the fact that the administration had announced they were for the taxpayer. I hope the time won't come, will never come, when the business people and the people of this country will assume that whatever is recommended by any administration is likely to be enacted into law, because after all, we have got a Congress here, which is supposed to pass the laws, and personally, I don't think any businessman was influenced by that.

I don't think they will do something—in other words, you are exactly right, the businessman will modernize his plant and put a machine in if they think it is desirable to their business to do it.

As you know, the big business corporations of this country have ample funds with which to do this.

Now, they should not be bribed, so to speak, to do something that they are not willing to do in the ordinary course of business. I think in the long run that would be a mistake, and I am with you 100 percent in what you said. I think this would be one of the most iniquitous provisions of the tax law that has ever been enacted in the 29 years that I have been here in the Senate.

I think it will lead to other things and it will have a disruptive influence and instead of helping business it is going to hurt business.

So I thank you for your contribution.

Senator PROXMIRE. Thank you very, very much, Mr. Chairman. I appreciate your remarks.

The CHAIRMAN. Senator Douglas?

Senator DOUGLAS. I, too, want to congratulate Senator Proxmire. He has made a very strong case on both of his points. I would like to ask him this question. Even assuming that the investment credit were desirable on other [illegible] nds, is it not true that the present provisions have been drawn so [illegible]oadly that it would provide a tax credit for improvements and recreation and amusements and retail trade which have nothing whatever to do with the ability of our goods to compete abroad, and a very dubious relationship to the rate of economic growth?

Senator PROXMIRE. I would agree 100 percent. I think that this is an indication of the real danger implicit in this provision, because there have been obvious reasons why the provision is likely to be extended in terms of the power, in terms of equity, and so forth. As I understand it the provision was already been extended to furniture and to other items of equipment that have nothing to do with production or productivity.

This is simply the beginning of the kind of extension that you could expect to get throughout our economic system. If you are going to permit business to depreciate at more than 100 percent as I indicated, here it is 116 percent, then on the basis of what is happening in our experience in depletion allowance we can expect this to be disseminated broadly and to further erode the tax structure.

Senator DOUGLAS. In other words, at a time when we are trying to close tax loopholes this will open perhaps the biggest tax loophole of all.

Senator PROXMIRE. I would agree exactly. I think it does precisely that. That is why I feel this particular provision goes very far to make this whole bill unacceptable although I enthusiastically support many other provisions in the bill.

Senator DOUGLAS. So do I.

Senator PROXMIRE. They are excellent.

Senator DOUGLAS. Thank you.

The CHAIRMAN. Senator Williams?

Senator WILLIAMS. Senator Proxmire, I, too, want to join the chairman and the Senator from Illinois on this well-prepared, excellently documented statement. I think it is recognized this $1.4 billion provided in this investment credit is in actuality a windfall over and above the normal 100-percent depreciation allowed in the bill.

Senator PROXMIRE. Exactly right, this is what it is.

Senator WILLIAMS. In effect it could be classified as a $1½ billion new loophole being put in our tax laws because there is no possible recovery in the future on this point.

Senator PROXMIRE. That is particularly true in view of the fact this is a broad provision that applies to investment whether that would have been made or not. We know that throughout America every year there are billions and billions of dollars of investments which are certain and sure and inevitable. Of course, the marginal investment which is relatively smaller which might conceivably be encouraged, is the only part that would deserve reward and yet the whole mass of additional investment gets it.

It is a fantastically broad and unnecessarily broad, it seems to me, provision for that reason.

Senator WILLIAMS. I have for some time favored a modernization of our present depreciation formulas and would go along with a liberalization of the present formulas, but I don't think that they should ever be extended to the point where a man could recover more than 100 percent of his cost.

In this instance they can recover 116 percent of their original investment, in new plant equipment which is a complete departure from anything that has ever been incorporated in our tax laws.

I noticed in one part of your statement you very properly point out the fact that the investment in caiptal had declined after the change, after the adoption of the accelerated depreciation methods and I am wondering, though, if we can attribute all of that to the change in the formula necessarily because at that same time we made another significant change in our depreciation schedules when we repealed the 5-year amortization certificates at the same time.

Senator PROXMIRE. I think that is a very excellent point.

I don't mean to attribute any of it to the change in depreciation. What I am trying to argue, however, is that the accelerated depreciation did not increase investment as perhaps it should have, and the fact that there was a fall-off in demand after the Korean war was by far the major factor in the influence on the amount of investment we had.

In other words, what I am trying to argue is that artificial encouragement through tax laws is a very small, very little, insignificant influence as compared with the real impact of the economic forces in our society.

Senator WILLIAMS. I thouht I understood what you meant and I think we can agree that the change or the repeal of the 5-year amortization certificates would also be a contributing factor.

Senator PROXMIRE. I think that is correct.

Senator WILLIAMS. Toward this subsequent falloff.

Senator PROXMIRE. It was indeed a very significant factor.

Senator WILLIAMS. Thank you.

The CHAIRMAN. Senator Gore?

Senator GORE. Senator Proxmire, it is not every man who comes before this committee who brings the capacity for logical, cogent analysis and articulate expression that you have displayed in this extremely able statement this morning, and I congratulate you.

In view of the fact that the House Ways and Means Committee took about 11 months to report this bill and bring it to the Senate for consideration, do you share with me some dubiousness about waiting for the proposal until next year to close some obvious loopholes of tax favoritism? Are you confident we will have a tax reform bill before the Senate next year?

Senator PROXMIRE. Well, I share your views very strongly on this particular matter. I feel that it is unlikely if you provide this kind of windfall, giveaway, loophole, that there would be any real basis for getting the kind of economic and political muscle behind a provision to close loopholes next year.

Once this goes through there is no real force and drive behind reform.

Senator GORE. If we could add to the bill provisions to eliminate a few more abuses and inequities, and eliminate the tax credit from the bill, it is just barely possible that room could be found to provide an increase in the exemption from taxable income for all taxpayers.

Senator PROXMIRE. Yes, sir, indeed, I think there are several interesting and very helpful opportunities if this could be done.

As you point out this could be done, there could be a real revenue-raising measure and it could be used, as you say either for increased equity in tax reduction or it could be used to provide a balanced budget at the time when there is a serious question as to whether we are going to have it.

The opportunities would be available.

Senator GORE. And with the apparent slowing of the rate of recovery, it becomes even more necessary, or may become even more necessary before we finish with this bill, to give consideration to stimulating demand.

Senator PROXMIRE. That is exactly right. It is demand that has been the driving force in our economy. If we decide on the basis of looking at the whole economic picture that we do need stimulation, then it seems to me it should come through tax changes that would increase the purchasing power of the great majority of the people.

This has always been the driving, directing force in our economy.

Senator GORE. Thank you.

The CHAIRMAN. Senator Carlson.

Senator CARLSON. Mr. Chairman, I also want to commend our distinguished colleague from Wisconsin for a very splendid statement in regard to two provisions in this tax bill.

I was wondering in view of the fact, I think we would agree we need some stimulus in the economy at the present time in order to increase employment, probably expand our gross national production if the Senator from Wisconsin would feel that a reduction in taxes might not be the best stimulant we could give at this time.

Senator PROXMIRE. It might well be. This is a matter of very delicate analysis and difference of judgment, of course. I am inclined to be somewhat concerned with it, more concerned perhaps than many of my colleagues with the prospect of an unbalanced budget in a period of expansion. I think we will still enjoy a period of expansion, and I think if we reduce taxes at the present time, and run a substantial deficit this year, and I think we will run a deficit even if we don't reduce taxes and a fairly big one, I think we might be in a period where we would just look forward to nothing but endless deficits of very great size.

I would hope that we wouldn't have to do that. I would appreciate, though, and would certainly share the view of those who feel if we are moving into a serious recession, a depression, that a tax cut may be necessary and desirable.

I would hope, and I know this is a little beside the coverage of this bill, perhaps, but I would hope we could approach it in different ways, such as a more realistic monetary policy, lower interest rates. Construction is one of the slowest segments of our economy at the present time. Housing starts are far below what they should be and interest costs are such a very large element in housing.

If we could get these costs down by a more realistic interest rate, not very low but lower than it has been, it would be a great stimulation.

Senator CARLSON. I am sure every member of this committee will remember that we had considerable testimony on low and high interest rates on this before us. And while we do seem to favor low interest rates we seem to run into a difficulty about a balance of payments if we get them too low, what would be your answer about that?

Senator PROXMIRE. My answer to that is this: I think the Federal Reserve can follow a new policy which it should have followed and has not followed significantly on the basis of testimony before the Joint Economic Committee. It should follow a policy of keeping short-term interest rates high by selling short-term and buying long-term Federal Reserve Government obligations. This they have not significantly done. If the Federal had done this the price of those long-term obligations would go up, and interest rates would go down. The Federal can do this. It has done it before. On the basis of their efforts to date, which have been very modest in this direction, they have been successful in keeping short-term obligations high and they have been successful to some extent in moderating long-term obligations but I would like to see a far more vigorous effort.

If the Federal Reserve did this the real problem in the adverse balance of payments would be greatly eased. The flight of capital overseas is larger in the short-term area. For obvious reasons long-term capital is unlikely to move because of low interest rates.

There is very little problem relatively, in people investing in obligations of more than 5 years overseas, to take advantage of higher interest rates abroad, but they do in 90-day bills, and bills of less than a year, obligation of less than a year.

Senator CARLSON. If we followed that suggestion of increased interest rates for short-term obligations and used that in substantial amount would that not threaten to increase the national debt?

Senator PROXMIRE. It could have an influence on the cost of servicing the national debt. Of course, the national debt, as you know, has a moderate middle type of maturity, and while much of it is in very short-term obligations the average maturity is around 5 or 6 years, so that I think there might be a balancing effect on the cost of servicing the national debt inasmuch as we are lowering long-term interest rates and raising short-term interest rates.

I would argue we don't have to raise short-term interest rates very much. If we maintain them at their present level we discourage oversea arbitrary-type investment.

The big thing we must do is bring down the long-term interest rates that affect construction, affect housing starts, and so forth.

Senator CARLSON. I believe I noticed in the morning papers we are going to borrow a billion dollars for 5 years, I believe it is, at 3¾ which is a fairly high rate for Government rates, is it not?

Senator PROXMIRE. It is indeed, and once again, if you will just permit me for a minute, I realize this is a little aside from the point of the tax bill, the tragedy to me is we have the tightest relationship between the supply of money and the gross national product that we have had since the midtwenties and this can only result in high interest rates to the kind you point to here, we have to borrow at 3¾ percent.

Senator CARLSON. The Senator from Delaware says that the length of term on these bonds is 6½ years instead of 5. I want the record corrected.

That is all, Mr. Chairman.

The CHAIRMAN. Senator Curtis?

Senator CURTIS. This is a little apart from the tax bill but I was home last weekend and it was not a borrower but a country banker who complained to me about the marked increase in interest that he had to charge his customers in recent months. Why is that?

Senator PROXMIRE. I have noticed that, too. The bankers—the country bankers in Wisconsin are not enthusiastic about high interest rates. Most people assume the bankers would favor it.

Senator CURTIS. What is causing the high interest rates?

Senator PROXMIRE. It seems to me the policy on the part of the Federal Reserve which has resulted in a situation in which reserves are very tight in the central banks and the central reserve banks. There are some reserves because of the vault cash situation in the country banks but they aren't very ample, because reserves are tight, because they don't have the money to lend, because they are restricted and restrained; of course, they can only lend money when they have it to lend.

They have to ration it out at a higher price. I think if the Federal Reserve Board would follow a policy of making more money available, more reserve available which they can easily do, that interest rates could come down.

Senator CURTIS. Well, did any Government decision or action precipitate the marked raising of interest on savings accounts in our commercial banks?

Senator PROXMIRE. I think, well, yes, there was, as I understand it, there was a limit, you gentlemen perhaps are better informed on this than I am, but I understand there has been a limit on the interest that commercial banks were allowed to pay. That limit has been now raised by action of the appropriate official in the administration, not by action of Congress. I think this may have had some effect and, of course, they are competing with the savings and loans and they feel they have to do so.

Senator CURTIS. Some of the large central banks, that is quite an item to pay out in interest on savings deposits, isn't it?

Senator PROXMIRE. It is indeed. It is a very big item.

Senator CURTIS. So they have to collect more interest to keep ahead, is that right?

Senator PROXMIRE. Well, that is correct, but of course if further reserves were available, if the rediscount rate were lower, for example, so they could borrow reserves, then they would be in a position where the banking community, as a whole, can create money and they would be able to lend more, and this fact that they are competing for deposits with the savings and loans would not be the effective point.

The effective point would be the fact that reserves are available, they can create money and can loan them.

Senator CURTIS. Rates have gone up markedly.

Senator PROXMIRE. They have indeed; yes, sir.

Senator CURTIS. That is all.

The CHAIRMAN. Just one more comment, Senator.

The more you consider this plan the less effective it will be, I think. Now, you take a struggling young industry. They frequently have to lose money for some years in competition with some well-established business. Then the well-established business will take 8 percent credit on its taxes, the struggling young business that hasn't got firmly established and wasn't up to that time enabled to make a profit would get nothing.

Senator PROXMIRE. That is exactly right. And furthermore with the restrictions that you now have of 25 percent of your net income as a maximum against which you can write off for tax credit you are in a position where the really growing company which has very small profits can only, what it is $30,000, or 25 percent of its net income, so there is a real restraint against a company that is growing and it should be the kind of company exactly that should be encouraged, if any company should be encouraged.

The CHAIRMAN. It would be a great discouragement to these struggling companies that are not able to make a net profit in the first years of their organization.

Senator PROXMIRE. Not only be a matter of discouragement to them but they would be competitively disadvantaged because their competition, the bigger, more established companies would have a very real tax advantage over them.

The CHAIRMAN. In other words, if it favors the well-established companies against the companies that may want to compete and are not yet established——

Senator PROXMIRE. It favors the stable company which is earning a substantial amount, and reinvesting amounts over the years, and now growing. It disadvantages the growing company and especially the growing small company.

The CHAIRMAN. I am told that A.T. & T., American Telephone and Telegraph Co., will get a tax credit of $104 million a year, yet the A.T. & T. is opposed to it. It is hard to explain.

Senator PROXMIRE. I think this is a matter of real statesmanship on their part. I think the fact that the Wall Street Journal questioned 68 companies——

The CHAIRMAN. A.T. & T. doesn't need stimulation, they are one of the most progressive companies, I suppose, in the world yet they would get $104 million.

Now, the steel companies, I am told if they make their normal expenditures for modernization will get $100 million. That is all combined, and that is just like a gift. And furthermore, we have greater steel capacity now than we can sell.

That would be an encouragement for them to overproduce.

What the administration is trying to do is to set aside the basic laws that govern business and I think it would be very disastrous if it succeeds.

I thank you again for the splendid statement you have made.

Senator Kerr?

Senator KERR. No questions.

The CHAIRMAN. Thank you.

Senator PROXMIRE. Thank you very much, Mr. Chairman.

Senator GORE. Mr. Chairman, before Senator Proxmire leaves, I would like to——

Senator CARLSON. If the Senator from Tennessee will yield, what we were saying is we used to hear from that side. Over here we were getting this up for Secretary Humphrey, and in the way of some of these——

Senator DOUGLAS. Well, you used to set it up for him, that is right. [Laughter.]

The CHAIRMAN. The Senator from Tennessee will pardon me, it is a strange coalition we have here: The CIO agrees with the U.S. Chamber of Commerce, the National Association of Manufacturers, and the AFL agrees with them, and then certain members of this committee agree with each other. [Laughter.]

When we do have a coalition we are not ashamed to have the loudspeaker on.

Senator GORE. I wanted to read into the record, Mr. Chairman, the capital investment plan for 1962, some of which undoubtedly is underway, of certain private electric power companies.

Alabama Power Co., $52 million; Consumers Power Co., $80 million; Louisiana Power & Light, $16 million; New Jersey Public Service Electric & Gas, $120 million.

Senator KERR. Will the Senator yield?

Senator GORE. Yes.

Senator KERR. Are those figures based on a 3 percent credit, 4 percent, 7 percent, or 8 percent.

Senator GORE. This is the capital investment planned by the companies.

Senator KERR. Not the credit?

Senator GORE. The credit would be percentage of this. Under the bill, 3 percent.

Ohio Power, $34 million; Oklahoma Gas & Electric, $19 million; Public Service Co. of Colorado, $50 million; Virginia Electric Power Co., $84 million.

So it is not only the steel companies and the food processing plants which would get an unjustified credit retroactively; it goes across the board.

A nickelodeon in a juke joint would be eligible, would it not, even if it is already installed?

Senator PROXMIRE. It is most difficult with a utility because, whereas with a steel company and other manufacturing lines you can understand where the incentive is, with a utility they are going to expand, they are going to invest depending on their market. We know that and we know their rates are regulated. I just can't see any incentive whether it is 3, 4, or 8 percent, whatever it is, any incentive that will have any real effect on utilities.

I can understand the argument, although I disagree it is going to be effective, with other concerns, but with a utility it seems to me this is strictly a windfall.

Senator DOUGLAS. But Senator, I think it is true that the administration objects to the inclusion of the utilities so that this sin should not be charged to them.

Senator PROXMIRE. Yes, I recognize that and I share this objection but the fact is, as I understand it, it was in the House bill.

Senator DOUGLAS. Yes, that is right.

Senator PROXMIRE. Yes.

Senator DOUGLAS. But it applies to other properties.

Senator PROXMIRE. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator.

Senator GORE. Mr. Chairman, I would like to raise a point if I may. I would like to bring up the question of the publication of the report gotten up at your direction by the joint committee, published July 21, 1961, on the tax effects of conducting business through foreign corporations.

I have carefully reviewed this report which I had previously been advised had been made public. I see nothing of a secret nature in it. I don't find a single taxpayer identified or named. Certain examples are cited, but this was also done in material presented to the Ways and Means Committee. The Internal Revenue Service has supplied similar examples to me.

The CHAIRMAN. Senator Gore, could I interrupt you?

Mrs. Springer reminds me that I authorized the release of it. In fact, it had already been made public and I saw no reason why it shouldn't be released so if there is any responsibility on the part of anyone, I am willing to accept it.

Senator GORE. So it is public.

The CHAIRMAN. It is public. I would like to hear what Mr. Stam has to say in regard to it because there are no names attached to it. I don't see why it should be classified.

Mr. STAM. The only problem that we had was, of course, in getting this information we had to inspect some confidential information in the Internal Revenue Service, and there was some question as to whether or not even though the name was not given there might be sufficient identification in the facts to point out a particular taxpayer. That was the only thought we had in mind.

The CHAIRMAN. The Chair simply wants to make this comment. If you have a printed document it is very hard to have it confidential and if there is any reason to keep it confidential, I don't think it ought to be printed as a Senate document and for that reason I released it. I had forgotten the incident. I think it was early this year.

Senator GORE. About 2 months ago.

The CHAIRMAN. Because it already had been practically released and there are no names in it. I think it is perfectly proper to release it and I will assume responsibility for doing it.

Senator GORE. Well, I thank the chairman because I did think it had been released, and now I understand it has, I read from it yesterday and it left me in a somewhat anomalous position to be reading from a report which had been said to be classified. But now that it has been made public I suppose the matter is settled.

Thank you.

(Discussion off the record.)

The CHAIRMAN. The next witness is Mr. Frank Barnett, of the Association of American Railroads.

Take a seat, sir.

STATEMENT OF FRANK E. BARNETT, VICE PRESIDENT AND GENERAL COUNSEL OF THE UNION PACIFIC RAILROAD CO., ACCOMPANIED BY ROBERT J. CASEY, ESQ. (CLARK, CARR & ELLIS)

Mr. BARNETT. Mr. Chairman and members of the committee, my name is Frank E. Barnett, I am vice president and general counsel of the Union Pacific Railroad Co., with offices at 120 Broadway, New York City.

I am appearing as the representative of the Association of American Railroads whose members operate 97 percent of all the railroad mileage in the United States and whose gross revenues constitute 99 percent of the revenues of the industry.

I am here to present to the committee the views of the railroad industry on the investment incentive tax credit incorporated in the Revenue Act of 1962. In light of the limited time available, I have filed a written statement outlining more fully the association's views.

The CHAIRMAN. Your prepared statement will appear in the record following your testimony.

Mr. BARNETT. I speak today for an industry which is, and has been for some time, sorely depressed, unfairly taxed, and burdened with regulations more pertinent to the condition of the railroads during the era of the First World War than to the era of the cold war. Yet, we must meet our obligations to a national economy which demands expansion and modernization.

As an industry, our current earning position is severely depressed. During the year just past, 24 class I railroads failed to earn their fixed charges, and the total net income of all class I railroads in the country was only $382 million.

This compares with the average earnings for the 10-year period 1951 through 1960 of $726.8 million. These depressed earnings are reflected in a return on our net investment of only 2.13 percent in 1960, and even this declined to 1.97 percent in 1961.

Obviously, this rate of return precludes the equity financing of our capital requirements and we have turned to credit financing by means of equipment trust obligations and conditional sales. As Senator Hartke has pointed out, the cost of such financing has risen from 2 percent in the not too distant past to as high as 6 percent more recently.

Exhibit A, attached to our written statement filed today, indicates that during the period 1946–55 when the class I railroads expended some $11 billion of capital funds, less than one-tenth of 1 percent was derived from equity capital, 40.33 percent from equipment obligations and 3.14 percent from other funded debt. The remaining 56.44 percent of the total of $11 billion was derived from internal sources, such as depreciation, retirements, and amortization after payments on the annual maturity of other debt obligations.

These internal sources accounted for 19.80 percent of the total invested, and the reinvestment of net earnings, reserves, and other funds accounts for the remaining 36.64 percent of the total investment. The decline in earnings and the oppressively long lives assigned to railroad property and equipment for depreciation purposes have, of course, seriously affected the internal sources of capital funds.

As an industry we know that we should invest more than $2 billion annually to increase and modernize equipment, improve and shorten route mileage, and modernize road properties.

Nevertheless, in 1961 our total expenditures for capital improvements was only $646 million and current 1962 estimates forecast only $770 million for capital expenditures. This is in startling contrast to recent history because in the years 1955–60 the same class I railroads expended an annual average slightly in excess of $1 billion for capital improvements.

It is estimated that an annual modernization program of 100,000 freight cars costing over $1 billion is necessary to erase the competitive disadvantage which has stemmed from our lack of the capital required to keep pace with the technological advances in the railroad industry.

We need only look at our refrigeration equipment to see the effect of the built-in economic obsolescence which is a blight on our industry.

Today the antiquated ice bunker car still constitutes the bulk of our refrigerated car fleet. The industry has known for years that these cars must be replaced by mechanically refrigerated units. We foresee the passage of even more years before the railroad industry accomplishes what the housewife did decades ago—throw out the icebox and replace it with a refrigerator.

The CHAIRMAN. Mr. Barnett, could I interrupt you for a moment?

Mr. BARNETT. Yes, sir.

The CHAIRMAN. What is the present depreciation for these bunker cars?

Mr. BARNETT. Excuse me?

The CHAIRMAN. What is the present depreciation on the bunker cars?

Mr. BARNETT. Yes, sir.

The CHAIRMAN. What is the depreciation now?

Mr. BARNETT. The depreciation now is based on a life which will range between 25 and 32 years depending on which section of the country you are looking at.

The CHAIRMAN. Then you can double that under this formula. What do you take off now?

Mr. BARNETT. Our annual depreciation on the whole refrigerator—on the whole ice bunker car fleet is your question, Senator?

The CHAIRMAN. Is what?

Mr. BARNETT. It would be—I am going to have to approximate.

The CHAIRMAN. Percentagewise, what do you take off?

Mr. BARNETT. We take off about 4 percent a year.

The CHAIRMAN. You don't avail yourself of doubling the depreciation under the 1954 Code?

Mr. BARNETT. Yes, sir; we do on the new acquisitions.

The CHAIRMAN. You take off 8 percent on a declining balance?

Mr. BARNETT. On the declining balance method, yes; that is correct.

The CHAIRMAN. Thank you.

Mr. BARNETT. We can have an approximation of the total dollar figure.

The CHAIRMAN. Does that run through for passenger cars and other kind of cars and equipment?

Mr. BARNETT. Yes, sir; it does.

The CHAIRMAN. Locomotives?

Mr. BARNETT. Locomotives; yes, sir.

Senator WILLIAMS. Might I interrupt? Revision of schedule F shortening the life of these cars so that you can write them off a little faster, would also be of great help to you, would it not?

Mr. BARNETT. Yes, sir, I am going to come to that, indeed, this is the thing we have been asking for for years and years, and trying our darnedest to get for the industry.

Senator WILLIAMS. As I see it you are confronted with a situation while the car physically may last 25 years it becomes obsolete in 10 years as the result of modern improvements?

Mr. BARNETT. There is no question about that. We have a recent example of that right on the Union Pacific. Generally speaking, diesel locomotives are depreciated over a 20- to 25-year life.

Last week in the Union Pacific we authorized the retirement of about 15 locomotives which we had used less than 10 years because of obsolescence.

Senator WILLIAMS. Under the present schedule you would be depreciating them for the next 15 years while they are standing in the yards as junk.

Mr. BARNETT. Well, they will be written out of our accounts this year, and this is solely because of obsolescence.

Senator WILLIAMS. But you are allowed to write them off when you retire them?

Mr. BARNETT. Yes, sir; when we physically retire them; yes, sir.

As funds became available these replacements are being made. Gradually mechanical refrigeration is replacing the ice bunker cars. It is, however, discouraging to realize that within a few years the piggyback and containerization programs will render obsolete the very mechanically refrigerated units we are buying today. Our shippers of perishable commodities, of course, demand equipment incorporating the latest advances in refrigeration. Unless their demands are met we will suffer even further losses of traffic to our competitors than we do now.

In a statement filed with this committee today, Hunter Holding, vice president of the Equitable Life Assurance Society of the United States, indicates that, were we able to acquire 100,000 cars a year, modernization of our existing fleet to the point where no cars were over 25 years of age would require an estimated 7½ years. That is a billion dollars worth of freight cars for 7½ years?

Senator KERR. Per year?

Mr. BARNETT. Yes, sir; per year; 100,000 cars at a cost roughly of $10,000 a car.

If we were going to increase our freight car fleet to its 1949 level it would take an additional year and a half at the rate of 100,000 cars to get us back up to the size we were in 1949.

Our annual requirements, in addition to the billion dollars acquisition of 100,000 cars, include 1,200 locomotive units. An acquisition program of this magnitude, besides giving the country a modern and economically efficient railroad industry, would spur the economy in many ways.

We would need 2,005,000 tons of steel products a year; 160 million board feet of lumber and 235,000 tons of other materials would be required. This, of course, takes no account of the man-hours and labor necessary to process such products and build the equipment.

The impact of this increased investment in the areas in which railroad locomotives and carbuilding companies maintain their plants would be dramatic.

Faced as it is by a multibillion-dollar modernization requirement, the railroad industry today lacks the funds to meet even its current liabilities. It is no wonder that we have a vital interest in the investment incentive tax credit. To us, the credit represents a means of acquiring some of the capital funds required for our modernization program.

During 1961, 64 class I railroads accrued Federal income taxes while 40 roads accrued no such tax liability. Assuming a similiar situation as of the end of 1962, it is clear that the efficacy of the credit as presently proposed will vary as it applies to each of these groups. The taxpaying roads will, we feel, be induced by the credit to make immediate additional capital investments. As to the nontaxpaying railroads, we believe that investment credit will generate funds only if the unused carryover period is extended long enough to warrant hope that the credit could be utilized against earnings in the future. We therefore propose that this committee consider extending the unused credit carryover period to at least 10 years.

Our endorsement of the investment incentive tax credit is necessarily premised on the administration's assurance that the proposal is not intended to be in lieu of depreciation reform.

In this regard we would direct this committee's attention to S. 1370 introduced by Senator Hartke providing 15-year lives for equipment and 20-year lives for road properties for depreciation purposes. This bill goes to the very heart of our problem as an industry. It recognizes our dependence upon internal sources for capital funds and thus complements the investment incentive tax credit.

S. 1370 provides that rolling stock acquired on or after the effective date of the legislation will be treated as having a maximum useful life of 15 years, and road property so acquired as having a maximum useful life of 20 years.

Properties on hand on the effective date may be written off over a remaining useful life not in excess of 15 and 20 years respectively. This legislation is consistent with the business judgment not only of those charged with the railroads' investment of funds, but also of those who invest in our debt securities. The excessively long lives for depreciation assigned to our properties have hindered our modernization program. To quote from Mr. Holding of the Equitable Life, which incidentally is the largest single holder of railroad securities in the world, Mr. Holding says:

> The extremely damaging result of the roads' inability to use a 15-year life for depreciation purposes has been the sharp curtailment of the railroads ability to acquire new equipment.

If enacted, S. 1370 will effectively remove this obstacle to investors such as Mr. Holding's company, the largest single holder of railroad securities today.

Gentlemen of the committee, there has been some question raised this morning as to the efficacy of a short, tax-writeoff period in stimulating the purchase of equipment.

At the risk of appearing to disagree with some of the distinguished gentlemen who have commented on this this morning, I could point out to you the experience in one facet of the railroad industry. What I am going to say is not a theoretical assumption but practical experience that we have gained in the fairly recent past.

During the Korean conflict, we were granted permission to use a fast writeoff period for freight cars acquired; the writeoff period, as you will remember, was 60 months. During the 5-year period this program was in effect we acquired an average of 73,000 cars a year. In 1955 when we expected the special amortization program would be terminated our acquisition increased to 157,000 cars. During the 1956 to 1960 period, our freight car acquisition averaged only 32,064 cars annually.

Now, special amortization, of course, while effective as a stopgap measure, is not the real answer to the railroad depreciation problem.

We would point out to this committee the writeoff period for railroad equipment in contrast to the periods allowed competitive transportation industries. In general, airplanes are assigned a useful life of 5 years; intercity buses a life of 7 years; heavy trucks and highway trailers a life of 8 years.

On the other hand, our diesel locomotives are assigned lives extending up to 25 years, our freight cars 28 years, and our passenger cars 35 years. As to our fixed plant, assigned useful lives run anywhere from 20 to 100 years. The resulting competitive disadvantage is obvious.

Unlike our competitors, the railroad industry must construct and maintain its own rights-of-way in order to operate while our competitors have available publicly financed and supported airports, highways, waterways, and harbor facilities. As of the end of 1960, class I railroads had invested some $18.4 billion of their own money to acquire and maintain their own railroad rights-of-way. The imbalance of tax treatment is even more strikingly illustrated by our investment of some $3.6 billion in grading and tunnels alone. We are allowed no depreciation whatsoever on that figure. And will never get a tax deduction under present methods of depreciation accounting for $3.6 billion of grading and tunnels until the property is finally abandoned in the year of final abandonment and presumably in the year the property is abandoned we aren't going to need the deduction anyway.

This inequity is recognized by the President in yesterday's transportation message wherein he proposes user charges for airways and waterways to recoup some measure of the Federal Government's capital investments in this area. It is interesting to note, however, that though requiring our competitors to repay a minor part of the Federal funds invested for their benefit, the manner of repayment through excise taxes would be a deductible business expense to the carriers.

Much has been said about depreciation reform at the administrative level. In fact, the President's transportation message refers to a current Treasury Department study dealing with useful lives of transportation property. The study is intended to reevaluate lives currently assigned in the light of existing circumstances giving weight to current economic forces including obsolescence. Apparently it is contemplated that Bulletin F will be revised. This industry, as others, has had the experience of Internal Revenue agents regarding Bulletin F lives as bare minimums, and on the face of Bulletin F itself it states it is only to be used as a guideline and it is not binding on anybody.

Administrative relief has a temporary quality being susceptible to change as administrations change. We appreciate the efforts of the present administration in our behalf, but we would urge legislation action as a more permanent solution to the problem.

It is significant to note that the enactment of S. 1370 would involve no loss to the Treasury in the long run and we recommend its enactment.

Lastly, we favor the enactment of a bill such as H.R. 6666 presently before the Ways and Means Committee which would permit us to establish a construction reserve out of taxable income on which Federal income taxes would be deferred. H.R. 6666 provides that funds thus set aside would have to be expended within 5 years or returned to taxable income.

Here again there will be no ultimate loss to the Treasury.

In conclusion, let me reiterate our wholehearted support for the investment incentive tax credit as one way of revitalizing an industry whose equipment is rapidly becoming even more obsolete than it is today.

Thank you, Mr. Chairman and gentlemen.

The CHAIRMAN. Mr. Barnett, do you favor both accelerated depreciation and 8-percent credit?

Mr. BARNETT. We would favor the shorter lives and the—well, it is now 7 percent.

The CHAIRMAN. If you have to choose between the two which would you prefer?

Mr. BARNETT. I think, Senator, that that choice is going to be made for us, but we would like them both.

The CHAIRMAN. I mean which would be more beneficial to the railroads, to leave the depreciation as it is?

Mr. BARNETT. Yes, sir.

The CHAIRMAN. Do you prefer the 8 percent or would you rather have an accelerated depreciation?

Mr. BARNETT. Yes.

The CHAIRMAN. Which one would you prefer?

Mr. BARNETT. I think that if we had to make a choice, we would probably take the shorter lives, Senator Byrd, and I will tell you the reason.

In the 7-percent credit you say, well, our industry in 1961 spent $646 million on capital improvements. Well, that sounds like we would have a credit of $44 million, I guess.

However, contrast the situation, for example, of the Pennsylvania Railroad with the Union Pacific Railroad. The Pennsylvania in 1961 spent about $48 million in capital improvements.

However, it only had a tax liability of $1.2 million in 1961. Therefore, the credit of the Pennsylvania under the current, as I understand the current version of the bill would only be $271,000. In the Union Pacific we spent about the same amount for capital expenditures, in other words, just under $50 million.

The limitation would not apply in the case of our company, and, therefore, our tax credit would be $3.5 million.

Now, this is a capricious application of the credit.

The CHAIRMAN. It is hardly reasonable for you to expect both the accelerated depreciation and the 8-percent tax credit. Your statement which is an excellent one, but had only a few words to say with respect to the 8 percent. All the rest of your statement was in regard to accelerated depreciation.

Mr. BARNETT. This is true.

The CHAIRMAN. Does it indicate that if the committee had to choose between the two, and I think we do, we can't have both, in view of the tremendous loss of revenue, that the railroads would prefer to have the accelerated depreciation on some reasonable basis rather than the 8 percent?

Mr. BARNETT. Yes, although at the same time we suport the 8 percent.

The CHAIRMAN. We appreciate that, but after all the Treasury deficit might be of interest to us.

Thank you very much, Mr. Barnett.

Mr. BARNETT. Thank you.

Senator DOUGLAS. May I ask some questions?

Isn't there a distinction between accelerated depreciation and shorter lives of operation? That is as I understand it the Treasury is already revising Bulletin F——

Mr. BARNETT. Yes, sir.

Senator DOUGLAS. And that the probable results of this provision will be to fix shorter periods of life upon capital instruments, isn't that true?

Mr. BARNETT. Yes, and we hope that the Treasury will come out shortly with its revised lives in Bulletin F.

Senator DOUGLAS. Yes.

Mr. BARNETT. But, Senator, we are not too overjoyed at that prospect because of the practical administration of the lives set forth in Bulletin F. And on that I can get very specific.

In the San Francisco Internal Revenue Service, for example, we have a group which believes that the useful life on a freight car should be 35 years. It is quite different in the Chicago office of the Internal Revenue Service and again different in the Washington branch of depreciation experts.

Senator DOUGLAS. Assuming that they carry out their aim, as I understand it, they want to fix working lives which will measure both depreciation and obsolescence?

Mr. BARNETT. Yes, sir.

Senator DOUGLAS. And assuming that this is carried out, they believe it will result in a net reduction of the average working life.

Now, that itself will give relief, will it not?

Mr. BARNETT. It will give us relief to the extent that the lives assigned are realistic.

Senator DOUGLAS. Now, further acceleration—strike that.

We already have the item in the, included in the 1954 tax bill which permitted double accelerated depreciation, isn't that true?

Mr. BARNETT. Yes, sir.

Senator DOUGLAS. So that if this were to be changed it would simply be more than a doubled accelerated depreciation, possibly a tripled accelerated depreciation.

Mr. BARNETT. I don't think that conclusion is quite a fair inference assuming that the lives recognize current economic obsolescence.

Senator DOUGLAS. Now, this is the point.

Mr. BARNETT. Yes.

Senator DOUGLAS. If the revised working lives of capital instruments in new Bulletin F are realistic, would you ask for anything more than the present accelerated depreciation, namely a double rate, would you ask for a triple rate?

Mr. BARNETT. No, sir, and I don't believe we are asking for a triple rate in asking for a maximum life of 15 years on equipment.

Senator DOUGLAS. I am very glad to hear you say that. I think it is highly important we clear this up. I favor a realistic depreciation rate which would take account of obsolescence but I am very dubious about further accelerating depreciation within the new average lives. These are two very separate and distinct things.

Mr. BARNETT. They certainly are, indeed.

The CHAIRMAN. Would it be possible for you to furnish the committee a statement of the depreciation on the different items, like tracks, railroad tracks, cars, and so forth?

Mr. BARNETT. Yes, sir, we can do that.

(The information requested follows:)

The following table indicates the investment as of the end of 1959 of all class I railroads in various classes of property, per the books of the railroads as recorded under ICC accounting classifications. These figures do not precisely correspond in each instance to the basis for income tax purposes, but indicate the magnitude of the problem. The table also indicates the shortest, longest, and average useful lives allowed by the Internal Revenue Service to 26 class I railroads during the year 1959, the only year for which such tax information is available. This information was compiled from copies of responses by the 26 railroads to the U.S. Treasury Department's depreciation survey which was initiated July 5, 1960, and shows the lives allowed by the Internal Revenue Service for the calendar year ended December 31, 1959.

It will be noted that the table does not include a group of accounts such as rail, ties, track fastenings, ballast, etc., commonly referred to as the track accounts. Both the Internal Revenue Service and the industry regard the entire track system as depreciable. Replacements of track segments in kind are expenses and are allowable deductions for tax purposes. It has been our experience, and the Interstate Commerce Commission after exhaustive hearings found last year, that the annual expenses involved in such replacement essentially equal appropriate allowance for annual depreciation.

Table showing, by types of property, the investment of all class I railroads in the United States, together with information as to useful lives allowed for depreciation purposes by the Internal Revenue Service to 26 class I railroads for the year 1959

Type of property	Investment as of Dec. 31, 1959, of all Class I railroads	Lives allowed to 26 class I railroads by IRS as of 1959		
		Longest	Shortest	Average
		Years	*Years*	*Years*
Grading, tunnels and subways (ICC accounts Nos. 3 and 5)	$3,649,189,362	84.0	35.0	57.1
(It is estimated that only 1 percent of the investment of over $3.3 billion in account 3, grading, is depreciable. The balance of the investment is frozen until final abandonment. Similarly, only about 10 percent of the investment in account 5, tunnels and subways, is depreciable.)				
Bridges, trestles, and culverts (ICC account No. 6)	2,169,919,021	79.0	41.0	57.7
Other roadway property (ICC accounts Nos. 13 and 39)	503,084,742	70.0	22.0	49.9
Buildings (ICC accounts Nos. 16-22, 29, and 35)	1,982,246,835	75.0	35.0	51.0
Wharves and docks (ICC accounts Nos. 23 and 24)	225,492,333	70.0	25.5	44.6
Communication systems, signals, and interlockers (ICC accounts Nos. 26-27)	1,062,661,901	45.0	25.0	33.9
Miscellaneous equipment (ICC accounts Nos. 37, 44, and 58)	553,421,188	26.0	7.0	16.8
Powerplant machinery and transportation systems (ICC accounts Nos. 45 and 31)	265,281,609	50.0	27.0	37.0
Locomotives, other than steam (ICC account No. 52)	4,158,049,272	23.2	16.7	20.3
Cars (ICC accounts Nos. 53 and 54)	8,250,604,551	35.0	21.0	28.1
Work equipment (ICC accounts Nos. 56 and 57)	375,657,622	34.4	6.7	26.5
The following items of investment of all class I railroads as of the end of the calendar year 1959 were not treated on the enclosed schedule principally for the reason that no current rates were available:				
Engineering (ICC account No. 1)	510,976,766			
Land for transportation purposes (ICC account No. 2)	1,458,669,461			
Other right-of-way expenditures (ICC account No. 2½)	7,538,308			
Elevated structures (ICC account No. 7)	20,974,785			
Ties (ICC account No. 8)	972,587,447			
Rails (ICC account No. 9)	1,799,379,262			
Other track material (ICC account No. 10)	1,276,108,284			
Ballast (ICC account No. 11)	891,916,976			
Track laying and surfacing (ICC account No. 12)	928,843,800			
Crossings and signs (ICC account No. 15)	21,256,788			
Roadway small tools (ICC account No. 38)	9,462,553			
Other expenditures—road (ICC account No. 43)	6,056,138			
Steam locomotives (ICC account No. 51)	83,969,924			

Sources: "Transport Statistics in the United States, 1959," Interstate Commerce Commission, and depreciation survey initiated July 5, 1960, U.S. Treasury Department.

The CHAIRMAN. In other words, now you take the accelerated depreciation so far as you can on new equipment, do you not?

Mr. BARNETT. Yes, that is right.

The CHAIRMAN. I understood you to say on tunnels that you got no credit until the tunnel wasn't used.

Mr. BARNETT. On grading and tunnels we have no depreciation at all. No allowance against taxable income.

The CHAIRMAN. That is on the assumption that they do not depreciate?

Mr. BARNETT. On the assumption they don't depreciate. We have an investment of about $3.6 billion in that item.

The CHAIRMAN. Would you give your percentage of your investment in those items that are not depreciated?

Mr. BARNETT. I can furnish that.

(The information referred to follows:)

Your attention is invited to the note in the above table, wherein it is emphasized that only a very minor part of the substantial investment in grading is depreciable for income tax purposes. In answer to the chairman's request for information as to the percentage of such property which is not depreciable, the railroads' investment in Interstate Commerce Commission account No. 3 "Grading" and account No. 5 "Tunnels" as shown in the attached table, is in excess of $3.0 billion. No detail of depreciable and nondepreciable percentages is available, although an official of the Interstate Commerce Commission estimated and advised us orally that the nondepreciable portion of this account would be in the neighborhood of 99 percent. For account No. 5 "Tunnels" the nondepreciable portion is similarly estimated to be about 90 percent. Obviously very nearly all the investment in grading will never be recovered until the road is abandoned.

(Mr. Barnett subsequently advised the committee that the total investment in the American railroad transportation system is $32.3 billion. For ready reference he submitted (next page) a statement prepared recently by the Bureau of Railway Economics of the AAR showing governmental expenditures incurred in connection with competing transport facilities.)

The CHAIRMAN. And give the other information with respect to accelerated depreciation, providing that you don't get depreciation after you exhaust your base—you don't suggest that, do you?

Mr. BARNETT. No; except to the extent——

The CHAIRMAN. It is only taken on the base, the obsolescence?

Mr. BARNETT. That is right; in our depreciation proposal.

The CHAIRMAN. If you exhaust your base, you get no more deduction.

Mr. BARNETT. As to our depreciation proposal, that would be true. At the same time, to the extent that you get back more than 100 percent of your cost on the 7-percent investment credit, we would like that, too.

The CHAIRMAN. Of course, it's been shown that in this credit thing it is possible to get back more than 100 percent.

Mr. BARNETT. Yes; it is true.

The CHAIRMAN. That is not taken off the base investment credit.

Mr. BARNETT. Yes. This, of course, is not the only area of the tax law where it is possible to recover more than cost. For example, one who is using percentage depletion can recover 1,200 times his costs.

Senator DOUGLAS. I am very glad that you say that, Mr. Barnett, because this is very important.

The CHAIRMAN. Senator Kerr?

Senator KERR. I was just getting ready to try to help this witness.

Mr. BARNETT. I thought that might elicit some unfriendly response. [Laughter.]

Senator DOUGLAS. The only help that the witness needed was to make a decision between the 8-percent credit and the accelerated depreciation.

Senator KERR. You mean to advise the chairman as to what his decision would be were he compelled to make a choice?

The CHAIRMAN. He thought probably Congress ought to make that choice.

Senator KERR. What is the total investment in the American railroad transportation system, approximately?

Mr. BARNETT. I believe it is about $18 billion, Senator Kerr. That is the figure that comes to my mind. The total investment.

Senator KERR. Would that be the depreciated——

Mr. BARNETT. No, sir. That would include the $3.6 billion which I mentioned in grading and tunnels which is not depreciable.

Senator KERR. My judgment is it is a good deal more than that. I wonder if you would supply it for the record?

Mr. BARNETT. Yes, sir; I would be glad to do that.

GOVERNMENT EXPENDITURES FOR CONSTRUCTION, OPERATION, AND MAINTENANCE OF TRANSPORT FACILITIES BY AIR, HIGHWAY, AND WATERWAY, AND PRIVATE EXPENDITURES FOR CONSTRUCTION, MAINTENANCE OF WAY, AND TAXES ON RAILROAD FACILITIES

SUMMARY

The following tables show the relentless growth and magnitude of Government expenditures for construction, operation, and maintenance of transport facilities used by air, highway, and waterway operators. Railroads, on the other hand, as investor-financed private enterprises provide, maintain, and pay property taxes on their own right-of-way facilities.

Such public expenditures have aggregated $193 billion, of which $44 billion has been provided by the Federal Government and $149 billion by State and local governments. Moreover, the Federal portion of these expenditures is growing. In the year 1962 alone the Federal Government will provide $4.6 billion, while State and local governments will provide $9.2 billion—a total of nearly $14 billion.

In 1956, for the first time, it was recognized by passage of the Federal Aid Highway Act that funds provided by the Federal Government should be paid by highway users. Nevertheless, substantial amounts of Federal highway money still come from general funds.

Although the Federal Government has not yet imposed user charges for water and air transportation, this and previous administrations have endorsed transportation user charges and the present administration during the past year has made specific recommendations for extension of such charges.

In a special message on highways presented to Congress on February 28, 1961, President Kennedy recommended certain increases in taxes to be paid by highway users, pointing out that practically all of the increase in revenues from these taxes should come from the heavier trucks that use diesel fuel and weigh over 26,000 pounds when loaded. He stated that "technical experts in the Bureau of Public Roads advise me that even this increase would not charge heavy trucks their fair share of the cost of this program." The President's proposals were adopted only in part by the Congress.

More recently, in his budget message to Congress on January 18, 1962, the President stated: "* * * it is clearly appropriate that passengers and shippers who benefit from special Government programs should bear a fair share of the cost of these programs." Accordingly, he recommended that the following user charges be enacted effective January 1, 1963: (*a*) a 5-percent tax on airline tickets and on airfreight waybills; (*b*) a 2-cent-per-gallon tax on all fuels used in commercial air transport, including jet fuels; (*c*) a 3-cent-per-gallon tax on all fuels used in general aviation; and (*d*) a 2-cents-per-gallon tax on fuels used on inland waterways, which would offset part of the cost of operation and maintenance.

If these proposals are enacted, it is estimated by the Bureau of the Budget that the annual yield from the airway user charges in 1963 would be $170 million, of which $105 million would be derived from the 5-percent tax on airline tickets, $7 million from the tax on airfreight, $36 million from the 2-cent tax on jet fuels, and $22 million from the tax on aviation gasoline. The estimated annual yield from the 2-cents-per-gallon tax on fuels on inland waterways is $10 million.

Examination of the President's user charge proposals in relation to the costs of airway and waterway facilities indicates that he is at this time recommending a rather modest initial contribution.

In fiscal 1963, the budget provides that the Federal Government will spend $691 million for facilities, operations, administration, and research on the Federal Airways System, of which $480 million is for operations and administration. A recent study by the Federal Aviation Agency finds that civil aviation's share of airway costs is about 70 percent. Thus, the President's proposal will yield only 35 percent of the total share assignable to civil airway users, or barely half of their share of the operations and administration costs alone.

The proposed user charge for inland waterways is even more modest in relation to expenditures for waterway facilities. In fiscal 1963, the budget estimates that the Federal Government will spend approximately $174 million for inland waterways, one-third of which represents operation and maintenance costs. Thus, the President's waterway user charge proposal would yield less than 6 percent of the total, or only 17 percent of the expenditures for maintenance and operation alone.

In other areas, also, transportation users do not reimburse the Federal Government for expenditures made on their behalf. Since passage of the Federal Airport Act of 1946, civil airport users have been beneficiaries of nearly $700 million in Federal grants for airport construction, including the administrative and research costs of the program. The annual amount of these grants continues to grow with no provision for reimbursement. For fiscal 1963 alone, $75 million has been authorized and budgeted for airport grants, plus $10.7 million for administration and research costs.

Under the "need" provision of the Civil Aeronautics Act of 1938, certificated domestic airlines have received more than $700 million in direct cash subsidy. Provision for such subsidies in fiscal 1963 amounts to $86 million, of which $71 million will go to the local-service airlines, $6 million to helicopter operations, and $9 million to airlines in Alaska and Hawaii.

Summary of Government expenditures for domestic transportation; airways, airports, domestic airmail subsidy, highways, and waterways [1]

Expenditures	Federal	State and local [2]	Total [2]
Prior to 1947	$13,733,604,489	$45,955,721,615	$59,689,326,104
1947	522,102,370	2,985,000,000	3,507,102,370
1948	666,790,053	3,517,000,000	4,183,790,053
1949	864,384,324	3,890,000,000	4,754,384,324
1950	892,368,978	4,224,000,000	5,116,368,978
1951	897,308,768	4,669,000,000	5,566,308,768
1952	946,935,839	5,043,000,000	5,989,935,839
1953	1,082,333,685	5,603,000,000	6,685,333,685
1954	936,933,734	6,595,000,000	7,531,933,734
1955	1,062,310,154	6,860,000,000	7,922,310,154
1956	1,214,828,828	7,816,000,000	9,030,828,828
1957	1,959,374,184	8,348,000,000	10,307,374,184
1958	3,110,445,771	8,355,000,000	11,465,445,771
1959	4,012,946,065	8,198,000,000	12,210,946,065
1960	3,604,945,350	8,618,000,000	12,222,945,350
1961	4,154,164,594	8,707,000,000	12,861,164,594
1962 (estimate)	4,589,093,000	9,156,000,000	13,745,093,000
Total	44,250,870,186	148,539,721,615	192,790,591,801
AIRWAYS [3]			
1925–47	$334,806,569	None	$334,806,569
1947	88,201,605	None	88,201,605
1948	88,730,833	None	88,730,833
1949	106,841,866	None	106,841,866
1950	121,311,131	None	121,311,131
1951	120,204,879	None	120,204,879
1952	119,218,553	None	119,218,553
1953	119,002,193	None	119,002,193
1954	112,202,520	None	112,202,520
1955	112,099,345	None	112,099,345
1956	122,053,358	None	122,053,358
1957	208,586,318	None	208,586,318
1958	318,858,835	None	318,858,835
1959	385,029,244	None	385,029,244
1960	461,727,000	None	461,727,000
1961	557,741,000	None	557,741,000
1962 (estimated)	613,266,000	None	613,266,000
Total	3,989,881,249		3,989,881,249

[1] This table summarizes expenditures for each type of facility as shown on sheets 4–8 with notes and sources of information. Data are for fiscal years, except highway expenditures (sheet 7) which are on a calendar year basis. Not included are Merchant Marine and Coast Guard expenditures, shown separately on sheets 10 and 11.

[2] Does not include State and local expenditures for waterways prior to 1947 as they are not available.

[3] Obligations for establishment, administration, maintenance, and operations of the Federal airways system, including flight and medical standards programs, years 1925 to date. Does not include costs of military facilities and funds transferred to the Civil Aeronautics Administration, the amounts of which could not be ascertained. Obligations of the Federal Aviation Agency for an accelerated research and development program for improving the national system of aviation facilities, including administrative expenditures for the program, are included for years 1958–62.

Sources: Annual Budgets of the U.S. Government; years 1925–26 from annual reports of the Postmaster General.

Summary of Government expenditures for domestic transportation: airways, airports, domestic airmail subsidy, highways, and waterways[1]—Continued

AIRPORTS

Expenditures	Federal		State and local[2]	Total[2]
	Grants in aid[1]	Administration and research		
Prior to 1947	$1,758,019,920	(3)	$1,546,721,615	$3,304,741,535
1947	3,041,906	$258,859	80,000,000	83,300,765
1948	25,490,758	268,462	80,000,000	105,759,220
1949	49,908,900	633,558	80,000,000	130,542,458
1950	44,049,461	808,386	90,000,000	134,857,847
1951	39,703,042	778,847	90,000,000	130,481,889
1952	19,538,231	778,055	90,000,000	110,316,286
1953	11,007,077	645,415	100,000,000	111,652,492
1954	(855,556)	2,233,770	113,000,000	114,378,214
1955	19,698,475	2,132,334	114,000,000	135,830,809
1956	17,794,280	2,680,190	171,000,000	191,474,470
1957	45,141,216	3,330,650	225,000,000	273,471,866
1958	70,325,745	4,012,191	254,000,000	328,337,936
1959	72,354,121	4,506,700	308,000,000	384,860,821
1960	81,949,350	5,842,000	342,000,000	429,791,350
1961	73,060,594	7,638,000	350,000,000	430,698,594
1962 (estimated)	75,000,000	9,797,000	360,000,000	444,797,000
Total	2,405,227,520	46,344,417	4,393,721,615	6,845,293,552

[1] Federal expenditures for civil airports prior to 1947 include a military contribution of $1 billion as estimated by Under Secretary of Commerce Rothschild in April 1958, and other Federal expenditures for civil airports by Federal agencies prior to the Federal Airport Act of 1946. Grant agreements under the act are shown for the years 1947–61, except 1954 when none was made and some were canceled; authorized appropriations are shown for 1962. Expenditures for development of Washington National ($37,000,000) and Dulles International (ultimately $175,000,000) Airports, revenue-producing Federal facilities, not included.
[2] The President's Airport Commission in 1952 estimated the acquisition cost of all U.S. civil airports with their ground establishments to be in the vicinity of $4,000,000,000. Deducting from this $4,000,000,000 total the Federal, State, and local expenditures of $695,258,465 shown for the 1947–52 period leaves $3,304,741,535 as expended prior to 1947. Annual State and local expenditures for years prior to 1954 and since 1960 not available but are here estimated. Amount of revenues not available.
[3] Not available.

Sources: "The National Airport Program," S. Doc. 95, 83d Cong., 2d sess., p. 34; hearings before the subcommittee of the Committee on Interstate and Foreign Commerce on bills to amend the Federal Airport Act, U.S. Senate, Apr. 14–17, 1958, p. 6; "Amendments to the Federal Airport Act," Rept. No. 654, U.S. Senate, 87th Cong., 1st sess., p. 6; Office of Airports, FAA; Budgets of the U.S. Government; and "The Airport and Its Neighbors," President's Airport Commission, May 16, 1952, p. 95. State and local expenditures for years 1954–60 are from Governmental Finances, published annually by the Bureau of the Census.

DOMESTIC AIRMAIL SUBSIDY[1]

Expenditures	Federal	State and local	Total
1939–47	$118,678,000	None	$118,678,000
1947	16,500,000	None	16,500,000
1948	29,600,000	None	29,600,000
1949	33,500,000	None	33,500,000
1950	36,800,000	None	36,800,000
1951	34,922,000	None	34,922,000
1952	25,401,000	None	25,401,000
1953	25,379,000	None	25,379,000
1954	30,753,000	None	30,753,000
1955	28,280,000	None	28,280,000
1956	28,901,000	None	28,901,000
1957	34,116,000	None	34,116,000
1958	39,649,000	None	39,649,000
1959	43,056,000	None	43,056,000
1960	57,927,000	None	57,927,000
1961	72,325,000	None	72,325,000
1962 (estimate)	81,930,000	None	81,930,000
Total	737,717,000	None	737,717,000

[1] Includes domestic trunk, local service, and helicopter airlines. Subsidy payments to domestic airlines as distinguished from compensation for carrying mail not available separately for years prior to 1951, and are here estimated by applying the sudsidy ratio (59 percent), as determined by CAB for entire 1939–50 period, to the total mail payments for each year from 1947 through 1950. Subsidy payments for 1961–62 include Alaskan and Hawaiian operations.

Sources: 1939–50, Civil Aeronautics Board, "Administrative Separation of Subsidy From Total Mail Payments to Domestic Air Carriers," September 1951, p. 5; 1951–60, CAB, "Service Mail Pay and Subsidy for U.S. Certificated Air Carriers," February 1961, table 2; 1961–62, Budget of the U.S. Government for fiscal year 1963, p. 783.

Summary of Government expenditures for domestic transportation: airways, airports, domestic airmail subsidy, highways, and waterways[1]—Continued

HIGHWAYS

Expenditures	Federal	State and local	Total
1921-47 [1]	$8,952,000,000	$44,409,090,000	$53,361,000,000
1947	325,000,000	2,780,000,000	3,105,000,000
1948	407,000,000	3,312,000,000	3,719,000,000
1949	513,000,000	3,685,000,000	4,198,000,000
1950	499,000,000	3,984,000,000	4,483,000,000
1951	497,000,000	4,429,000,000	4,926,000,000
1952	567,000,000	4,803,000,000	5,370,000,000
1953	655,000,000	5,328,000,000	5,983,000,000
1954	695,000,000	6,287,000,000	6,982,000,000
1955	790,000,000	6,592,000,000	7,382,000,000
1956	897,000,000	7,445,000,000	8,342,000,000
1957	1,470,000,000	7,894,000,000	9,364,000,000
1958	2,455,000,000	7,882,000,000	10,337,000,000
1959	3,237,000,000	7,649,000,000	10,886,000,000
1960	2,704,000,000	8,039,000,000	10,743,000,000
1961	3,143,000,000	8,115,000,000	11,258,000,000
1962 (estimated)	3,491,000,000	8,546,000,000	12,037,000,000
Total	[2] [3] 31,297,000,000	[4] 141,179,000,000	172,476,000,000

[1] Records not available prior to 1921.
[2] Includes $4,374,000,000 expended through work relief during 1933-42.
[3] Of this total, $15,665,000,000 was covered by receipts of the Federal highway trust fund from user charges in the period 1956-62.
[4] Of this total, $80,166,000,000 was covered by State and local highway user imposts and toll receipts in the period 1921-62.

Sources: U.S. Department of Commerce, Bureau of Public Roads, "Highway Statistics Summary to 1955," tables HF-201 and HF-202 for years through 1947; "Highway Finance 1948-57," April 1958, tables HF-1 and HF-2 for year 1948; Bureau of Public Roads releases of February 1960, Jan. 6, 1961, and Jan. 7, 1962, table HF-1 for years 1949-62.

WATERWAYS

Prior to 1947	$2,570,100,000	[1]	$2,570,100,000
1947	89,100,000	$125,000,000	214,100,000
1948	115,700,000	125,000,000	240,700,000
1949	160,500,000	125,000,000	285,500,000
1950	190,400,000	150,000,000	340,400,000
1951	204,700,000	150,000,000	354,700,000
1952	215,000,000	150,000,000	365,000,000
1953	271,300,000	175,000,000	446,300,000
1954	97,600,000	195,000,000	292,600,000
1955	110,100,000	154,000,000	264,100,000
1956	146,400,000	200,000,000	346,400,000
1957	198,200,000	229,000,000	427,200,000
1958	222,600,000	219,000,000	441,600,000
1959	271,000,000	241,000,000	512,000,000
1960	293,500,000	237,000,000	530,500,000
1961	300,400,000	242,000,000	542,400,000
1962 (estimate)	318,100,000	250,000,000	568,100,000
Total	[2] 5,774,700,000	[3] 2,967,000,000	8,741,700,000

[1] Not available.
[2] Includes inland waterways, intracoastal waterways, Great Lakes, and coastal harbors. Obligations for construction, operation, and maintenance of channels and harbors, locks and dams, alteration of bridges over navigable rivers, a portion of the costs of advanced engineering and design, and other minor costs related to navigation. Costs do not include navigation portion of multiple-purpose projects. St. Lawrence Seaway and Panama Canal expenditures not included.
[3] State and local expenditures for years 1954-60 are for water transport and terminal facilities. Expenditures not available prior to 1954 and since 1960 but are here estimated for 1961-62.

Sources: Federal expenditures from annual reports of the Chief of Engineers, U.S. Army, and budgets of the U.S. Government. State and local expenditures for years 1954-60 are from Governmental Finances, published annually by the Bureau of the Census.

Summary of Government expenditures for domestic transportation: airways, airports, domestic airmail subsidy, highways, and waterways[1]—Continued

INLAND AND INTRACOASTAL WATERWAYS

Expenditures	Federal	State and local	Total
Prior to 1947	$1,375,000,000		
1947	47,600,000		
1948	61,900,000		
1949	85,900,000		
1950	101,900,000		
1951	109,500,000		
1952	115,000,000		
1953	145,100,000		
1954	54,000,000		
1955	57,200,000		
1956	78,300,000		
1957	106,100,000		
1958	119,100,000		
1959	145,000,000		
1960	157,000,000		
1961	160,700,000		
1962 (estimated)	170,100,000		
Total	[1] 3,089,400,000	(2)	(3)

[1] Does not include Great Lakes and coastal harbors. Expenditures for inland and intracoastal waterways prior to 1955 were estimated by the Corps of Engineers at 53.5 percent of the total waterway expenditures. Data shown for subsequent years assumes the same proportion of the total expenditures were for inland and intracoastal waterways.
[2] Not available separately for inland and intracoastal facilities. (See sheet 8.)
[3] Not available.

Sources: Annual reports of the Chief of Engineers, U.S. Army, and budgets of the U.S. Government.

MERCHANT MARINE

1916–47	$16,843,000,000	None	$16,843,000,000
1947	[1] 281,000,000	None	[1] 281,000,000
1948	183,000,000	None	183,000,000
1949	124,000,000	None	124,000,000
1950	100,000,000	None	100,000,000
1951	101,000,000	None	101,000,000
1952	230,000,000	None	230,000,000
1953	235,000,000	None	235,000,000
1954	153,000,000	None	153,000,000
1955	163,000,000	None	163,000,000
1956	220,000,000	None	220,000,000
1957	181,000,000	None	181,000,000
1958	174,000,000	None	174,000,000
1959	202,000,000	None	202,000,000
1960	270,000,000	None	270,000,000
1961	282,000,000	None	282,000,000
1962 (estimated)	352,000,000	None	352,000,000
Total	[2] 19,532,000,000		19,532,000,000

[1] Excess of repayments and collections over expenditures.
[2] Expenditures for years 1916–26 are those of the U.S. Shipping Board and U.S. Shipping Board Emergency Fleet Corporation. Expenditures for years 1927–32 are those of U.S. Shipping Board and Merchant Fleet Corporation which functions were transferred to the Department of Commerce in June 1933. Expenditures for years 1933–38 are those of the U.S. Shipping Board Bureau and the U.S. Maritime Commission (established in 1936). Expenditures for years 1939–54 are described as "Promotion of Merchant Marine" (functional code 451) by the Bureau of the Budget, which exclude accounts charged to national defense. Expenditures for years 1955 to date also exclude defense functions and are described as "Promotion of Water Transportation—Maritime Activities" (functional code 511 through 1958, 510 through 1960, and 502 through 1962).

Sources: Budgets of the U.S. Government for years 1928, 1935, 1941, 1948, and 1956–63.

Summary of Government expenditures for domestic transportation: airways, airports, domestic airmail subsidy, highways, and waterways [1]—Continued

COAST GUARD

Expenditures	Federal	State and local	Total
1921–47	$2,443,000,000	None	$2,443,000,000
1947	142,000,000	None	142,000,000
1948	106,000,000	None	106,000,000
1949	132,000,000	None	132,000,000
1950	149,000,000	None	149,000,000
1951	162,000,000	None	162,000,000
1952	205,000,000	None	205,000,000
1953	230,000,000	None	230,000,000
1954	222,000,000	None	222,000,000
1955	190,000,000	None	190,000,000
1956	189,000,000	None	189,000,000
1957	194,000,000	None	194,000,000
1958	219,000,000	None	219,000,000
1959	229,000,000	None	229,000,000
1960	238,000,000	None	238,000,000
1961	276,000,000	None	276,000,000
1962 (estimated)	279,000,000	None	279,000,000
Total	[1] 5,605,000,000		5,605,000,000

[1] Expenditures by the U.S. Treasury and U.S. Navy for the Coast Guard, described as "Provision of Navigation Aids and Facilities, Coast Guard" or "Promotion of Water Transportation, Coast Guard," which exclude those accounts charged to national defense by the Bureau of the Budget.

Sources: Budgets of the U.S. Government for years 1935, 1941, 1943, and 1948–63.

Private expenditures for construction, maintenance-of-way and taxes on railroad facilities—Class I line-haul railroads in the United States

Calendar year expenditures	Maintenance [1]	Construction [2]	Taxes [3]	Total
1921–47	$16,573,389,000	$5,966,706,000	$3,077,400,000	$25,617,495,000
1947	997,650,000	235,016,000	128,100,000	1,360,766,000
1948	1,116,459,000	288,084,000	139,500,000	1,544,043,000
1949	1,059,227,000	262,076,000	143,600,000	1,464,903,000
1950	1,059,910,000	235,591,000	148,100,000	1,443,601,000
1951	1,222,516,000	296,108,000	156,600,000	1,675,224,000
1952	1,257,946,000	359,325,000	160,500,000	1,777,771,000
1953	1,313,369,000	321,811,000	164,000,000	1,799,180,000
1954	1,107,113,000	286,541,000	163,800,000	1,557,454,000
1955	1,136,614,000	291,544,000	171,000,000	1,599,158,000
1956	1,151,504,000	362,876,000	177,500,000	1,691,880,000
1957	1,178,560,000	342,792,000	182,700,000	1,704,052,000
1958	985,040,000	231,798,000	180,100,000	1,396,938,000
1959	997,615,000	217,267,000	183,100,000	1,397,982,000
1960	955,112,000	285,615,000	181,400,000	1,422,127,000
Total	32,112,024,000	9,983,150,000	5,357,400,000	47,452,574,000

[1] Expenditures for maintenance-of-way and structures other than stations, office buildings, shops and enginehouses. Depreciation, amortization, and retirement excluded.

[2] Gross capital expenditures for roadway and structures, excluding stations, office buildings, shops, and enginehouses except 1921–28 and 1960 for which years expenditures on stations and office buildings are not separately available and in 1921 and 1960 for which years expenditures on shops and enginehouses are not separately available.

[3] Estimated taxes chargeable to roadway and track properties only. Estimates are computed on basis of ratio (45.8 percent) of such taxes to total reported State and local taxes in 1957 as reported by the railroads to the Bureau of Railway Economics, AAR.

Sources: Interstate Commerce Commission reports except col. 2 for years prior to 1950 and col. 3, which are from reports of the railroads to the Bureau of Railway Economics, AAR.

Senator KERR. Your maintenance of rights-of-way is a chargeoff of expense, of course?

Mr. BARNETT. Yes, sir.

Senator KERR. The rights-of-way expenditure to which you referred was in the building of either a different classification or class of roadbed?

Mr. BARNETT. Yes.

Senator KERR. Rather than improving—rather than in maintaining the one you had?

Mr. BARNETT. Rather than maintaining, that would be either a new roadway, a different roadway, or an improved roadway.

Senator KERR. Yes.

Mr. BARNETT. For example, signal systems are included in the track structure, generally speaking, and we are making enormous investments now in the so-called CTC, centralized traffic control, that would be capitalized.

Senator KERR. Yes.

Now, that is on the single track area?

Mr. BARNETT. It could be on a double track, but the usual application is in single track.

Senator KERR. Primarily?

Mr. BARNETT. Yes, sir.

Senator KERR. If you were building a roadbed to permit 200 miles an hour, though, rather than 120, that would be an investment which is not depreciable?

Mr. BARNETT. To the extent that the investment consisted of additional grading, if you want to increase the possible speed over your roadbed, obviously you would need a lot of grading that you don't have now; you would need more of it. You would need more firmly packed grading, and that would be capitalized and would never be charged off for tax purposes until the line is abandoned.

Senator KERR. Don't you think that if the railroads had equipment that they could compete in today's market for both a larger percentage of freight traffic and also passenger traffic?

Mr. BARNETT. I think there is no question about that. The equipment—our modern day life requires speed of delivery, and new equipment would help us out there. New classification yards, new freight interchange yards, would help us enormously to compete. I think we could do a much better job in competition if we could attain the modernization program I have outlined this morning.

Senator KERR. For instance, what is the present schedule for passenger traffic from here to New York City?

Mr. BARNETT. About 4 hours.

Senator KERR. What would be involved in building or improving roadbed and equipment that would let you make a 2-hour schedule? Of course, the Union Pacific doesn't go from here to New York.

Mr. BARNETT. No, sir; it is the Pennsylvania.

Senator KERR. But you are appearing for those, too?

Mr. BARNETT. Certainly. Say it is 200 miles, assuming we had the equipment which would go that fast, it certainly wouldn't be less than an additional expenditure of—well, a million dollars a mile would be my guess to improve the roadbed to the point where you could have absolute safety.

Senator KERR. Well, aren't the airlines and the buses spending that much on air-conditioned equipment and jet equipment?

Mr. BARNETT. It is my understanding that the Boeing 707 costs about $5 million a copy. Certainly, the investment in the jet fleet has been enormous in the last few years.

However, about a year ago, I had the interesting task of figuring out how much the total jet fleet of the airline industry would cost, and I found out that the total amount on order as of about a year and a half ago amounted to an investment of about half the then current market value of the stock of the Union Pacific Railroad Co.

Senator KERR. That doesn't give me the information I want.

Mr. BARNETT. Excuse me, I will try again.

Senator KERR. Because I don't know what the present market value of the stock is.

Mr. BARNETT. I see.

At that time the total market value of Union Pacific was about $750 million.

Senator DOUGLAS. That is exclusive of bonded indebtedness?

Mr. BARNETT. Yes, sir.

Senator KERR. What would be involved in trackage and equipment, let's say, to provide overnight, efficient overnight, service to Chicago, St. Louis?

Mr. BARNETT. Well, there is——

Senator KERR. There is almost that now?

Mr. BARNETT. There is almost that now.

Senator KERR. Yes.

Mr. BARNETT. I would think it would be a matter of acquiring, perhaps, two or three additional trains or perhaps a half dozen additional trains, which is not a large investment.

Senator KERR. Would the present roadbed condition, would it be adequate?

Mr. BARNETT. The present roadbed is, generally speaking, maintained for freight service in some areas.

In other words, at a lower level of maintenance than it would be if maintained for passenger service. This difference, however, is not too significant and as far as the roadbed is concerned it would take very little expenditure to do that.

Senator KERR. You referred to the improvement a while ago, with which I am familiar, but I can't state the term you used, which gives you so much better and more efficient control of traffic.

Mr. BARNETT. CTC, the centralized traffic control.

Senator KERR. Yes.

That represents quite a sizable investment, doesn't it?

Mr. BARNETT. Yes, that does represent an enormous investment because it involves the installation of electronic controls over miles and miles and miles. On the Union Pacific, I think on our main line, I think we only have half of our main line under CTC at the present time.

Senator KERR. What has that cost you?

Mr. BARNETT. A total of somewhere between $50 and $60 million.

Senator KERR. Would the improvement of the roadbeds to enable you to provide the better passenger service improve your competitive position on freight transportation?

Mr. BARNETT. Yes, it would. One of our great problems is the fact that something of the order of 1½ percent of our gross revenue goes for loss and damage claims and an improved roadbed would certainly help that.

Senator KERR. I would like for you to understand, and for the record to show, that I try to maintain a position of objectivity as between the competing transportation industries, but it has seemed to me that on the basis of the present environment in which you are operating, the railroads have such an unfavorable competitive position that your situation is going to be less advantageous than, rather than holding your own or be more advantageous.

Mr. BARNETT. The rules under which we operate were much more appropriate 50 or 60 years ago than they are today, the railroads conditions will steadily deteriorate year by year by year inevitably unless we can be allowed to strike off our competitive chains and do something.

Senator KERR. How much of your adverse position is due to, if any, to a disadvantageous position with reference to labor costs?

Mr. BARNETT. The studies which were made for the Presidential Commission on Work Rules indicated that the antiquated rules cost the industry about $500 million a year of which, so the study indicated, about $300 million a year, was chargeable to the maintenance of an unnecessary fireman on freight locomotives, freight and yard locomotives. That might be one measure of our competitive disadvantage.

Senator KERR. Is the trend in the other industries such that there is as much chance of there becoming as unfavorably situated as you are, or would the maintenance of their present posture be one that would make it absolutely necessary for your situation in that regard to be improved?

Mr. BARNETT. The other transportation industries certainly are now running into some of the trouble that we have had. We know, for example, what is—what has happened in the airline industry during the calendar year 1961.

However, they do not have the problem of supplying and maintaining their own facilities. In the airline industry, for example, the Federal Government is maintaining the airways, after the plane is in the air. Similarly their terminals are in large measure bought and paid for by the Federal Government. There is bound to be an advantage, that can't be otherwise.

Senator KERR. Now, I want to say this to you. I am interested in the railroads, I think they are absolutely a necessary part of our transportation system. I think their improvement is a vital necessity for the opportunity of an expanding economy, and I think we are going to have an expanding economy.

I don't think we can build highways fast enough or safe enough to carry the passengers and freight traffic that is going to be here in 5 and 10 years on the basis of the present trend of more and more of it going on the highways and less percentagewise going on the railroads.

Is there any possibility of the railroads rehabilitating their passenger service facilities servicewise to where they would be competitive or are they interested in it?

Have they charged that off and seek to develop themselves primarily as freight carriers or is there any thought being given to reclaiming a part of the passenger traffic?

Mr. BARNETT. The views on that question, Senator, vary within the industry. But speaking for the industry, and as a general rule, the railroads have not charged off the passenger business by any means. We are constantly trying to improve it. You see the sore spots here in the East, in particular, the New Haven where there is little or no ability to improve the present service.

In answer to your question, I don't believe that the railroads have charged off the passenger business by any means, although we have been severely and sorely criticized by the Interstate Commerce Commission itself for not doing so.

Senator KERR. I had thought that the service to passengers on the airlines, the handling of baggage, and so forth, was terrible until I took a trip recently on the railroads, and I had to carry about 75 pounds of baggage about a quarter of a mile. The opportunity was of some value in that I learned that I was still able to do it, but I wasn't right sure at the time that I was going to be able to live to enjoy it.

Mr. BARNETT. I sympathize with you.

One reason for having to carry baggage about three-quarters of a mile is the tremendously long trains that some railroads are trying to run today.

Senator KERR. And the total absence of what we used to call redcaps with any appreciable or evident interest in the convenience of the passengers.

This is not any part of this bill, but I just wondered if, with reference to these extremely long trains which you run in order to handle more business at less cost, did you ever think about installing a conveyer from the other end of the yard where a lot of passengers unload?

Mr. BARNETT. That has been thought about and indeed many times I wish for one myself to get on and off these things.

In the West we don't have so much of a problem, to the extent that we do at least in the East. I had the experience myself many times of going into Chicago on one of our eastern trains, arriving there and thinking I would like part of my fare back because they had not taken me all the way to Chicago because I had to walk the last 5 miles.

Senator KERR. I just believe that a more aggressive attitude on the part of railroads would bring some other results like this piggyback program that you have implemented that now accounts for, I believe as much as 10 percent of the freight traffic on some railroads?

Mr. BARNETT. Yes, sir.

Senator KERR. And I think imagination, I think the only thing worth as much to you as this tax credit would be more aggressive thought and more vivid imagination. I don't know, I may be mistaken.

Mr. BARNETT. I couldn't agree with you more, Senator Kerr. You mentioned piggybacking; there is one place where imagination has been exercised. I happen to be a member of the finance committee of the Trailer Train Co. which we set up specifically to buy 80-foot flatcars for use in piggybacking. In the last 2 years we have now bought and financed about $95 million worth of those cars, and that is only a part of the field.

Senator KERR. There has been no indication that there is anybody on this committee for this bill, but I happen to be for this tax credit, because I think that it will do more good than harm, and I think so far as the railraods are concerned they may be among the primary beneficiaries of it, but the question I would like to have you answer for the record is this: If it is enacted, do you think it would become a part of the pattern including more aggressive management, more imagination in management, and more determination, both to solve their labor problems and to do the rest of the things that are going to be required for them to hold their own and improve their position and maybe their passenger operations and hold their own, at least in claiming the continuing likely percentage of the constantly expanding freight business?

Mr. BARNETT. I think it would become part of such a pattern, Senator, and I would go a little further. You asked me whether I think it would become part of such a pattern, the pattern you have outlined. I think it would become part of a pattern; and, furthermore, I think, unless in the railroad industry we originate and follow such a pattern, that we are going to be much worse off than we are now.

I think it is an absolute necessity.

Senator KERR. In other words, if the railroads are reconciled to extermination, I see no reason to pass this bill.

Mr. BARNETT. We are not by any means reconciled to extermination, not by any means.

Senator KERR. I would hate to see you get to where the only value you would have would be to somebody to buy it for the tax loss they would acquire.

Mr. BARNETT. So would I, sir.

Senator KERR. I have been assured by the evidence of this witness and I must say I have been reassured by some other things I have seen and heard from management in the railroad line, but I don't know many places where I think boldness and aggressive action and imagination coupled wtih the experience they have got would be of any greater benefit to any industry or for greater service to the country.

Mr. BARNETT. I agree with you 100 percent.

The CHAIRMAN. Any questions?

Senator Carlson?

Senator CARLSON. Mr. Barnett, do you think the repeal of the transportation tax which was advocated by the President yesterday in his message to Congress on transportation tax would be helpful or encourage increased passenger traffic?

Mr. BARNETT. I think it would. I haven't touched on that matter today because as I understand it we are considering H.R. 10650.

However, the repeal of the excise tax on transportation of passengers is so obviously called for by simple justice and equity, it is a tax that was put on in order to discourage passenger business during World War II, in order to discourage the use of passenger facilities, and my goodness, there it is, it is still there. It is an obvious penalty which should be removed.

Senator CARLSON. Mr. Barnett, I think most of us appreciate the problem we are confronted with. I requested the staff for information on the collection—in 1961 we actually collected on transportation of passenger tax $264 million; in 1962 it's a budget estimate of $280 million.

Personally, I favor the repeal of it and I sincerely hope we can. Was there any evidence when we repealed the tax on the movement of freight and goods that it was helpful?

Mr. BARNETT. Yes, because the transportation of freight is extremely competitive and the difference between carriage by private carriage or by truck or by railroad is measured in fractions of a cent, and certainly the repeal of the tax on freight did help, although I would be a little hard pressed to give specific evidence of that, because of declining business generally during the time when the repeal took place.

Senator CARLSON. While it is true you have discussed the investment credit section of this bill and also accelerated depreciation, the item dealing with passenger tax would certainly be eligible for consideration by this committee on taxes affecting your industry?

Mr. BARNETT. Yes.

Senator CARLSON. I don't want to get clear out of the field but I was interested in the President's message yesterday, I happen to have it here, and I am going to ask you how much you think this might affect you from a competitive standpoint and dollarwise.

> I recommend that the post office be given greater flexibility in arranging for the transportation of mail by motor vehicle carrier.

Is it not true that many of your trains, particularly out in the Middle West, in the shortrun operations are dependent on the mail that you are carrying and the income you receive from mail?

Mr. BARNETT. No question about that. Our mail income is substantial. We, of course, would oppose that particular part of the President's message as strenuously as we could. It would be——

Senator CARLSON. Do you have the figures as to how much income you receive from the transportation of mail? I should know it because I am on the committee, but I do not.

Mr. BARNETT. In the calendar year 1961, the Union Pacific received income from the transportation of mail of $22 million.

It is a safe rule of thumb to assume that that would be about 5 percent of the industry. Our revenues generally constitute about 5 percent of industry revenues.

Senator CARLSON. I am personally familiar with the value of the income that you receive from carrying mail, particularly out in the rural sections of this Nation.

Mr. BARNETT. Yes.

Senator CARLSON. Because we have had evidences of where the continuance or removal of the train depended on the mail income or mail revenue.

Mr. BARNETT. Indeed, it does.

Senator CARLSON. And I can see for our area where this might cause us more difficulty in maintaining some of our train service, should this recommendation be followed, even more than it is at the present time.

Mr. BARNETT. It would undoubtedly increase the problem in your area. No question about it.

Senator CARLSON. Mr. Chairman, I am concerned, as is every other member, about the railroads and their value to the future of this

Nation's economy. I appreciate your statement this morning, Mr. Barnett.

Mr. BARNETT. Thank you.

The CHAIRMAN. Senator Curtis?

Senator CURTIS. Mr. Chairman, I will be very brief.

I want to say we in Nebraska regard the Union Pacific as a very important and valuable concern.

Mr. BARNETT. Thank you.

Senator CURTIS. In connection with the future business possibilities, 3 or 4 years ago, when Congress had under consideration amendments to the Railroad Retirement Act, I made the statement that under the French system of railroads they had more people on their pension rolls than they had workmen for the railroad, and, of course, the railroad industry had to carry the load.

I was at that time informed the same was substantially true in the United States, and had figures submitted to me which showed it is nearly as much.

Do you have any comment on that?

Mr. BARNETT. Only that the problem will increase, as do all pension problems, as we go further in our medical advances which increase longevity.

Senator CURTIS. Yes.

Mr. BARNETT. We are going to have an increasing problem, Senator.

Senator CURTIS. As a program being financed by a particular industry is spread to more and more relatives and dependents and families, rather than the workers themselves, or those things that happen to his health and well-being in connection with the job?

Mr. BARNETT. Yes.

Senator CURTIS. Are you also wrestling with the problem of oppressive taxation from local units of government for your railroad property?

Mr. BARNETT. Yes, sir; we are. And there is a bill now being proposed which would give the Federal court jurisdiction to enjoin the assessments or collection of a tax by a locality, a municipality, or a State, declaring that the imposition of an assessment rate at a higher rate than industry generally is a burden on interstate commerce, giving the Federal court jurisdiction.

Senator CURTIS. Is the problem particularly acute in a large metropolitan area?

Mr. BARNETT. Yes, sir; it is, but it is acute all over the country.

Senator CURTIS. But what I am getting at is, the large metropolitan areas, they come to Washington and say, "Do something about our mass transportation."

They, themselves, are doing something, many of them, only in the wrong direction.

Mr. BARNETT. They, themselves, are largely at fault. Last year we made a survey of how much excessive tax the railroads paid; in other words, we went around to different States and we took every railroad in the country, and we would compare the rate at which the railroad property was assessed as a percentage of true value with the rate at which property generally was assessed.

And in the 30-some States we found that the railroad industry was paying over $160 million a year more than other taxpayers on the same value of property.

Senator CURTIS. Mr. Chairman, I shall not take any more time.

The CHAIRMAN. Thank you.

Just one question, Mr. Barnett.

You have made a very excellent witness, fair and frank. You mentioned you were in a company that was building these piggyback cars, did you not?

Mr. BARNETT. No, sir; we are buying them and financing them from the builders, the regular manufacturers.

The CHAIRMAN. I wanted to ask about the question of taxation.

Mr. BARNETT. Yes.

The CHAIRMAN. Then they lease them to the railroads, do they?

Mr. BARNETT. Yes, sir.

The CHAIRMAN. The railroads do not buy them?

Mr. BARNETT. No; the railroads do not buy them. This company leases them to the railroads.

The CHAIRMAN. Now, the 8-percent tax credit would not apply to that, would it? You can take your rental off, but if you do not own the property, you could not take 8-percent credit on depreciation?

Mr. BARNETT. We believe that the present 7-percent credit would apply to such——

The CHAIRMAN. I thought it applied to the ownership.

Mr. BARNETT. As I understand the bill——

The CHAIRMAN. Mr. Stam, if they lease property built by other companies, would the 8-percent tax credit apply to that?

Mr. STAM. I think it does.

The CHAIRMAN. I thought you had to own the property.

Mr. STAM. No; they have some provision in there for the lessee.

Mr. BARNETT. Senator, I refer you, I have the print of the bill here, on page 22 to the provision, I am not referring to it by section number because I cannot find the section number at the moment.

The CHAIRMAN. Well, we can look at it.

In other words, it applies to——

Mr. BARNETT. It is section 38, "Property," and the definition which appears on page 22 of the bill, I believe, takes care of that.

The CHAIRMAN. A number of people and companies rent machines of different kinds?

Mr. BARNETT. Yes, sir.

The CHAIRMAN. They would get 8 percent on that, even though they do not own the machines?

Mr. BARNETT. I believe they would; yes, sir.

The CHAIRMAN. Would they?

Mr. BARNETT. Yes, sir. Under the section to which I referred.

The CHAIRMAN. I rent some lifting machines which cost about $12,000, $15,000, and only use it during the apple season, and only pay the rental during the apple season, then it goes back to the company. Could I take 8 percent off of the value of that machine?

Senator KERR. I would like to have Mr. Stam's opinion on that because I have grave doubts of that.

Mr. STAM. Pardon me, what was that?

The CHAIRMAN. I say if I rented a machine or anything else and used it a part of the year, could I take 8 percent credit on what the machine cost?

Mr. WOODWORTH. The question of—it can be either the lessee or the lessor can take the credit. However, they would not give it to the lessee in the case of where it was rented for less than a year, because there would be no credit, since its use would be for less than 4 years.

The CHAIRMAN. In other words, you can take it off regardless of whether you own that particular property or not?

Mr. WOODWORTH. Yes; at the option of the lessor.

The CHAIRMAN. That is one other objection I have to the provision.

Senator KERR. But if the one who constructed it took the credit, then if the lessor took the credit, the lessee could not?

Mr. WOODWORTH. That is correct.

The CHAIRMAN. I thought it was well established that in all things relating to depreciation you have to own property in order to take it off.

Thank you very much, Mr. Barnett.

Mr. BARNETT. Thank you.

(Mr. Barnett's prepared statement follows:)

STATEMENT OF FRANK E. BARNETT, VICE PRESIDENT AND GENERAL COUNSEL OF THE UNION PACIFIC RAILROAD CO., ON BEHALF OF THE ASSOCIATION OF AMERICAN RAILROADS

The following statement is presented on behalf of the Association of American Railroads with respect to the Revenue Act of 1962 (H.R. 10650). In the aggregate, the members of the association operate 97 percent of the railroad mileage in the United States, and derive 99 percent of this country's gross railroad revenues. Thus, the views expressed herein constitute the position of the railroad industry.

It is no secret that today the railroad industry is fighting for survival. The severity of the crisis it is experiencing can best be measured by the grave concern expressed by the legislative, judicial, and administrative bodies, on both the Federal and State levels, currently attempting to define and solve our many problems. These problems are as numerous as they are diverse, and yet in the ultimate they may be stated as a fundamental question of economics: How may a sorely depressed, overregulated, and heavily taxed industry meet its obligations to a national economy which demands expansion and modernization?

We are keenly aware of a basic need to generate the capital for modernization of our facilities. Toward this end we endorse that portion of the Revenue Act of 1962 known as the investment incentive credit, and commend it as a means, not only of stimulating an increase in employment opportunities and in the gross national product, but also as one way to initiate much needed plant modernization.

Apart from the investment credit, we would like to emphasize for this committee other areas of tax reform which we believe would go far in emancipating the railroad industry from the competitive disabilities imposed on it by the tax statutes. We propose the enactment of S. 1370, which would provide a 15-year maximum life for our equipment, and a 20-year maximum life for our roadway property. Further, we recommend the attention of this committee to H.R. 6666 presently before the Ways and Means Committee. This bill provides for a reserve for construction.

Before discussing these proposals, we should briefly outline our position in the general economic scale in terms of earnings and possible investment.

Needless to say, our current earnings position is not bright. During the calendar year 1961, 24 class I railroads failed to earn their fixed charges. In fact, all the class I railroads in the United States had a net income of only $382 million during that 12-month period, as against average earnings for the 1951–60 period of $726.8 million.

For almost a hundred years, restrictive regulation at the Federal and State levels, as well as steadily increasing costs of operation, have resulted in a progressively lower rate of return on our net investment. The calendar year

1960 saw a meager return of 2.13 percent, which declined to 1.97 percent for 1961. Obviously a rate of return such as this precludes equity financing of our capital requirements.

Our only other outside source of capital funds has been credit financing by means of equipment trust obligations and conditional sales. In the not too distant past, such financing could be had at an interest rate of from 2 percent to 3½ percent. More recently we have been required to pay as high as 6 percent[1] on the same financing. This high rate is the direct result of our poor earnings record.

During the 6 years 1955 through 1960, class I railroads expended an additional annual average of slightly over $1 billion for capital improvements. However, the calendar year 1961 saw an industry expenditure of only $646 million on capital improvements. Current 1962 estimates foresee only a $770 million expenditure.

This is startling in light of a recent study, sponsored and published by the Brookings institution,[2] indicating that our industry would, assuming available funds, invest more than $2 billion per year for additional and more modern rolling stock, tunnels, shortening route mileage, and otherwise modernizing plant and equipment.

Presently, we are confronted by an urgent need to improve our freight car fleet, especially to upgrade its quality with modern features suited to the needs of today's shipper. It is estimated that an annual modernization program of 100,000 cars is necessary to erase the competitive disadvantage which has resulted from our inability, due to a lack of capital, to keep pace with the technological advances in our industry. A good example would be the refrigerator car used for the transportation of perishable goods which constantly is being improved. The built-in economic obsolescence of existing refrigeration equipment has burdened us for years. In 1961, the old ice bunker car constitued the bulk of our refrigerator car fleet though we know, and have known for years, that these cars should be replaced by mechanically refrigerated units. Within a few years, the fast developing piggyback and containerization programs will render obsolete even the mechanically refrigerated unit. The constant demand from our shippers for cars incorporating the latest advances in the industry further adds to our burden.

In point of fact, Hunter Holding, vice president of the Equiaable Life Assurance Society of the United States, which we are advised is the largest single holder of railroad securities, in a statement filed today with this committee, states that were we able to acquire 100,000 cars a year, modernization of our existing fleet to the point where no cars were over 25 years of age, would take an estimated 7½ years. He estimates another 1½ years would enable us to increase our fleet to its 1949 numerical status, with no cars older than 25 years.

An annual 100,000-car acquisition program also would benefit our suppliers. Adding to our freight car requirements an annual need for 1,200 locomotive units, our yearly acquisitions translated into material and supplies would represent 2,005,000 tons of steel products, 160 million board feet of lumber, and some 235,000 tons of other materials, not to mention the man-hours required to process such products and build the equipment. Consideration should be given to the effect this increased investment would have in areas in which railroad locomotive and car building companies maintain their plants. Such plants are located in Alabama, Illinois, Indiana, Massachusetts, Missouri, New Jersey, New York, Ohio, Pennsylvania, Virginia, Washington, West Virginia, and Wisconsin. Funds flowing into these States would go far in stabilizing our national economy.

Thus it is that we come before this committee, faced by a multibillion-dollar modernization program, but lacking the funds to meet even our current liabilities. It is no wonder that we have a vital interest in that portion of the Revenue Act of 1962, referred to as the investment incentive credit. In part, the credit will enable us to acquire the capital funds with which to meet our modernization needs.

Being practical, we recognize the credit cannot serve all of our members alike. We have within our ranks three distinct groups. There are those taxpaying roads, substantial in number, which, encouraged and assisted by the credit, will pour additional millions into the national economy. Then, there are those taxpaying roads, relatively few in number, which recently have made heavy capital

[1] Statements of Senator Hartke, Congressional Record, Mar. 16, 1961, p. 3885.

[2] "Railroad Transportation and Public Policy," James C. Nelson, the Brookings Institution, April 1959.

expenditures in effectuating modernization programs which the credit will encourage in the first group. These roads do not require the magnitude of capital investment in the immediate future, as do the roads in the first group. Lastly, there are those roads, 40 in number as of December 31, 1961, which, because of their precarious financial position, have no current tax liability against which the credit may be employed. It should be noted that, in spite of their losses, this last group has made substantial capital investment in recent years. It is clear that the efficacy of the credit as presently proposed will vary as it applies to each of these groups.

Obviously, the roads in the first category will be induced by the credit to make immediate additional capital investments. While the investment forthcoming from the roads in the second category will not be as immediate, it is obvious that the credit similarly will induce them to make future investments to keep pace with developments in the industry. As to the last group, the investment credit will generate funds only if the unused carryover period is so extended as to warrant the hope of its utilization in the future. We therefore propose that this committee consider extending the unused investment tax credit carryover period to at least 10 years. With this modification we feel that the investment credit would in some measure attain its stated objectives within our entire industry.

As for the technical aspects of the proposed credit, we note that the bill in its present form requires that section 38 property be depreciable. The report of the House Ways and Means Committee recognizes that railroad track and signals meet this requirement, even though track is accounted for on the retirement method. It is clear, therefore, that the drafters of the legislation regard the retirement method of accounting as a method of accounting for depreciation, as the term "depreciation" is used in section 48(a)(1) of the bill. While this is consistent with existing judicial authority, it is significant that it be noted at this point.

As we have noted, we endorse the investment credit as one means of helping us as an industry to regain economic self-sufficiency. We also recommend it as a means of encouraging our customers to expand existing facilities which, in turn, will result in an increased demand for our services.

Our endorsement of the investment credit of necessity is premised on the administration's assurance that such proposal in no way is intended to be in lieu of realistic depreciation reform. As this committee knows, for many years we have vigorously pressed for a revision of outmoded and obsolete depreciation policies. More particularly, we have requested time and again congressional action on this matter. In this regard we direct this committee's attention to S. 1370 introduced by Senator Hartke, providing 15-year lives for equipment and 20-year lives for road properties for depreciation purposes. The legislative proposals embodied in this bill go to the very heart of our problem as an industry in recognizing our dependence on internal sources for capital funds.

During the 1946–55 period, class I railroads expended $10,966,450,000 on the acquisition of transportation property. Of this total expenditure, a minimal 0.09 percent was derived from equity capital, 40.33 percent from equipment obligations, and 3.14 percent from other funded debt. The remaining 56.44 percent of the total amount so expended was derived from internal sources. These sources were depreciation, retirements, and amortization (reduced by payments on annual maturity of equipment obligations) which accounted for 19.80 percent of the total amount so expended, and the reinvestment of net earnings, reserves and other funds, which accounted for 36.64 percent of the total expenditure.[3] The decline in earnings of the class I railroads and the oppressively long lives assigned to railroad property and equipment for depreciation purposes have necessarily adversely affected this internal source of capital funds.

Under S. 1370 roadway property acquired on or after the effective date of the legislation may be treated for tax purposes as having a maximum useful life of 20 years, and rolling stock so acquired may be treated as having a maximum useful life of 15 years. Properties acquired prior to such effective date may be written off over a remaining useful life of 20 and 15 years, respectively.

In our opinion, such legislation recognizes the business judgment, not only of those charged with the responsibility of the railroads' investment program, but also of outside investors in our industry. The excessively long lives assigned to our properties for tax depreciation purposes have hindered our acquisition of

[3] Exhibit A.

modern equipment and facilities. We need only refer this committee to the above-noted statement filed on behalf of the Equitable Life Assurance Society of the United States in which Mr. Holding states:

"The extremely damaging result of the roads' inability to use a 15-year life for depreciation purposes has been the sharp curtailment of the railroads ability to acquire new equipment."

Any industry will think twice about expansion if it must contemplate, as is presently our case, the recapture of its 1962 investment in dollars valued in 1992 or even later.

If enacted, S. 1370, by its shortening of lives at the option of the taxpayer, will do much to remove this obstacle to investment. This is not a theoretical assumption, but rather the result of practical experience gained in the not too distant past. During the Korean conflict, we were granted permission to utilize a fast write-off period for freight cars acquired. During the 5-year period this program was in effect, we acquired an average of 73,000 cars each year. In 1955, when we expected the special amortization program would be terminated, our acquisition increased to 157,000 cars. During the 1956–60 period, however, our acquisition averaged only 32,064 cars. We note, however, that emergency amortization, while effective as a stopgap measure, will not serve as a foundation for long-range reform.

As any heavy industry, we must plan many years ahead. Assuming we undertake a particular construction or acquisition program, its completion lies some 4 or 5 years away. Thus, spectacular as may have been its result, the emergency amortization program merely illustrates what can be achieved with short lives, and is not suggested as a method of meeting our current needs.

The presently existing service lives assigned to railroad property were set during the early years of income tax administration, and formalized in bulletin F more than 30 years ago. They simply reflect the then prevailing judgment that existing railroad properties would last forever. Gradually, we have been caught in the squeeze between long lives and declining net earnings. Eventually we found it necessary to try to make our property last forever through rebuilding. Suddenly, we were faced by a mortality experience indicating, so we were told, that our properties did in fact last forever. Might we point out to this committee, as we have tried so often in the past to the Internal Revenue Service, that such mortality experience fails to take into account the patching and rebuilding programs which were necessary to keep existing and often obsolete properties in service.

Additionally, we would suggest that this committee consider the writeoff period for railroad equipment in the light of the periods presently allowed others in the transportation industry. In general, airplanes are assigned a useful life of 5 years, intercity buses a life of 7 years, heavy trucks and highway trailers a life of 8 years. On the other hand, our diesel locomotives are written off over periods extending up to 25 years, our freight cars over periods of 28 years, and our passenger cars over periods of 35 years. As for our fixed plant, the assigned useful life runs anywhere from 20 to 100 years. We need not underscore the resulting competitive disadvantage we face.

We face a further serious competitive disadvantage in that, unlike our competitors, we are required to construct and maintain our own rights-of-way in order to operate. While our competitors have available publicly financed and supported airports, highways, waterways, and harbor facilities, the class I railroads as of the end of 1960 had invested some $18.4 billion of their own capital funds in road properties. This is indeed anomalous, especially if we consider that we have invested some $3.6 billion in grading and tunnels alone, no portion of which will be recovered until the property involved is at long last abandoned.

We can no longer meet our obligations with thrice-rebuilt properties. Technological advances demand we forge ahead, not merely keep pace. Our antiquated yards must be replaced by electronic yards, our ice-bunker cars by mechanical refrigerator units, and our flat-bed cars with trailer trains. We must have new equipment and roadways, and must have them now.

During the past few months we have heard much with respect to depreciation reform on the administrative level. In fact, as an industry we have engaged in many conferences with the Treasury Department and the Internal Revenue Service in the hopes of securing administrative relief. In spite of these efforts we realize, and wish to impress on this committee, that, at best, administrative relief is a temporary measure.

As presently proposed, administrative relief would take the form of a revision of the obsolete Bulletin F, a publication which on its face states that it is to serve only as a guide in establishing depreciation rates. We have experienced, as has every other taxpayer, the use of Bulletin F standards by an examining agent only as a starting point in the tax audit processes. In spite of the lives set forth therein, we have found its application varies from agent to agent and from district to district throughout the United States. Consequently, it is impossible for those charged with a responsibility of management to find any absolutes in the all-important area of depreciation.

Further, administrative relief has a way of changing from administration to administration. It is not beyond the realm of possibility that a current Bulletin F revision might go untouched for another 20 years. Thus, while appreciative of the cooperation of the present administration in attempting to solve our problems, we feel that the only adequate solution is legislative action. It is significant to note that enactment of S. 1370 in no way involves an ultimate loss of revenue to the Treasury, nor do its provisions conflict with the investment credit proposal.

We therefore commend to this committee's careful consideration S. 1370 introduced by Senator Hartke.

Finally, as an industry we favor the enactment of a bill permitting us to establish a construction reserve out of taxable income on which Federal income taxes would be deferred. Such provisions are embodied in H.R. 6666, which provides that funds set aside would have to be expended within 5 years in the purchase of equipment or other capital facilties used in transportation or to reduce debt incurred in connection with such acquisitions. The total addition to the reserve in any year may not exceed the total depreciation chargeable to expense for such year under the uniform system of accounts prescribed by the Interstate Commerce Commission. The construction reserve fund contemplated in this proposal would definitely tend to level out the peaks and valleys of railroad orders for equipment. It would permit orderly long-term programing which would be little affected by minor swings in the economy.

In conclusion, may we again state our wholehearted support for the investment credit and commend this committee's attention to the other remedial measures suggested in this statement.

EXHIBIT A.—*Principal sources of capital funds, class I railroads, 1946–55* [1]

[In thousands of dollars]

Year	Gross capital expenditures for transportation property	External sources of capital funds—Sale of securities				Internal sources of capital funds					Total, all net sources of capital funds
		Funded debt [2]		Stock [3]	Total, external sources	Annual maturities of equipment obligations	Depreciation, retirements, and amortization	Excess of depreciation over equipment obligations maturities	Net earnings, reserves, and other sources	Total, internal sources	
		Equipment obligations	Other funded debt								
1946	576,003	207,517	463	1,780	209,760	159,700	368,409	208,709	157,534	366,243	576,003
1947	848,667	394,597	750	1,000	396,347	152,200	389,650	237,450	214,870	452,320	848,667
1948	1,268,962	554,564	92,099	----------	646,663	178,900	414,604	235,704	386,595	622,299	1,268,962
1949	1,304,454	506,770	1,272	----------	508,042	248,200	444,990	196,790	599,622	796,412	1,304,454
1950	1,078,633	426,202	51,468	----------	477,670	262,900	472,046	209,146	391,817	600,963	1,078,633
1951	1,425,440	721,678	23,526	3,377	748,581	270,500	489,286	218,786	458,073	676,859	1,425,440
1952	1,369,738	619,623	56,332	1,785	677,740	299,200	516,891	217,691	474,307	691,998	1,369,738
1953	1,262,136	430,145	837	277	431,259	323,600	538,967	215,367	615,510	830,877	1,262,136
1954	895,499	272,328	5,853	427	278,608	336,500	557,382	220,882	396,009	616,891	895,499
1955	936,918	289,673	112,026	1,137	402,836	348,500	558,530	210,030	324,052	534,082	936,918
Total, 1946–55	10,966,450	4,423,097	344,626	9,783	4,777,506	2,580,200	4,750,755	2,170,555	4,018,389	6,188,944	10,066,450
Percent of total	100	40.33	3.14	0.09	43.56	----------	----------	19.80	36.64	56.44	100

[1] ICC, Statistics of Railways in the United States (1946–53), and Transport Statistics in the United States (1954 and 1955), tables 128, 129, 137, 145, 146–A, and 158 or sec. A–1; and exhibit A to verified statement No. 1 by Graham E. Getty in *Ex parte 206* (Oct. 15, 1956), p. 23. Includes lessor companies.

[2] Includes only funded debt for the purchase of equipment and additions and betterments and conditional or deferred payment contracts.

[3] Includes stock issued only for additions and betterments.

The CHAIRMAN. The next witness is Alexander L. Stott of the Bell Telephone System.

Take a seat, sir.

If you will permit the Chair to make a personal statement, I am very glad to have you because the first job I ever had was when I was 15 years old. I stopped school, and I was manager of the Bell Telephone Co. at Winchester.

Senator KERR. Where?

The CHAIRMAN. Winchester.

Senator KERR. What State?

The CHAIRMAN. It is in the great State of Virginia.

I worked 10 years for them, and I finally got $60 a month, an increase of $1 a month per year.

I obtained a very fine business education by my association, and I have been impressed ever since with the frugality, efficiency, and the excellent management of the Bell Telephone Co.

You may proceed.

STATEMENT OF ALEXANDER L. STOTT, VICE PRESIDENT AND COMPTROLLER, AMERICAN TELEPHONE & TELEGRAPH CO.

Mr. STOTT. Mr. Chairman, we are very pleased that you have been a telephone company employee. We think it is pretty good, too.

My name is Alexander L. Stott. I am vice president and comptroller of the American Telephone & Telegraph Co. I am appearing on behalf of the Bell System companies which are heavy users of capital equipment and have always had a keen interest in construction and depreciation matters.

I have prepared a statement to give you our views on certain matters relating to the proposed tax bill which have been discussed in the hearings before your committee. My statement sets forth our views in some detail on the incentive tax credit, the stock option provisions of the law, and the proposal to eliminate the $50 dividend exclusion and the 4 percent dividend credit. I will summarize our views in a brief statement to your committee and I respectfully ask that my complete statement be made a part of the record.

The CHAIRMAN. Your prepared statement will be made a part of the record following your testimony.

Mr. STOTT. Thank you.

When I testified before the Ways and Means Committee nearly a year ago on the President's tax message, there was a proposal for a form of tax credit from which utilities were excluded. H.R. 10650 presents a different situation because utilities are included for a 3 percent tax credit and other taxpayers for a 7 percent credit.

Since the purpose of the credit is to promote construction and growth, the question is whether it would have that result if it were applied to telephone companies. As far as the Bell System companies are concerned, it would not. The Bell System construction program for 1962 is approximately $2.8 billion and it will probably remain in this general area in the immediate future.

Senator KERR. Would you repeat that statement. Where are you reading from?

Mr. STOTT. Sir, I have just a small prepared statement.

Senator KERR. Repeat that last statement.

Mr. STOTT. Yes, sir.

The Bell System construction program for 1962 is approximately $2.8 billion and it will probably remain in this general area in the immediate future.

This construction is designed to meet the needs of the public for telephone service. We have an obligation to construct adequate facilities to meet this need. Clearly, it would not be economically desirable to build excess plant merely to obtain a tax credit. The Bell System companies have been able, under sound regulation, to obtain the additional amount of new capital from investors required to carry on construction of new facilities. Therefore, we can see no justification for using tax moneys to help finance our expansion. As the proposed incentive now stands, our business would obtain substantial benefits whether its construction were increased or not. For example, under a 3-percent rate our credit would be in the range of $75 million for 1962; at a 4-percent rate it would be about $100 million; and at an 8-percent rate it would be about $200 million. If we received this credit we would be taking money from the taxpayers for expansion which we believe should properly be obtained from investors.

I might add that we have reservations about the effect of the tax credit on the overall economy. In the first place, the credit is not depreciation reform, and we think depreciation reform is a very important item. The credit is not a tax cut, it is not related to taxable income; it is not related to tax rates, and it is not available to all taxpayers. We view the credit really as a form of a subsidy, and we do not think that business needs a subsidy to expand.

In any case, we are convinced it would not be sound tax policy to offer a subsidy until adequate depreciation provisions are adopted for tax purposes and have had a chance to operate for some period of time. The credit might prove to be a windfall to many rapidly growing companies which would expand in any event. But it would be of little help to those companies which have no current funds for expansion and such companies are often the very ones whose plant and equipment is in the most need of modernization.

It seems to us that one taxpayer's subsidy is another taxpayer's penalty, and we think the credit would introduce an undesirable area of discrimination among taxpayers.

Furthermore, we feel that the private enterprise system ought to be able to do this kind of job itself, and if it is to remain strong and healthy we think that it should not have to look to Government to solve its problems. We think on this point that tax reform would really be an item which would get the economy moving.

I might say that the Secretary of the Treasury and other spokesmen have pointed on several occasions to their program to revise Bulletin F as a necessary corollary to the tax credit with a view to achieving an increase in construction and productivity and sustaining a higher level of economic growth.

I would like to say that the revision of Bulletin F would not affect the Bell System companies for a rather interesting reason. Our depreciation rates are prescribed for us by various regulatory commissions, the FCC being the most important in this connection, and we make very detailed engineering studies of the mortality characteristics of our plant as a basis for these rates. So we do not believe that changes in Bulletin F would affect our situation.

As a matter of fact, the Bell System advocates a different approach to depreciation reform. We think the basic difficulty in recent years has been the inability of business to recover the purchasing power of its investment in plant and equipment.

As a result of inflation, tax depreciation allowances have been inadequate. Taxable income has been overstated, and capital has been taxed under the label of income.

I describe in my filed statement a method called price level depreciation which would permit the recovery of the original purchasing power, we think, without inequity to the public or other taxpayers, and according to our estimates at a cost little, if any, greater than the proposals for the investment incentives.

I realize that many different methods have been advocated for improving depreciation allowances for tax purposes. And I might say over the years we have studied, and we have considered most of these proposals. It is our conviction that price level depreciation is the most equitable.

But we would urge that whatever depreciation methods may ultimately be adopted that there should be a provision in the tax law which is now lacking that a taxpayer may not use for tax purposes a depreciation method that is more liberal than the method that he uses in his books of account.

Generally accepted accounting principles require realistic depreciation methods for financial and accounting purposes; and we think that this requirement would protect the Government's tax revenues by preventing the arbitrary use of faster depreciation methods for tax purposes than can be justified for financial reporting purposes.

Before concluding, I would like to comment briefly on two other subjects, sir, that came up in the discussions before your committee. One is the stock option provisions of section 421, and the other is the dividend credit provisions. These subjects are not in the bill, in H.R. 10650, but we would like to speak to them very briefly.

We are troubled that any major changes in the tax law relating to these subjects would seriously impair our ability to raise equity capital needed in our business.

I might note that the Bell System has had to raise about $15½ billion of new money from investors in the postwar period to do the service job for this country, and that over $9 billion of this money was equity capital raised from small investors throughout this country.

I think you can understand our concern if any action were taken to impair this source of capital to our business.

First, I would like to tell you about the terms of our employee stock plan which is offered under the provisions of section 421, the so-called stock option section of the law.

As I have indicated, we have had to obtain very large amounts of new capital each year to meet our obligations, and we have had to tap every source of capital.

In the postwar years this stock plan, which had been offered to our employees, has produced about $1.7 billion of new equity capital or about one-fifth of the equity capital that we raise from investors.

In each of the years 1960 and 1961, for example, the Bell System obtained over $300 million of new equity capital through the sale of stock to its employees.

Under this plan, stock is offered to all employees meeting minimum length of service requirements on a voluntary and a nondiscriminatory basis. But no one can purchase more than 300 shares. The stock is paid for in installments over a 24-month period on a payroll deduction basis.

The maximum price is fixed at 85 percent of the market price at the time the offer is made. But to make completion of purchases desirable on a declining market, the price does not exceed 85 percent of the market price at the time installment payments are completed.

About 400,000 out of our some 700,000 employees are currently participating in this stock plan, and by doing so they are obtaining a proprietary interest in our business and, at the same time, they are providing the business with a great deal of needed capital.

The point that I would like to make is that our plan is quite different from the executive stock-option type of plan, and I would urge that if any changes are to be made in section 421 that they would recognize the fact that there are capital-raising types of plans used by many large businesses in this country which are quite important to the overall economy.

I would say, sir, that my filed statement on this matter explains our position in considerably more detail.

The CHAIRMAN. Yes.

Mr. STOTT. The last subject I would like to mention very briefly is the suggested repeal of the $50 dividend exclusion and the 4 percent dividend credit.

Here again our ability to obtain new capital would be impaired. We now have 2,050,000 stockholder accounts representing about 2½ million individual shareholders. Over 900,000 of these accounts have been added since the passage of the dividend credit provisions in the Revenue Act of 1954. A majority of these new accounts fall in the middle and small income groups.

I might say that about 850,000 or about 40 percent of our stockholder accounts may be regarded as small investors. They hold less than 30 shares, and they receive less than $100 of dividend income a year.

If the present provisions of the 1954 code providing for the $50 dividend exclusion and the 4-percent dividend credit were to be revoked, we believe that many potential investors as well as some present share owners would be discouraged from the type of equity investment which is so important to the expansion of our business. Again my filed statement covers this subject in much more detail.

I appreciate the chance to talk to your committee, sir.

Senator KERR. Mr. Chairman, may I put a question?

The CHAIRMAN. Yes.

Senator KERR. You say your investment this year will be $2.8 billion?

Mr. STOTT. Yes, sir.

Senator KERR. How much of that is from cash flow?

Mr. STOTT. Our depreciation will run about $1.2 billion. I would say in total about $1.7 billion will be internally generated funds. About $1.1 billion will have to be raised in the market from investors.

Senator KERR. You have a table here, and I do not understand to what it applies.

Mr. STOTT. Yes, sir. That table applies to the dividend credit proposal at the back. It covers the external financing of all U.S. corporations. It is intended——

Senator KERR. Of all U.S. corporations?

Mr. STOTT. Yes, sir.

Senator KERR. I see.

Mr. STOTT. It is intended to show financing by all U.S. corporations in the 8 years before the passage of the dividend provisions and then compare that with the 8 years afterward. It does not cover us specifically. We are included though.

Senator KERR. What percentage of your financing is in the form of convertible debentures?

Mr. STOTT. We used convertible debentures very extensively in the early postwar years when, I would say, we had about eight or nine large convertible debentures. They brought in about $5.6 billion of equity capital for us.

Our reason for using convertibles, was that in the early postwar years our earnings were rather unsatisfactory. Our rate program had not gotten underway, and we really put them out with the idea of getting them converted into equity capital after our earnings had improved.

Senator KERR. But as of now you do not use it?

Mr. STOTT. We have not in our last equity offer, sir. We had a direct offer to stockholders a year ago in the ratio of 1 for 20 at a price of $8.6.

Senator KERR. I just happened to have seen one of your annual statements.

Mr. STOTT. Yes, sir.

Senator KERR. What is the present overall funded indebtedness of A.T. & T.?

Mr. STOTT. Of the Bell System, sir?

Senator KERR. Yes.

Mr. STOTT. Yes. I would think it is on the order of $7 billion. I can give you that figure—it is $7.270 billion.

Senator KERR. How much of that is in the form of convertible debentures?

Mr. STOTT. Practically none at this point.

Senator KERR. That is mostly debentures that have been converted?

Mr. STOTT. Yes, sir. I think there is a little tag end of one convertible that has not been called. It is a very small amount.

Senator KERR. What is the overall, what is the total, depreciated value?

Mr. STOTT. The capital?

Senator KERR. Depreciated value of your assets, $22 billion, $23 billion?

Mr. STOTT. Around $20.3 billion would be our depreciated plant, sir.

Senator KERR. Replacement value?

Mr. STOTT. On the basis of some studies that we have made, you might use a figure of around 20 percent or more to get to that other figure. If you go back in time, some of our earlier plant has suffered considerable ravages from inflation, whereas the later plant has practically none, and the mix of this, I think, would be on the order of 25 percent.

Senator KERR. You anticipate $1.1 billion of additional borrowings this year?

Mr. STOTT. Yes, sir. New money needs will be in this area.

Senator KERR. In that area.

Mr. STOTT. We need around $1 billion a year, give or take a little. Some years we draw down some cash; last year we had a big equity offer. But our new money requirements are around this order of $1 billion, $1.1 billion.

Senator KERR. And on the basis of your outstanding indebtedness what is the annual retirement?

Mr. STOTT. You mean of our debt, sir?

Senator KERR. Yes.

Mr. STOTT. Our debt has maturities, generally speaking, that will start around the year 1975 and go to the year 2,000, just about. We have a couple of issues past that time, but the big bulk of our debt will have to be retired, I would say, between 1975 and 1990.

Senator KERR. Is there any considerable part of that indebtedness in the form of sinking funds?

Mr. STOTT. No, sir; none of it is in the form of sinking fund.

Senator KERR. So that as of this time there is no considerable program of retirement in operation?

Mr. STOTT. No, sir. We, from time to time, have had two or three issues which had been sold at high cost where we had call provisions and we have exercised the call provisions to retire them.

Senator KERR. Thank you very much.

Mr. STOTT. Yes, sir.

The CHAIRMAN. Just one question. A complete return—

> to double taxation of corporate dividends as a means for raising more tax revenues, or to simplify the administration of dividend withholding, without regard to the possible damage it might cause to the economy, should be rejected.

I understand the first part of that, but what do you mean "or to simplify the administration of dividend withholding"?

Mr. STOTT. I had understood that some of the withholding provisions of this bill might be rather complex if we tried to administer them with this $50 exclusion. And the 4 percent dividend credit because it would be hard to tell where the impact of the withholding fell if you had several stocks. So one of the arguments was, that if you eliminated the $50 exclusion, and the 4 percent credit, you would simplify that considerably.

The CHAIRMAN. In other words, you think it would be very difficult to have a withholding plan if you continue to have the 4 percent——

Mr. STOTT. I personally do not think so. But I think that was one of the reasons proposed for this thing, sir. I do not think it would make any difference.

The CHAIRMAN. I still do not quite understand why you say it would simplify it, and it should be rejected.

Mr. STOTT. Let me see if I can make what I had in mind there clear. If the $50 exclusion and the 4 percent credit were in the law and you had withholding of 20 percent of dividend income on top of that then it would be a very complex determination for anyone to figure out how the credit and the $50 exclusion applied to any particular dividends that they got, and their problems in getting refunds might be difficult. But we do not think this is a good reason.

The CHAIRMAN. From your standpoint then the word "simplify" is not quite the proper word to use.

Mr. STOTT. Yes, that is probably right, sir.

The CHAIRMAN. There is just one other thing. I stated this morning that Bell Telephone would get a tax credit of $104 million, and it is based on the 4 percent rate, is it not?

Mr. STOTT. At the 4 percent rate it is on that order, sir; that is right.

The CHAIRMAN. If it was an 8 percent rate?

Mr. STOTT. It would be about $200 million.

The CHAIRMAN. $200 million. That is on your present construction program?

Mr. STOTT. On this $2.8 billion construction program.

The CHAIRMAN. Would that figure include any of these new things, such as the efforts you are making in the space area and things like that?

Mr. STOTT. This $2.8 billion construction program is our total construction program, sir.

The CHAIRMAN. That is the total outside of the actual telephone system?

Mr. STOTT. Yes, sir.

Senator KERR. That includes it.

Mr. STOTT. It includes it; that is right. It is our total construction.

The CHAIRMAN. The whole thing, including the operation of the telephone part of it.

Mr. STOTT. Yes, sir.

The CHAIRMAN. In space and these new things you have undertaken.

Mr. STOTT. Whatever we are trying to do, sir, is in that program, that is right.

The CHAIRMAN. Senator Carlson.

Senator CARLSON. Just this: I think, Mr. Stott, I ought to mention that it was just—some not a year ago, not quite that—that the 2 millionth shareholder or stockholder in your great corporation was selected.

Mr. STOTT. That is right, sir.

Senator CARLSON. And it was a Kansan from Wichita, Kans., and we are very proud of that fact.

Mr. STOTT. We have his picture on the cover of our annual report. They are a very attractive family.

Senator CARLSON. A very fine family, and we are proud of the fact that they were Kansas people and we are proud of your corporation.

Mr. STOTT. Yes, sir; thank you.

Senator CARLSON. That is all, Mr. Chairman.

The CHAIRMAN. Thank you very much, Mr. Stott. You have made a very excellent witness.

Mr. STOTT. Thank you.

(Mr. Stott's prepared statement follows:)

STATEMENT OF ALEXANDER L. STOTT, VICE PRESIDENT AND COMPTROLLER OF AMERICAN TELEPHONE & TELEGRAPH CO., ON H.R. 10650

This statement is made on behalf of the Bell System companies to give our views on the proposal in the pending legislation for an incentive tax credit and other matters. Because the Bell System is a heavy user of capital equipment, it has always had a keen interest in construction and depreciation matters. In recent years the construction program of the Bell System companies has been running in the neighborhood of $2.5 billion a year.

There can be no disagreement with the objective of stimulating modernization and expansion of the Nation's productive facilities. If our Nation is to create the jobs needed for its expanding work force and improve our competitive position in world markets, our productive facilities must be rapidly modernized.

Since the purpose of the incentive tax credit is to promote construction and growth, the question is whether it would have that result. As far as the Bell System companies are concerned it will not. Apparently this is also true of many other companies. On February 8, 1962, the Wall Street Journal published the results of a survey it had made of the plans of 68 large corporations. All except 1 stated that their construction programs would not be significantly affected if the proposal should be enacted, and 29 stated that the credit would not change their capital spending plans at all.

The Bell System's construction program for 1962 is approximately $2.8 billion and will probably remain in this general area in the immediate future. This construction is designed to meet the needs of the public for telephone service and we have an obligation to construct adequate facilities to meet this need. Clearly it would not be economically desirable to build excess plant merely to obtain a tax credit. We have been able, under sound regulation, to obtain from investors the additional amount of new capital required to carry on our construction of new facilities. Therefore, we can see no justification for using tax moneys to help finance our expansion. As the proposed incentive credit now stands, our business would obtain substantial benefits whether its construction were increased or not. For example, under a 3-percent rate we estimate that our credit would be in the range of $75 million for 1962. At a 4-percent rate it would be about $100 million, and at an 8-percent rate it would be about $200 million. If we received this credit we would be taking money from the Government which we should obtain from investors and not the taxpayers.

The investment credit is not a step toward needed tax reform. Rather, it is a subsidy to spur new construction by reducing the cost of acquiring new equipment. We do not think that business needs a subsidy to expand—it needs basic tax reform. In any case we are convinced that it would not be sound tax policy to offer a subsidy until faults in the present tax structure have been remedied. The credit may prove to be a windfall to many rapidly growing companies which would expand in any event. But it would be of little help to those companies whose plant and equipment is in the most need of modernization. Since one taxpayer's subsidy is another taxpayer's penalty, the credit would introduce an undesirable area of discrimination as among taxpayers. Furthermore, if the private enterprise system as we have known it is to remain strong and healthy, we believe it would be a mistake to take a step which may tend to cause business to look more and more to the Government to solve its problems.

It has been stated that the incentive credit is only part of the proposed program for spurring economic growth and that the other component would be a downward revision of depreciable lives set forth as guidelines in Bulletin F. On January 18, 1962, the Secretary of the Treasury said, "I consider our program of depreciation reform [Bulletin F]—including the investment credit—a central part of our economic policy." If the proposed incentive credit becomes law, there is a distinct possibility that it will be regarded as providing tax depreciation reform, and true reform will be long deferred.

Revision of Bulletin F may be useful in some areas. It should be kept in mind, however that Bulletin F is only an administrative guide, specifying average service lives for property by industry groups. Actual depreciation allowed for tax purposes is seldom derived solely by reference to these guidelines. This situation would not be changed simply by having the Treasury Department issue a new bulletin listing shorter lives. Such action would certainly be of no value to us and we suspect the same would be true for many other businesses.

In our case, depreciation rates are established on the basis of our own detailed engineering studies. As a matter of actual practice, the depreciation which we claim for tax purposes is based on rates prescribed for our companies by regulatory authorities for accounting purposes.

In my opinion it is important to understand why the Nation has fallen behind in modernization and expansion of productive facilities. High tax rates, and inflation in the postwar years are clearly at the root of our trouble. Depreciation allowances for tax purposes have failed to recover the purchasing power of the investment in plant being used up in providing goods and services, taxable income has been overstated, and capital has been taxed under the label of income. To maintain the purchasing power of its investment in plant and equipment, business must replace the capital eroded through taxation, either by undertaking outside financing or by retaining more earnings in the business. Many businesses have not been in a position to replenish their capital by these methods and so have not been able to keep their plant and equipment up to date. Furthermore, even where businesses have been able to obtain the capital needed to offset this erosion, they have put a burden on the savings of the country and have reduced the amount of capital that otherwise would have been available for expansion of the economy.

We believe that the first and most important step to stimulate modernization and expansion should be basic tax reform to permit depreciation allowances adequate to preserve the purchasing power of the investment in the productive facilities of the Nation. Such depreciation allowances could be calculated by adjusting the depreciation determined on the basis of the number of dollars originally invested in plant by the changes in the price level between the year of investment and the current year. The purpose of price-level adjustment of depreciation is to allow for changes in the general purchasing power of the dollar and not for changes in the price of particular assets.

We realize that many methods have been advocated for improving tax depreciation allowances and on the basis of studies we have made, we are convinced that price-level depreciation would be the fairest method for all concerned; that is, the public, business, investors, and the Treasury. But, whatever depreciation methods are adopted, effective control of tax depreciation can be achieved through a requirement in the tax law that the taxpayer may not use for tax purposes any depreciation method that is more liberal than the method used in his books of account. Since generally accepted accounting principles require realistic depreciation methods for financial reporting and accounting purposes, this requirement would protect the Government's tax revenues by preventing the use of fast depreciation methods for tax purposes where such methods cannot be justified for financial reporting purposes.

By recognizing changes in purchasing power in the computation of depreciation allowances for tax purposes and requiring that no more liberal tax depreciation methods may be used than are used for accounting purposes, substantial amounts of new funds would become available for modernization and expansion to businesses with an appreciable investment in productive facilities. All businesses would obtain relief on an equitable basis, and businesses with the greatest need for modernization would share in the relief. Furthermore, whereas the expected cost of the proposed incentive credit is currently estimated at about $1.4 billion, without including any changes in depreciation tax treatment, the cost of recognizing realistic depreciation deductions based on purchasing power, with appropriate safeguards, would be about $2 billion. We are convinced, too, that inadequate depreciation allowances for tax purposes have been holding back growth and that realistic tax depreciation allowances which reflect the change in the purchasing power of the dollar are a necessary condition for a dynamically growing economy.

I should like to comment briefly on two other subjects which were mentioned during the appearance of the Secretary of the Treasury before your committee earlier this week. These are, first, the suggestion to change the restricted stock option provisions presently contained in section 421 of the Internal Revenue Code and, second, a proposal to eliminate the $50 dividend exclusion and 4-percent dividend credit presently available to individuals. Any major changes in these provisions would seriously impair our ability to continue to obtain the amounts of new capital needed in our business.

RESTRICTED STOCK OPTIONS

Concerning changes in the restricted stock option provisions, our position in this matter was set forth in a statement appearing at page 180 in the record of the hearings held by your committee last year on S. 1625. Briefly, our position is that if there should be any legislation which would change the existing law in this field it should be carefully drafted so as not to cripple the operation of the capital-raising type of employee stock purchase plan which is being used to great advantage by American Telephone & Telegraph Co. and many other companies.

Reference to our company's stock purchase plan will illustrate how very different such a plan is from the incentive-type stock option ordinarily offered only to executives. Under our plan, shares are offered to all employees meeting minimum length-of-service requirements, on a voluntary and nondiscriminatory basis, at a price set at 15 percent below market value. Payment for shares is made by employees on an installment basis over a 24-month period, with no right of prepayment. The essential corporate purpose of the plan is to raise new capital. Important, too, is the opportunity provided for employees to save systematically while at the same time acquiring a proprietary interest in the business. Sales of stock under our plan in the years since World War II have produced about $1.7 billion, or about one-fifth of the total new equity capital raised by the Bell System in this period. Almost 400,000 employees of American Telephone & Telegraph Co. and its subsidiaries are now participating in the plan. It is currently providing about $300 million in equity capital annually as compared to our current new money requirements of about $1 billion a year.

Many other companies have used and are now using stock purchase plans of this kind. A survey which we undertook recently of other companies indicated that, in the 1957–61 period, some $500 million of stock was approved for offering by 33 separate corporations under this kind of employee stock purchase plan.

The primary purpose of the broadly based employee stock purchase plan, that of raising needed equity capital, is far different from the purpose of incentive stock option arrangements for top management. It is generally agreed that compensation is the basic business reason behind the granting of stock options to executives. There are strong reasons advanced for the position that the granting of such options serves a legitimate purpose. What I want to emphasize is that the purpose served by executive options is completely unrelated to any need of the business for additional capital, whereas the raising of needed capital is the essence of the employee stockpurchase plan. I might add that our companies have never offered incentive-type stock options to their executives.

The two types of plans are therefore quite different in scope and purpose. Nevertheless, our capital-raising employee stock purchase plan is treated for tax purposes under the identical rules which apply to options. We believe that this is fundamentally unsound. The small discount available to an employee in connection with his purchase of stock under an employee stock plan such as that of our company is merely normal underpricing—no more of a price differential than is necessary to sell the large number of shares required for any successful capital-raising endeavor. But under the complicated provisions of section 421, which was devised initially to deal with executive stock options, the discount is subject to tax as ordinary income despite the fact that, from the corporate employer's standpoint, no compensation is intended and none is paid.

Section 421 does give our employees a modest tax benefit in that they do not have to pay income tax on the differential between the purchase price and the market value of the stock at the time of acquisition but can defer this tax until disposition of the stock. Without the protection provided in section 421, even this slight benefit would presumably disappear. This would certainly have an adverse effect on the capital-raising type of employee stock purchase plan.

I therefore urge that any legislation directed toward changing the present provisions of the code in this area expressly recognize the distinction between capital-raising employee stock purchase plans and executive stock options. It seems to us that if any changes are to be made, the tax status of the employee stock purchase plan should be improved so as to give greater encouragement to the use of this type of plan, which has made such a valuable contribution to the Nation's economy by providing new capital to industry. Certainly this type of plan should not be stripped of the limited tax benefit it now has.

PROPOSED REPEAL OF $50 DIVIDEND EXCLUSION AND 4-PERCENT DIVIDEND CREDIT

The proposed repeal of the $50 dividend exclusion and 4-percent dividend credit will probably fall with greater impact on the Bell System than on most other corporate enterprises. Many investors, especially small investors, are financially interested in our enterprise and the Bell System is more dependent than most other businesses on the securities markets to secure the necessary funds for expansion to meet the public's demand for service.

The American Telephone & Telegraph Co., the parent company of the Bell System, has more than 2 million share owners' accounts, representing more than 2.5 million individual share owners. Since the passage of these dividend provisions in 1954, almost 1 million share owners have been added, the great majority being small investors. About 40 percent of A.T. & T.'s share owners' accounts hold less than 28 shares of stock and receive less than $100 in dividends per year.

To meet the public's demand for service the Bell System has had to raise about $15.5 billion in new capital from investors since the end of World War II. More than $9 billion was equity capital, obtained through the issuance of some 175 million additional shares of stock and representing over 20 percent of all new equity capital raised by corporations. It is clear that no other U.S. corporation has depended on the investing public and its willingness to place its savings in risk capital as heavily as has the Bell System.

In 1954 both the House and Senate committees were explicit in their reports as to the reasons for enacting the dividend exclusion and dividend credit. It was stated that the double taxation of distributed corporate earnings had contributed to the impairment of investment incentives, and had driven investment capital away from equities into safer forms of investment. Thus, the ability of companies to raise equity capital was restricted and they were forced to rely too heavily on debt.

Dividends received from corporations by individual share owners were not subject to the normal tax prior to the Revenue Act of 1936. At that time, our economy had very little demand for new equity capital. Hence, the effect of imposing a double tax burden on distributed corporate earnings was then of little significance. But in retrospect the long-range effect on investment incentives and capital formation was serious.

It was quite clear in 1954 that remedial action was required to remove the obstacles from risk capital formation for the good of the economy.

Advocates of repeal of the $50 dividend exclusion and the 4 percent dividend credit have advanced two principal arguments supporting their position.

> The first is that the existing provisions are not efficient in that the tax effects are spread over outstanding shares rather than over new shares alone. Thus, it is asserted the stimulating effects are diluted with little increase in the supply of equity funds and a minor reduction in the cost of equity financing.
>
> The second is that the existing provisions deal inadequately with the problem of tax relief and double taxation and are wholly inequitable as between taxpayers in different income brackets.

These arguments in no way negate the existence in 1954, or today, of the factors which motivated the action taken by Congress in 1954. No one has contended that conditions have so changed since 1954 that a return to the older tax basis is desirable. Instead, it is argued that the 1954 act does not go far enough to be fully effective and so should be repealed until something better is devised.

It is inconsistent to offer tax incentives to corporate business to increase its spending for plant and equipment and, at the same time, enact legislation that will substantially reduce the supply of capital available for that purpose. In short, all the tax inducements in the world for business to expand its plant and equipment will be worthless unless investors willingly risk their savings to finance that expansion.

Investment capital in the United States is not an unlimited reservoir that can be tapped at will. The supply of investment capital can be great or small depending on what investors think of the outlook. If investors have confidence that they will receive fair treatment they will have an incentive to commit their capital—otherwise they will not. Clearly the 1954 legislation was to relieve the punitive effects of double taxation, which contributed to the impairment of investment incentives.

It is argued that the dividend provisions give taxpayers in higher income brackets proportionately greater relief. It is obvious that the inclusion or exclusion in taxable income of any kind of income subjects taxpayers in different tax brackets to different tax effects so long as personal incomes are taxed at progressive rates. Even the $600 exemption for dependents provides proportionately greater tax reduction to taxpayers subject to the higher tax brackets. But this fact has been recognized by the Congress time and again in legislation where the effects on public policy were more important than the relative impact on taxpayers of different means.

While the remedy granted by the act of 1954 was admittedly only partial, the upsurge of investors in equities since that time has been remarkable. In 1954 only 7 million individuals owned shares in American corporations. Today there are around 15 million, an increase of more than 100 percent in only 8 years.

The majority of these new share owners are in the middle and lower income brackets. A 1960 survey of stock ownership among American families made by the University of Michigan Survey Research Center shows that 58 percent of the value of all publicly traded stocks in private possession is owned by families with less than $15,000 annual income; 36 percent is owned by families with less than $10,000 annual income; and 10 percent is owned by families with less than $5,000 annual income. The median income of share owners as reported by the latest New York Stock Exchange survey was $7,000. In other words, one-half the share owners in America have an annual income below the $7,000 mark and are in the income level of most schoolteachers and retired individuals. In these groups the incentive to save must be encouraged, not stifled, if the Nation is to obtain the capital needed for dynamic growth.

Since the passage of the 1954 act, the amount of capital, both debt and equity, provided by investors to corporate enterprises has increased substantially. Government data in the attached table show that the average annual amount of external equity financing by all U.S. corporations in the 8 years ending with 1961 was $3.2 billion, as compared with an annual average of $1.9 billion in the preceding 8 postwar years, or a 68-percent increase. In the same period, the average annual amount of all external financing increased from $7.6 billion to $11.1 billion, or about 46 percent. These amounts represent new investment capital actually supplied to business by investors for the expansion of plant and equipment, and do not include funds placed by investors in outstanding securities through market purchases.

It is argued that corporate profits and stock prices have been more important than the dividend credit provisions in stimulating stock ownership. However, corporate profits today are lower than when the provision was passed by the Congress in 1954. The well-known series published by First National City Bank shows that net income of leading manufacturing companies as a percentage of net worth has declined from 12.4 percent in 1954 and 15.0 percent in 1955 to 10.5 percent in 1960 and 10.1 percent in 1961.

U.S. Department of Labor data show there are today more than 4.5 million unemployed persons, considerably above the normal level. The Department estimates that 13.5 million new workers will join the labor force during the 1960 decade. Business must provide jobs for these millions of workers and to do so will require great expansion running into many billions of dollars. Studies indicate it requires an average investment of around $12,000 to provide one new job in American industry today. Further, a greater share of available savings will be needed to advance the greatly expanded programs for schools, highways, and adequate housing.

The administration has an expressed goal for the Nation's economic rate of growth of 5 percent per annum, about twice that experienced in recent years. If business is to achieve this rate it will require much more rapid capital expansion than the present rate and much greater incentive for investors to place their savings in free enterprise. For this reason, it is extremely important to avoid any expedient that might throttle the creation of new capital required for the expansion of our economy. A complete return to double taxation of corporate dividends as a means for raising more tax revenues, or to simplify the administration of dividend withholding, without regard to the possible damage it might cause to the economy, should be rejected.

External financing of all U.S. corporations,[1] 1946–61

[Billion dollars]

	Equity	Debt	Total		Equity	Debt	Total
1946	$1.3	$5.0	$6.3	1957	3.5	8.7	12.2
1947	1.4	6.3	7.7	1958	3.6	7.0	10.6
1948	1.2	6.5	7.7	1959	3.7	9.3	13.0
1949	1.6	1.0	2.6	1960	3.0	8.1	11.1
1950	1.7	4.6	6.3	1961	4.0	7.1	11.1
1951	2.7	9.0	11.7				
1952	3.0	8.0	11.0	Total 1954–61	25.8	63.1	88.9
1953	2.3	5.2	7.5				
Total 1946–53	15.2	46.5	60.8	Annual average:			
				1946–53	1.9	5.7	7.6
1954	2.1	3.2	5.3	1954–61	3.2	7.9	11.1
1955	2.7	9.6	12.3	Percent increase	68	39	46
1956	3.2	10.1	13.3				

[1] Source: Survey of Current Business, U.S. Department of Commerce. 1961 Data Preliminary—Economic Report of the President, January 1962.

The CHAIRMAN. The committee will recess until 2:30 this afternoon.

(Whereupon, at 12:35 p.m., the committee adjourned, to reconvene at 2:30 p.m., the same day.)

AFTERNOON SESSION

Senator CARLSON (presiding). The committee will come to order. I think some of the other members will be here in a short time.

The first witness we are going to hear this afternoon is Hayward A. Gay, National Machine Tool Builders' Association.

Mr. Gay, we appreciate your appearance before the committee.

Mr. GAY. Thank you, Mr. Chairman.

Senator CARLSON. You may proceed in your own way, sir.

STATEMENT OF HAYWARD A. GAY, DIRECTOR OF THE NATIONAL MACHINE TOOL BUILDERS' ASSOCIATION

Mr. GAY. My name is Hayward A. Gay. I am a director of the National Machine Tool Builders' Association and chairman of its Taxation and Renegotiation Committee. This trade association's members account for about 90 percent of the machine tool production in the United States. I am also vice president and manager of the machine tool division, the Cincinnati Milling Machine Co. My testimony here today will be on behalf of the association. My remarks will be addressed primarily to the investment credit provisions of H.R. 10650.

The National Machine Tool Builders' Association favors the investment credit as a first step toward modernization of American productive facilities. This step is essential both to strengthen the domestic economy and to broaden the foreign market for American goods.

We understand some estimate the investment credit provision would cost our Treasury approximately $1.5 billion in taxes annually. We refute this contention. It would only delay taxes while we are modernizing our production lines. Then the increased business developing from our greater productivity and lower costs should generate additional taxes far in excess of those not collected during the period of revitalization.

Recently, much attention has been given to the deterioration of the U.S. balance of payments and the unfavorable condition of the American economy when compared to that of industrial countries overseas.

For example, the annual rate of growth of industrial production in the United States between 1951 and 1960 averaged only 3 percent. By contrast, the average rate for the same period in countries of the European Economic Community was 7.4 percent. Again, the annual rate of growth of the gross national product of the United States for that period averaged 2.6 percent, comparing unfavorably with the 5.3 percent average for members of the European Economic Community.

These sobering figures reflect the fact that American industries are losing the competitive edge previously enjoyed over the countries of Western Europe. In my own industry, for example, the U.S. share of world production of machine tools dropped from 40 percent to 24.2 percent during the period 1955–60. The countries of Western Europe, on the other hand, increased their share of the world market during those years from 35.1 percent to 39.3 percent. Even more disturbing is the fact that the iron curtain countries' share of world production jumped by over one-third, from 21.4 percent to 29.2 percent.[1]

A painful reminder of the slow pace of industrial growth in this country is, of course, the growing number of men without jobs. The general level of unemployment from 1953 through the first 6 months of 1961 rose from 2.9 percent to 7.4 percent. In the machine tool industry, employment fell from 96,400 to 71,000 or a drop of 26 percent. During the corresponding period unemployment decreased steadily in the industries of our major competitors in Japan and Europe.

If unemployment and productive torpor are symptoms, what are the causes? One answer often advanced is costs, and in particular, wage costs. But we are not critical of the fact that wages in this country are at an unprecedented high. We are proud that American industry can pay such wages and are aware that high wages make good consumers. In the United States we have relied on the miracle of productivity to effect the 3 to 1 wage-cost advantage enjoyed by our oversea competitors.

I might add, in our machine tool industry it must be remembered that the total payroll is over 50 percent of our costs.

However, in order to keep productivity ahead of advancing wages, it is necessary to make repeated, massive investments, not only in technical research and development, but also in new plants and equipment which put to use the teachings of research.

Unfortunately, taxation policies prevailing in the United States for the last 25 years have operated to deter rather than to encourage reinvestment. Our depreciation laws are administered under regulations which, in their practical application, limit depreciation allowance in accordance with fixed lives established by artificially drawn-out replacement patterns prevailing in the depression burdened thirties. Under these regulations no workable accommodation can be made for the rapid obsolescence resulting from modern technology. The short-term revenue benefits of this philosophy of taxation are

[1] European Committee for the Cooperation of the Machine Tool Industries.

illusory particularly when compared with yields possible under a system designed to encourage modernization and growth.

Our present policies are particularly self-defeating in view of the situation in Europe and Japan. The devastation of industrial facilities in Europe and Japan during World War II enabled those countries to replace outmoded equipment with modern facilities while the United States increased its productivity at a much slower rate.

Moreover, practically every European Government with whose industries the United States must compete has also adopted some form of investment incentives. In the Netherlands, for example, I understand that apart from normal depreciation, taxpayers are offered special investment deductions and accelerated depreciation up to 33 percent on new buildings and equipment.

The association has been encouraged by the announcements of both the Secretary of the Treasury and the Commissioner of Internal Revenue that shorter, more realistic depreciable lives for basic industrial production equipment will be shortly announced. As the Treasury Department determined after careful study, however depreciation reform alone is not enough.

The investment credit is essential because of the immediate incentive it would provide. It must be remembered that credit does not enter into the computed cost of the product. Depreciation reform, while equally urgent, is of more gradual benefit.

The combination of the tax credit and effective depreciation reform will, in our opinion, go far to solve the problem of obsolescence in American industry. For this reason, we recommend enactment of the 8-percent credit as originally proposed by the House Ways and Means Committee.

The association's views with respect to other provisions of the bill are contained in its written statement which I respectfully request be entered into the record of this hearing. However, in closing I would like to say that the National Machine Tool Builders' Association is particularly opposed to section 13 relating to controlled foreign corporations. This provision not only penalizes foreign investment but also departs from our traditional policy of taxation of "realized" income only.

It appears to us, in other words, to be in contradiction of the administration policy of free world trade.

That, sir, is my statement.

(Mr. Gay's statement with respect to other provisions of H.R. 10650 follows:)

OTHER PROVISIONS OF H.R. 10650

The National Machine Tool Builders' Association has the following brief comments on other provisions of the bill:

Section 3. Appearances with respect to legislation.—We fully support the proposed legislation to permit a deduction for ordinary and necessary business expenses relating to appearances with respect to legislation.

The rule under which such expenses are disallowed by the Internal Revenue Service arose not from specific action by Congress but from court decisions and administrative regulations. The proposed legislation would, therefore, do no more than correct an inequity which has resulted from judicial action.

It is clearly desirable to encourage appearances by taxpayers and presentation of relevant information when legislation is being considered. Of particular importance is the full allowance of deductions for dues paid to trade associations which may find it necessary, on occasion, to present the views of members on legislative matters. It is only through such associations that smaller companies can effectively present their views before Congress and other legislative bodies.

Section 4. Disallowance of certain entertainment expenses.—We agree that everyone should bear his fair share of the cost of the Government. In our view, however, the proposed changes in the law relating to travel and entertainment are unnecessary and would, in practice, greatly increase the burden placed on smaller businesses upon audit of tax returns.

Subsection (a) of proposed section 274 provides that no deduction shall be allowed for any expense with respect to an activity or facility which is of a type generally considered to constitute or be maintained for entertainment, amusement, or recreation except to the extent that the expense is established by the taxpayer to be "directly related to the active conduct of the taxpayer's trade or business * * *."

To a businessman, the first question is what is the difference between the "ordinary and necessary" test of existing law and the phrase "directly related to the active conduct of the taxpayer's trade or business"? It would seem that the language of the proposed bill, taken alone, adds nothing to existing law. It appears, howeevr, from the report of the Committee on Ways and Means that this phrase is intended to require that the taxpayer show "a greater degree of proximate relation between the expenditure and his trade or business than is required under present law." It is significant to me that the words of the proposed bill and of present law were not susceptible of differentiation without further explanation.

It appears, therefore, that the House of Representatives is merely asking the revenue agent to look more closely to determine whether a given expense is, in fact, a necessary business expense. This responsibility is already assigned the agent under the present law.

To attempt to distinguish between entertainment related to the active conduct of business and entertainment ordinary and necessary to the conduct of business requires the examining agent to look either to results in terms of business realized from entertainment or to attempt to deal in "degrees of proximate relation." The former would be grossly unfair and the latter would lead to endless controversy and expense. It would seem that the hardest hit would be the smaller taxpayer who does not have adequate resources to defend his deduction.

Section 13. Controlled foreign corporations.—The association opposes the provisions of section 13 of the bill dealing with "Controlled Foreign Corporations." We urge that section 13 be stricken from the bill in its entirety.

The basic philosophy of our income tax has always been that gains will be recognized (and be subject to tax) only when realized by the taxpayer. Indeed, some commentators have indicated that a "realization" of income may be a constitutional prerequisite for income tax liability under the 16th amendment to our Constitution. The provisions of section 13 of the bill do not require any realization of income before that income is subject to tax. Exactly the opposite is true. Under section 13 an American company which owns 10 percent or more of the stock in a foreign corporation can be required to pay U.S. tax on income which it has not received, and which it may never receive.

Section 13 makes no provision for foreign losses. If a foreign subsidiary has a profitable year, U.S. tax will be imposed in respect of its earnings. If there is a loss in a later year, however, there is no way in which this loss can be applied to reduce the tax liability of the U.S. parent corporation. A company having foreign subsidiaries will thus be put at a tax disadvantage as opposed to its domestic competitors who have no foreign subsidiaries.

In addition, the American investor abroad will be placed at a competitive disadvantage with investors from other countries, who are not taxed on their retained foreign earnings.

No other major trading nation in the world penalizes its foreign investment as American foreign investment will be penalized by this bill. Great Britain has been struggling with a balance-of-payments problem for many years, but she has never attempted to impose an additional tax liability such as this on her citizens who are engaged in foreign production. Britain, in fact, gives favored tax treatment to its corporations operating abroad. We should heed the British experience.

The technical provisions of section 13 are incredibly complicated. Compliance with these provisions will require every American controlled foreign corporation to keep a separate set of books based upon American tax accounting principles; not an easy task even for a domestic corporation. Each American stockholder affected by section 13 will have to keep his records in respect of the operations of the foreign companies.

Frankly, we do not understand many of the technical provisions of section 13. Our lawyers tell us they think they understand them. We have some doubt whether anyone really understands them. One thing is certain; if the bill is passed, the provisions of section 13 are going to give thousands of tax lawyers and accountants many hours of work, and will provide courts all over the land with interesting and unusual tax cases for decision.

At the present time, when most responsible critics agree that we should strive for simplicity in our tax laws, it seems almost cynical to propose the enactment of a measure which is one of the most complex revenue provisions ever submitted to the Congress.

In conclusion, we wish to make two points. First, other countries do not place restrictions on their taxpayers similar to those contained in section 13, and there is no indication that they intend to do so.

Second, the discouragement of foreign investment through tax legislation is entirely inconsistent with the past policy of this country and with the proposed changes in tariff legislation which would encourage free movement of business between countries.

Section 14. Gain from disposition of certain depreciable property.—The capital gain treatment on disposition of depreciable property used in the trade or business has the practical advantage of offsetting, to some extent, the reluctance of business to invest in more modern equipment. Removing the capital gain treatment would, therefore, intensify the present problems resulting from inadequate investment in modern plants and equipment.

A change in the capital gain treatment on sale of depreciable property should be given serious consideration only if Congress adopts the incentive tax credit to encourage new investment and the present plans of the Treasury Department for changes in administration of the depreciation laws are fully implemented.

Section 19. Withholding of income tax on interest and dividends.—In principle, the association supports withholding on interest and dividends if this is necessary to obtain full compliance with the tax laws. It is clear that those receiving interest and dividends should pay their fair share of taxes.

On the other hand, some companies have concern as to the administrative expense which will be involved in withholding. We, therefore, urge that any system adopted be kept as simple as possible.

Section 20. Information with respect to certain foreign entities.—In our view, the present law provides for furnishing adequate information. We, therefore, recommend against adoption of this provision for additional recordkeeping and filing of information returns.

Senator CARLSON. Mr. Gay, we appreciate your statement.

Do some of the machine tool builders have foreign subsidiaries at the present time? Are they operating in foreign countries as well as domestically?

Mr. GAY. Yes, this is true. A number of the companies have wholly owned subsidiaries, some have entered licensing agreements with European companies, and some have joint ventures where they have a partial interest in a foreign company.

Senator CARLSON. I think we all share your concern about increasing not only the productive capacity of our machine tool industry in this Nation but making it profitable and to permit tax legislation that will give them modern facilities.

I was wondering what your view would be on this situation, for instance. I have a letter that just came to my desk, and I will not mention the company's name, and it does not deal with machine tools, but it is an interesting illustration. It says:

> Take my own company, for instance. Year in and year out we spent $4 million a year annually on new equipment. Part of this goes into replacing equipment and remodeling existing stores, and a large part goes into new stores. Compare us to a competitor, for perfectly good reasons, is not making similar expenditures. Why then it is equitable or desirable to give us a 7 percent credit and to withhold it from a competitor who does not make such expenditures?

What is the answer to that letter?

Mr. GAY. Well, Senator Carlson, first, I am thinking and speaking in terms of productive equipment and not capital facilities which might be applicable here in the category of stores.

Our contention is that the manufacturing facilities in this country are not modern from a technological point of view, and not competitive with such facilities abroad because of their more recent opportunity to put in late modeled equipment.

Our plants are basically still operating on the mass of machine tools that were built during World War II, and again during Korea.

We had two tremendous surges that I am sure you are aware of.

There has been a lot of technological improvement since then. The volume of industrial consumption, you might say, as Senator Proxmire brought out earlier this morning, has not been as great as many of us wished it would have been; with the end result that in the eyes of many people, and you often hear it stated there is adequate capacity but this capacity is high-cost capacity, and it is not competitive.

Now again I am speaking only for our industry, and we are a very small industry. As I pointed out, we have gone from 90,000-some people down to 76,000. Well, there are many individual corporations in this country that employ more people than that. There are many corporations who have more sales than our entire industry.

Still we are really the key to the efficiency of industrial—at least metalworking—production in this country, and it is our sincere belief that our plants are not modern, and that when our esteemed foreign competitors catch up on their delivery situation, there will be a greatly expanded importation of machine tools into this country, which will result in what we might say would be an exportation of jobs, because they are priced regularly 30 to 40 percent under us in world markets, and with the margins that are now shown in our operations, it is unlikely we can meet those prices. But we can only approach them by greatly improved efficiency in our manufacturing.

Senator CARLSON. Mr. Gay, I can assure you that the members of this committee have been well advised and informed of the importance of your industry, through a former member who served here for many years, Mr. Flanders of Vermont, who was a machine tool manufacturer in his own right.

Mr. GAY. I know him very well.

Senator CARLSON. I appreciate the importance of your industry in this work, and I appreciate your statement.

The Senator from Illinois is now here and he will take over.

Senator DOUGLAS (presiding). I have no questions, Mr. Gay. Thank you.

Mr. GAY. Thank you.

Senator DOUGLAS. The next witness is Mr. Alex Zeeve, Jr., of the Machinery Dealers' National Association.

STATEMENT OF ALEX ZEEVE, JR., PRESIDENT, MACHINERY DEALERS NATIONAL ASSOCIATION

Mr. ZEEVE. Mr. Chairman and members of the committee, please accept my sincere appreciation for the opportunity to appear before your committee today in support of the tax credit plan, as president of the Machinery Dealers National Association, representing 225 firms in approximately 25 States and 45 cities, each of whom carries an average stock of 190 used or rebuilt machines, carrying an average sale price of about $3,000 each.

Mr. name is Alex Zeeve, Jr., and I am president of Alex Zeeve & Co., Inc., of New York City.

We appear before you in behalf of the thousands of small-and-medium-sized metalworking firms who need the type of assistance provided in H.R. 10650. Our board of directors voted to support the tax credit plan because we feel it provides immediate aid to the thousands of small- and medium-size firms who cannot wait for the long-range benefits of depreciation similar to those established in the 1954 code.

It is just as important for the smaller manufacturer to "upgrade" his equipment with good modern machinery, as it is for the industrial giant to do the same by buying new equipment. No matter what is done in Bulletin F to shorten the useful life of machinery, it will not help the average buyer whose decision to buy a used machine is dictated by the fact that he simply cannot afford the cost of a new machine. His choice remains between buying a good used machine or no machine at all.

Used machines are purchased by manufacturers because of their availability for immediate use, lower original investment, speed in tooling up for a particular job, and special shortrun contracts not warranting the cost of new equipment. Many a later model machine is purchased to replace an older model machine which is referred to in the industry as upgrading. This upgrading process continues until the buyer is in a position to buy a new machine. For example, in 1960 American manufacturers purchased 88,000 used machine tools and the same year purchased only 28,000 new machines.

Sufficient research has already been conducted which proves the need for assistance in our Nation's fight against industrial obsolescence. Small business needs the type of help established in H.R. 10650 so it can upgrade its equipment to compete in domestic and foreign markets. The large firms can compete in foreign markets by establishing plants in selected countries. Obviously this is not possible for the smaller firms.

We have pleaded for equal deprecation schedules for the purchases of both new and used equipment ever since the inequities were established in the 1954 code. In this bill, H.R. 10650, for the first time, our Government has recognized this inequity and is attempting to correct it. However, we feel the provision in the bill which limits used equipment to a maximum of $50,000 in a given year is inadequate for tooling up a plant.

We realize that the Ways and Means Committee deliberated long and carefully in establishing 8 years or over of remaining useful life as a basis for receiving the full credit. However, we believe the bill would be more effective in helping to upgrade machinery if the bill specified 6 years of remaining life as the qualifying factor for full credit.

There are those who have said that H.R. 10650 provides windfalls because of its retroactive application. This, we simply cannot understand because most tax bills are retroactive to a specific date, usually the preceding January 1.

I might add, parenthetically, gentlemen, departing from the text from which I am reading, that here today I have heard numerous allusions to this windfall simply because if the bill is enacted it will affect purchases that have been, qualifying purchases that have been, made back to January 1 of this year.

My own feeling is that if I were the comptroller of any manufacturing company in this country today I would be more inclined to hold off on purchasing if I knew that the effective date of some pending tax legislation was some date in the future than I would be if I knew that the date was going to be retroactive.

In other words, for example, gentlemen, if this bill were passed with an effective date of January 1, 1963, and I were a corporation treasurer or comptroller about to make some purchases of new equipment for my company, I am quite certain that some purchases that I might normally make in the fall of 1962 and in through November and December of 1962, I would be very well advised not to make them but hold them over until the effective date of the law.

In other words, basically, I feel that there is more windfall, there are more windfall possibilities, if the date is not retroactive than if it is retroactive.

We have discussed H.R. 10650 with businessmen from most sections of the country and are pleased to report their general acceptance of the provisions of the bill. They also believe the applicable percentage should be 8 percent as recommended by Secretary Dillon.

In summary, we respectfully ask your committee to support and act favorably on H.R. 10650 because:

1. It will provide an immediate tax credit for small and medium sized metalworking manufacturers who need to upgrade their machinery now.
2. It will help them to compete in domestic and foreign markets.
3. It will help improve our economic stability so urgently needed in this fast-changing world.

That completes my statement, gentlemen.

Senator DOUGLAS. Any questions?

There is one question I would like to ask on a matter of used machinery.

Mr. ZEEVE. Yes, sir.

Senator DOUGLAS. It was touched on yesterday. If there any danger that the sum of the depreciation charges that have been taken by the original owner of the machine, plus the sales price which he received from the sale of the machine, and the capital loss on the sales price which will be credited to import tax purposes, is there any possibility this will exceed 100 percent of the charges?

Mr. ZEEVE. I do not think it can, sir, because the worst that can happen to any used machine, whenever it is put up for sale, will be that it would literally be scrapped, in which case the return would be nil, negligible, in any case and, as I understand it, H.R. 10650 does provide, as presently written, that any gain that any seller of a used machine has made over what his book value is as of that time, would be subject to normal taxation rather than to capital gains as heretofore.

Senator DOUGLAS. Well, suppose there is a capital loss on the sale of the machine. He buys it for $10,000 and he has taken, let us say, $9,000 in depreciation charges, and he sells it for $3,000.

Do you believe that he should charge off the $7,000 of loss on the sale of the machine? Would that be credited to him as a capital loss?

Mr. ZEEVE. If I am not mistaken, sir, there is existing legislation covering it which this bill does not encompass, which says that in a case like that if he literally scraps the machine——

Senator DOUGLAS. He sells it.

Mr. ZEEVE. He sells it, he does not scrap it?

Senator DOUGLAS. Yes.

Mr. ZEEVE. I am afraid, sir, that I do not know the answer, although I am sure that the Treasury Department must know how such a matter would be dealt with.

Senator DOUGLAS. What is the answer?

Mr. STAM. $2,000 capital gains under present law?

Senator DOUGLAS. Under this bill.

Mr. STAM. Under this bill the gain would be ordinary.

Senator DOUGLAS. Would you submit a statement on this matter to be printed at the conclusion of this testimony. (See next page.)

Mr. STAM. Yes.

Mr. ZEEVE. If I might make one further observation, Senator Douglas, the very nature of the type of machinery we are dealing in, in which our predecessors here at this table, also the builders of new machine tools, would also apply; the very nature of this capital equipment is such that we hardly feel there is any possibility of people actually going out and buying this type of equipment in order to make speculative profits under any change that might be made in the law.

In other words, in everyday language nobody goes out and buys a boring mill or a lathe with the hope of trying to make a speculative profit such as he might in some other commodity. You either buy a machine tool to use it or you do not use it at all.

Senator DOUGLAS. The question I was raising was whether you could make a speculative profit by getting credit for a loss, that was the point, by the seller.

Let me ask another question.

Mr. ZEEVE. Yes, sir.

Senator DOUGLAS. Suppose the machine tool originally cost $10,000, the original owner, under accelerated depreciation charges off $9,000, sells the machine for $5,000.

Will the second purchaser be able to take depreciation charges beginning with the $5,000 that he paid, so that the total of the depreciation charges would be $14,000 rather than $10,000, the original cost of the tool?

Mr. ZEEVE. If I follow you, Senator Douglas, the first owner of the machine paid $10,000, he has written $9,000 of that off, so that at the time he sells it to the second buyer he has only $1,000 of book value left in it?

Senator DOUGLAS. That is correct. He sells it for $5,000.

Mr. ZEEVE. He sells it for $5,000, he has made a $4,000 profit over his then book value, which would be subject under 10650——

Senator DOUGLAS. It is the second man I was speaking about.

Mr. ZEEVE. Yes. The second man would then pick this machine up at what he paid for it, which was $5,000, that is what he paid for it, so he has to pick that up on his books at $5,000.

But the Government will have collected ordinary income tax on the $4,000 profit that the first owner had cleared on the item.

Senator DOUGLAS. Capital gains tax?

Mr. ZEEVE. No, at a normal tax, not a capital gains. That feature was put in by the Ways and Means Committee in order to do away with speculative things such as that.

In other words, any profits that a firm made over their existing book value would no longer be subject to capital gains tax but would be subject to normal income tax, as we understand the bill.

Senator DOUGLAS. Is that correct?

Mr. ZEEVE. That is right.

Mr. STAM. That is ordinary income tax.

Senator DOUGLAS. Thank you, I have no further questions.

Thank you very much.

Mr. ZEEVE. Thank you very much, Senator.

(The statement by the staff previously referred to follows:)

Assuming a taxpayer buys a machine, to be used in his business, for $10,000, holds it for several years during which deductions for depreciation aggregated $9,000, and he then sells the machine for $3,000.

Section 1001 of the Internal Revenue Code says: "The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis * * *."

Section 1016 says: "Proper adjustment in respect of the property shall in all cases be made * * * in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization and depletion, to the extent of the amount allowed as deductions in computing taxable income * * * but not less than the amount allowable * * *."

Thus, under present law, the adjusted basis of the machine at the time of sale would be $10,000 less $9,000, or $1,000. The difference between the $3,000 sale price and this $1,000 is a gain of $2,000 to be included in gross income.

Under section 1231 of present law such a gain would (unless offset by similar losses) be taxed as a capital gain. Under section 14 of this bill, however, this gain, since it is not more than the depreciation previously deducted, would be taxed as ordinary income.

Senator DOUGLAS. The next witness is James K. Polk of Whitman, Ransom & Coulson.

You have a very historic name in American history, Mr. Polk. Do you happen to be a descendant of the former President Polk?

Mr. POLK. I do not mean to be disrespectful, but the President had no children, so I go to a common ancestor. I am collaterally related.

Senator DOUGLAS. I notice you are with the firm of Whitman, Ransom & Coulson. Was Judge William L. Ransom an original member of your firm?

Mr. POLK. Yes; and Governor Whitman.

Senator DOUGLAS. Charles S. Whitman?

Mr. POLK. Yes.

Senator DOUGLAS. A very distinguished law firm. We are very glad to have you here.

STATEMENT OF JAMES K. POLK, ATTORNEY AT LAW

Mr. POLK. Thank you.

I have been chairman of the Depreciation Committee of the Section on Taxation of the American Bar Association, and I am special adviser to that committee now, and I have been a member of the Taxation Accounting Committees of the American Gas Association and the Edison Electric Institute.

I helped write Treasury Decision 4422, Bulletin F, at that time.

I make these statements merely to show my exposure and experience in this field of depreciation. I am not speaking for any of these organizations, but appear for myself.

The remarks which I will make will be confined to the failure of the present bill to make a proper exception from the provisions of section 1245 for dispositions of property as normal retirements by taxpayers computing depreciation deductions under section 167, under composite group or multiple asset proceedings.

This is an extremely important matter. It affects accounting, reporting, methods of computing income to a far greater degree than appears from a casual inspection.

Now, section 1245, in my own belief is a very sound section that prevents the conversion or is intended to prevent the conversion into capital gains of things which are otherwise ordinary income items.

The report of the Committee on Ways and Means points out that depreciation deductions under the Internal Revenue Code are allowed against ordinary income. It is then observed that if the depreciation deductions thus taken were excessive they reduced the basis of the property faster than its decline in value, so that when the property is sold there is a gain which, under present law—and they are talking about section 1231 of the 1954 code—which under present law would be taxed as a capital gain.

The Ways and Means Committee report observes that the taxpayer who has thus taken excessive depreciation reductions, and then sells an asset has, in effect, converted ordinary income into capital gains.

To cure this loophole, section 1245 of H.R. 10650 is stated by the House Ways and Means Committee to have been adopted, and the only reason given for its adoption is to insure that there be treated as ordinary income to the extent of previous depreciation deductions taken any gain on the sale or other disposition of depreciable property.

Now, the bill in section 1245(b) enumerates certain exceptions to its application, including dispositions by gifts, transfers at death, transactions which are tax free, because the basis is carried over, involuntary conversions, treatments in the cases of partnerships, and so forth.

These exceptions are all sound within the complete philosophy of the section itself, since there are no tax loopholes to be plugged in these cases. There are no conversions of ordinary income into capital gains involved.

The bill, however, is defective when it fails to exclude from its reach normal retirements in the case of taxpayers employing multiple asset, composite, or group depreciation methods.

Now, a normal retirement is defined in the Internal Revenue Code regulations as a retirement for any cause taken into consideration at the time of acquisition in estimating its life expectancy.

Any retirement other than a normal retirement, for instance, a condemnation of a piece of property, which could not be foreseen at the time of acquisition, the gain on that is presently recognized, first, and then subjected to capital gains limitations under section 1231 if it is a depreciable asset. This section 1245 cures and eliminates the capital gains treatment.

But in the case of normal retirements from multiple asset, group, or composite depreciation accounts, both the costs and the proceeds on retirement are carried to the depreciation reserve. No gain and no loss is recognized in any event upon a normal retirement.

The Internal Revenue regulations in this regard resort to a sort of fiction in order to reach that result. They state that when you adopt—and they require that you adopt this composite or group accounting where you have multiple assets—that when you adopt that type of accounting the adjusted basis of an asset so included is the originally estimated salvage value.

Now, that sounds a little strange, but it works out all right, because what it does is to say that if you dispose of the asset no gain or loss is going to be recognized; you have this low adjusted basis, the salvage value.

However, if the disposition is above or below this adjusted basis, this salvage value, then there is a factor not covered by this multiple asset, composite depreciation philosophy. So they take care of that in the regulations.

They say that the variation between the amount received upon the disposition of an asset, this adjusted basis or the salvage value, in fact, that that differential must be either reported over a new period starting at the time of disposition and running for the average life of that kind of property, or if the taxpayer so maintains his books and records consistently, it may be credited to the reserve for depreciation.

This works out a proper answer, too, because you compute the depreciation by taking the original cost of all your assets in the group, deducting the depreciation reserve accumulated up to that point, taking the undepreciated balance then remaining, and recovering that over the remaining life of the surviving properties.

That lets you recover your entire cost once, just your cost, all at ordinary income rates. There is no conversion at any point under this scheme to a capital gains limitation on a normal retirement.

Now, that method of accounting has been adopted by the great majority of corporations having multiple asset investments. I know that the utilities all use it.

Consolidated Edison, one of my clients, has individual cards punched for 13 million of these units of retirement, 13 million separate items of property.

Now, it shows location, it shows date of acquisition, it will show the date of discardation. Those cards form the control of the book entries charging or debiting fixed capital upon acquisition, crediting fixed capital for the proper amount when that proper pole or overhead transformer is retired.

At the same time, the depreciation reserve is charged for the whole original cost of the asset; and then you come to the question of what you do with the salvage, and what is the salvage.

If Senator Byrd were here I could put this in terms of his apple orchards. He has hundreds of thousands of trees. He knows the cost, perhaps, of every tree. If they were depreciable he could compute annual depreciation on the entire number of trees.

When the time comes to retire a tree he can take the cost out of his fixed capital, he can charge it to his reserve, but he piles the pieces of trees that are cut down in a pile, sooner or later he sells them, but he does not keep any record, nor does anybody else keep a record, of what you get for each individual tree.

You do not know. You sell them to a junkman. He comes and buys. All of that salvage, however, is taken to the reserve for depreciation and since it increases the reserve for depreciation, it is a debit to cash and a credit to the reserve for depreciation; it diminishes the undepreciated balance which you are going to amortize and depreciate over future years.

Senator DOUGLAS. And suppose you had already taken that?

Mr. POLK. Well, let us put it this way, sir: Suppose you start with $100, by way of an illustration. You have an asset that costs you $100. You debit fixed capital $100. You figure you are going to receive a $10 salvage out of it. Over the years, if everything works out exactly in accordance with your forecast, you will, with a 10-year life, take $9 a year as your annual depreciation as a deduction from income, ordinary income, and you will credit a reserve for depreciation $9 a year. At the end of your 10th year you have accumulated $90 in your reserve for depreciation. At that point you discard the asset, and get for it—we will come back to what you get for it in a minute.

You discard the asset. When you discard the asset you will credit your fixed capital $100 to wipe it out, it is gone, and you will debit your reserve $100, you having provided a reserve by these annual charges over the life, the service life, of the asset.

Now, if you got your precise $10 salvage, you will debit cash, and credit the reserve, and everything comes out even.

If, however, you got $12 or $8, your reserve will not match at that point. It will be $2 out, over or above. However, you are going to deduct that reserve from your remaining assets for your next computation and, therefore, it washes itself out.

Now, this is a system of depreciation accounting which has been approved by the Commissioner of Internal Revenue as accurately reflecting income for 30 years, 40 years. Consolidated Edison has a specific approval that it accurately reflects income.

Senator DOUGLAS. Mr. Polk, may I ask a question?

Mr. POLK. Certainly.

Senator DOUGLAS. Take the average manufacturer. Will he deduct from the original capital value of the machine the expected salvage value which he would realize from his sale as scrap?

Mr. POLK. The regulations require that he should do that, that the amount that is recoverable through depreciation is the original cost, less the salvage.

Senator DOUGLAS. How will he know in advance what the salvage value will be?

Mr. POLK. That has been one of the——

Senator DOUGLAS. In 10 years, 20 years, 25 years in advance, how can he tell?

Mr. POLK. It is extremely difficult, sir, to tell. But you make your estimates, and you continually vary them as you go along, based upon studies.

You run your studies about every 5 years, and you correct your salvage adjustment. But with this composite depreciation accounting, salvage variations flow over into the reserve for depreciation, and this automatically and completely insures that you recover, as ordinary income deductions in the computation of taxable income, the precise net retirement loss; that is, the precise difference between original cost and the final amount of salvage actually realized.

Now, the trouble with section 1245 is that it steps in and attempts to make you compute a gain—only a gain now, no loss—a gain on the disposition of each asset.

First, you cannot do it. But even if you could do it, you would present the taxpayer with an entirely untenable position. He cannot possibly live under section 1245 and section 167 at the same time.

Senator DOUGLAS. Do you have this copy of the bill as it passed?

Mr. POLK. I think I have, sir.

Senator DOUGLAS. H.R. 10650?

Mr. POLK. Yes, sir.

Senator DOUGLAS. What page in that bill do you refer to?

Mr. POLK. I am sorry, I happen to have the CCH bill.

Mr. STAM. 137.

Senator DOUGLAS. A member of the staff suggests that it is 137.

Mr. POLK. Yes. It is marked as section 14. It begins on 137, sir. It goes over to 138.

Senator DOUGLAS. Specify the particular that you are dealing with.

Mr. POLK. Well, the language is in (a)(1) where it says that the gain computed in that rather complicated manner, it is set out as the excess of the lower of (A)(B) over the adjusted basis; that that again shall be subject to ordinary income tax rates.

Then, over at page 142 it says that "this section shall apply notwithstanding any other provision of this subtitle." That makes it override section 167 which is the general depreciation section. I do not know what it does to the regulations under section 167. I do not know whether they can survive if they are written in respect of a section that is overridden by section 1245.

But I have assumed that they did survive. If they do not survive then you are taxing as gain the premature retirements without allowing the losses.

Let me explain. In composite or group depreciation, we estimate the average life of the assets in each group. Such average life may be, say, 20 years. With property having an average life of 20 years, some units will go out of service at the end of 1 year, and some will last 39 years. That is how you get the 20.

Now, as to the unit that goes out at the end of 1 year, you have been using a 5-percent rate because 20 years gives a 5-percent rate. And when it goes out at the end of the first year, you get no loss under composite depreciation.

If the unit goes out in the 30th year, you do not compute any gain although you may have had, if you could regard each unit as carrying with it some kind of an individual depreciation reserve, you have had 150 percent depreciation on that unit, there is no gain.

The gains and losses offset each other, and the pot, as a whole, is what you are depreciating and recovering, and you will do it just precisely and exactly if you apply the rate of 5 percent to every asset for every year of its service life. That is composite depreciation.

Senator DOUGLAS. What is your criticism of this language?

Mr. POLK. That is under 167.

When I get over here to 1245 it says I have to compute a gain on every disposition of an asset. That I should not do. If it is a normal retirement, no calculation of gain or less should be made. The Government is not being deprived of revenue by this proposal.

The reason for enacting such section 1245 was to prevent the conversion of ordinary income into capital gains, which is specifically recited as the basis for the exclusions under 1245(b).

Those transactions, gifts, transfers at death, and so forth and so on, do not have in them the possibility of converting ordinary income into capital gain and, therefore, those transactions are excluded from 1245.

Senator DOUGLAS. Is it your contention that you should not compute gain and loss on individual machines but simply for the group as a whole?

Mr. POLK. You should not compute gain or loss where you have composite depreciation methods employed.

I have suggested language which would be this, that this be amended by adding——

Senator DOUGLAS. What page is this, now?

Mr. POLK. On top of page 140 they have exceptions and limitations, (b), and they list a number of things: gifts, transfers at death, tax-free transactions, involuntary conversions, and so forth.

To that subsection that there be added a new subsection (7), and I would suggest that that read somewhat as follows:

> Subsection (a) shall not apply to gain from normal retirements in the case of a taxpayer who uses composite or group accounts for computing depreciation under section 167 and who has consistently followed the practice of charging the reserve with the full cost or other basis of normal retirements and of crediting it with all receipts from salvage.

That is the end of my quote. That is precisely what the regulations under 167 now provide. That is precisely what is done at the present time, and I say that section 1245, since there is no conversion, should adopt the same rule as to a normal retirement.

Senator DOUGLAS. In the illustration which you used, you described an apple tree which, ceasing to bear, has been cut down, and I suppose in Biblical language, will be cast into the fire.

Mr. POLK. No; we will sell the wood, apple wood for hammar handles or something.

Senator DOUGLAS. Firewood or whatever may happen. [Laughter.]

But now suppose the machine is not scrapped for its value as steel but is sold to be reused by another company, and that is what the previous witness was talking about, I think. What would you do in that case, when it was sold for a machine?

Mr. POLK. The amount received—sure.

Senator DOUGLAS. It will be sold for more than what its value as scrap would be.

Mr. POLK. That is right. That happens. It happens in the public utility industry when somebody hits a pole, knocks it down and has to pay for it, the utility may receive a great deal more than the depreciated cost. That amount is treated as salvage, and it goes into the reserve as a salvage receipt. But it just balances another one where you did not get anything because the pole rotted and fell on the ground. The salvage is averaged, just as everything else is averaged, under this method of accounting.

Senator DOUGLAS. This raises a question then in your composite figures as to the ultimate salvage value. Do you treat this as mere scrap or do you treat it as the average price which you get for used machines?

Mr. POLK. We actually determine the average ratio or percentage of original cost which is recovered in these operations, whatever form they may take, these dispositions, these salvage disposals.

If the salvage disposals in dollars compared with original costs run a constant 3 or 5 percent, that is the figure that we use, and that is how we get at it.

We do not care what the recipient who pays us the money does with the machinery. Most of the machinery that we sell is not in usable condition.

Senator DOUGLAS. I can understand that in the case of a utility. But in the case of a machine shop which uses lathes and so forth, boring machines——

Mr. POLK. Under this section——

Senator DOUGLAS. That is different.

Mr. POLK. 1245, as now written, if I could answer the question you addressed to the previous witness, under section 1245 as now written, the man who make the casual sale of a machine does not have a multitude of these machines that he is turning over, previously would have claimed a capital gain limitation on it.

Under section 1245 he cannot claim a capital gain limitation. It will be ordinary income, and under——

Senator DOUGLAS. You are speaking of present law?

Mr. POLK. Under this section.

Senator DOUGLAS. Of the bill?

Mr. POLK. Yes.

Senator DOUGLAS. Yes.

Mr. POLK. Under the bill we could not claim the capital gains even with the amendment I have suggested, because it would not be a normal retirement.

Normal retirements are defined in the code, in the regulations, as retirements for causes contemplated in estimating average life out of a mass account, an account having hundreds of items or thousands of items.

You do not use item depreciation in mass accounting. You use this composite method. That is a technique of accounting which has been developed, which has been established as properly reflecting income, and the bill as it now stands, without the amendment which I have suggested, would make it inoperable.

Senator DOUGLAS. What types of industires aside from the utilities use this composite retirement system of mass accounting as contrasted to individual items?

Mr. POLK. I think that any organization that has investment in mass properties, it could be the United States Steel Corp., it could be any company that had many, many units.

I have some clients that are not in the untility business that do use composite depreciation, so I know it is used outside of the utility and the railroad industries.

The principal point I would make here is that the Commissioner's regulations under section 167, simply say that if you have this type of investment you must use this kind of a depreciation calculation.

Then if you adopted the bill provisions without amendment you would make it just plain impossible to live with.

Senator DOUGLAS. Are you saying that the language in the bill before us would prevent these mass accounts, composite charges, and that you would have to treat each individual piece of equipment as an isolated affair?

Mr. POLK. Yes, sir; because, if I must pay a tax on a gain, I am going to have to be allowed my losses.

If whenever my proceeds of disposition exceed the basis, and I must pay a tax on it, then I must be allowed a loss if the proceeds of disposition do not make me whole.

If I am not allowed the losses and have to pay the gains, I cannot live with that kind of a system. I will have to go to item depreciation, which is a fantastic burden upon business.

Senator DOUGLAS. Is there a representative of the Commissioner of Internal Revenue here in the hearing room?

There is a disadvantage in dealing with this subject and not having——

Mr. POLK. I have had an opportunity to discuss this briefly, but I think sufficiently, with Mr. Stam and the members of his staff, and I am sure they understand it, and I think once it is understood that it will be realized that this is just an inadvertent omission from the bill as it was passed and one that must be corrected. I certainly hope so.

Senator CARLSON. Mr. Chairman, right on that point, this is a very complicated section. I have here the summary of the revenue bill of 1962, a statement prepared by the Joint Committee on Revenue and Internal Taxation, and I read from it dealing with section 14, now, on page 6:

> The bill also provides that in computing the basis on which depreciation may be taken, salvage value may be ignored up to the amount equal to 10 percent of the cost or other basis of the property.

Is that helpful in this case?

Mr. POLK. I do not see how. It says that you may ignore the salvage and depreciate on a 100 percent of your cost, and ultimately pull into income whatever salvage you get. It is a helpful thing at times. But whether I ignore salvage or not, if I take depreciation for 2 years on a 10-year life property, I would take 20 percent instead of, if it had a salvage value of 10 percent, of maybe 18 percent in my depreciation; then if the asset is sold at a figure over or under my adjusted basis, I would have to have gain or loss. If it is gain, the proposed section 1245 says it is taxed. If it is a loss, section 167 says I cannot have it. They just have to be brought together.

Senator CARLSON. That is all.

Senator DOUGLAS. The members of the staff inform me that they think you have something. They would like to work with you on language, and they are not necessarily certain that your language is correct.

For the sake of the average person I would like to see this worked out in an arithmetical example so that we can see what the precise testimony is.

Mr. POLK. I would be happy to make myself available at any time at their convenience.

Senator DOUGLAS. Thank you very much.

(The following letter dated March 21, 1962, gives Mr. Polk's views on sec. 14 of the bill:)

WHITMAN, RANSOM & COULSON,
New York, N.Y., March 21, 1962.

Re section 14, revenue bill of 1962, entitled "Gain From Dispositions of Certain Depreciation Property."

HON. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

MY DEAR SENATOR BYRD: The proposed Revenue Act of 1962, H.R. 10650, in section 14, provides for a new section 1245, which would tax as ordinary income gain from the disposition of certain depreciable property. This letter is written to urge that the provisions of the House bill be amended to include a further exception, the omission of which I am certain was an oversight, and which is of extreme importance in order to avoid costly changes in accounting methods by taxpayers who, for depreciation accouning, use so-called composite or group accounts. For the most part, this group of taxpayers consists of those businesses which have tremendous numbers of depreciable properties.

Section (a) of the proposed new section 1245 states the general rule as follows:

"(a) GENERAL RULE.—

"(1) ORDINARY INCOME.—Except as otherwise provided in this section, if section 1245 property is *disposed* of after the date of the enactment of the Revenue Act of 1962, the amount by which the lower of—

"(A) the recomputed basis of the property, or

"(B)(i) in the case of a sale, exchange, or involuntary conversion, the amount realized, or

"(ii) in the case of any other disposition, the fair market value of such property,

exceeds the adjusted basis of such property shall be treated as gain from the sale or exchange of property * * *" [Italic supplied.]

This provision is explained in general terms in House Report No. 1447, at page 66, as follows:

"Under present law, in the case of depreciable property the taxpayer may write off the cost or other basis of the property over the period of the useful life of the asset in his hands. This cost or other basis can be written off evenly (or in a 'straight line' over the asset's life), under the declining balance method, under the sum-of-the-year's digits method, or under any other consistent method which does not during the first two-thirds of the useful life of the property exceed the allowances which would have been allowed under the declining balance method. This depreciation deduction is a deduction against ordinary income. If either the useful life of the asset is too short, or the particular method of depreciation allows too much depreciation in the early years, the decline in value of the asset resulting from these depreciation deductions may exceed the actual decline of the value of the asset. Wherever the depreciation deductions reduce the basis of the property faster than the actual decline in its value, then when it is sold there will be a gain. Under present law this gain is taxed as a capital gain, even though the depreciation deductions reduced ordinary income. The taxpayer who has taken excessive depreciation deductions and then sells an asset, therefore, has in effect converted ordinary income into a capital gain.

* * * * * * *

"Your committee's bill, as recommended, in general treats as ordinary income any gain on the sale or other disposition of certain depreciable property to the extent of the depreciation deductions taken."

Except as specifically provided in the bill, the ordinary income treatment applies any time property is disposed of. Recognizing, however, that in ordinary business practices, there are dispositions which should not give rise to ordinary income tax treatment, the bill provides six general categories of exceptions to the general rule. The first exception is for gifts. The second exception is provided for transfers at death. The third category of exceptions is provided in the case of a series of transactions which generally are tax-free and in which the basis is carried over. A fourth category of exceptions is provided in the case of so-called like-kind exchanges of property used for production or investment, and for involuntary conversions. Another exception is provided in the case of the sale or exchange of property in obedience to Federal Communications Commission orders or orders of the Securities and Exchange Commission. Special rules are also provided in the case of distributions of depreciable personal property by a partnership to a partner.

Thus, it will be seen from the foregoing that there is a clear intent not to impose a tax on a disposition where no gain or loss is recognized. Consequently, it appears clear that the omission of an exception for dispositions from composite or group accounts was not based on considered policy, but was an oversight which arose from a failure to comprehend the full accounting significance of composite or group depreciation accounts.

The philosophy of the House bill appears directed at the usual layman's concept of item depreciation accounting; and it wholly misses and makes no provision for depreciation accounting on the basis of group or composite accounts, which are recognized and provided for by the regulations, and have been so recognized and provided for by predecessor regulations and Revenue Service practice since 1918. To make this clear, it is necessary to refer briefly to the provisions of existing regulations.

Regulations section 1.167 (a)–8(a) entitled "Gains or Losses on Retirements" provides as follows:

"For the purposes of this section the term 'retirement' means the permanent withdrawal of depreciable property from use in the trade or business or in the production of income. * * * The tax consequences of a retirement depend upon the form of the transaction, the reason therefor, the timing of the retirement, the estimated useful life used in computing depreciation, *and whether the asset is accounted for in a separate or multiple asset account*." [Emphasis supplied.]

In general, under provisions of regulations 1.167(a)–8(a), where an asset is retired by sale at arm's length, recognition of gain is subject to the provisions of sections 1002 and 1231 and other applicable provisions of law. Regulations 1.167(a)–8(c), relating to basis of assets retired, then provides that in the case of a normal retirement of an asset from a multiple asset account where the depreciation rate is based on average expected useful life, the term "adjusted basis" means the salvage value estimated in determining the depreciation deduction in accordance with the provisions of section 167. The manner in which this latter provision would apply in relation to proposed section 1245 is not clear. Presumably it would be necessary for purposes of section 1245, to compute gain or loss on every disposition and therefore to determine allowable depreciation for the particular asset to the date of disposition in every instance.

To the foregoing rules, there is an exception in regulations 1.167(a)–8(e) (2), reading as follows:

"(2) Where multiple asset accounts are used and acquisitions and retirements are numerous, if a taxpayer, in order to avoid unnecessarily detailed accounting for individual retirements, consistently follows the practice of charging the reserve with the full cost or other basis of assets retired and of crediting it with all receipts from salvage, the practice may be continued so long as, in the opinion of the Commissioner, it clearly reflects income. Conversely, where the taxpayer customarily follows a practice of reporting all receipts from salvage as ordinary taxable income such practice may be continued so long as, in the opinion of the Commissioner, it clearly reflects income."

A good many companies, including the Consolidated Edison Co. of New York, Inc., account for asset retirements under this last-quoted provision. Where a company so accounts, no gain or loss is recognized upon a sale or other disposition which is regarded as a normal retirement. Only in the case of so-called abnormal retirements is gain or loss recognized.

Of prime importance, it should be noted that under composite or group accounting for deprecation, the proceeds of a sale in the case of a *normal* retirement are carried to the depreciation reserve, and no gain or loss is taken into account. This means that the proceeds of sale become a function of the determination of annual income and consequently *are subjected to normal tax rates*. There is no conversion in the case of a normal retirement of ordinary income into capital gains limitations. There is no reason, therefore, why section 1245 should be applied to normal retirements in the case of taxpayers employing group or composite depreciation methods.

The underlying philosophy of group depreciation is not that each component unit accumulates a reserve which attaches to that unit; but that each unit of property is a computing factor in the maintenance of a depreciation reserve which relates to the aggregate of the units in each group classification. If the average expected life of property in a group is 20 years, it is actuarially probable that some units will be "disposed of" within 1 year and that some units will last 39 years. The recoupment of the investment in all assets in the group is precisely assured if no gain or loss is recognized on the disposition or retirement of an asset before it achieves average life expectancy for the group, and if depreciation is allowed in respect of all survivors until their disposition or retirement. All retirements for causes contemplated in estimating the average service life are designated "normal" retirements in the accounting terminology recognized in this composite or group depreciation area and specifically adopted in internal revenue regulation.

Any disposition of a unit of property in a composite or group account for causes *not* contemplated in estimating the average service life of the classification of assets is designated an "*abnormal*" retirement. As above stated, in the case of a taxpayer who consistently follows the practice of charging the reserve with the full cost of assets retired, *no* gain or loss is recognized on a "*normal*" retirement; but gain or loss *is* recognized and taxed on an "*abnormal*" retirement.

As noted above, the reason expressed by the Ways and Means Committee and stated in the President's message for the enactment of section 1245 is inapplicable to normal retirements under group or composite depreciation accounting, since there is, in fact, no conversion or ordinary income deductions into capital gains benefits in respect of such normal retirements. Further, the application of the section 1245 language to normal retirements would work such a distortion in taxable income that it would require the abandonment of composite depreciation accounting by many taxpayers. In every instance in which a retirement occurs after attaining average age (after sec. 1245 provisions become fully applicable), apparently the entire salvage or selling price would be treated as ordinary income. Moreover, unless "losses" on disposals of assets occurring *before* their attainment of average age were allowed, which would be improper in composite or group depreciation accounting, the taxpayer would be precluded under such a system from recouping costs.

The composite or group method of accounting is the only practical method of maintaining depreciation records in modern business conduct of an enterprise having any major magnitude. All utilities coming under regulation by Federal or State public regulatory commissions have mass properties involving, in many instances, for one taxpayer more than 10 million property units subject to depreciation. Modern machine accounting is universally adopted. Item accounting is explained in text books but is only the starting point in teaching the development of the accounting techniques of the composite and group depreciation accounting methods which are employed in going businesses. I believe that it is essential that a practical taxing statute be geared to the generally employed modes of business conduct, of accounting, and of the record techniques employed in actual business practice.

The bill as presently drafted fails to make an exception for the tax treatment of depreciable property where the allowances under section 167 have been based upon composite or group depreciation accounting, and gain or loss is not recognized upon disposition. As stated above, section 1245 would apparently require a computation of gain on dispositions which were normal retirements and thus be violative of the entire philosophy and concept of composite and group depreciation accounting, and if adopted in this form, would probably result in forcing many companies to forego composite or group accounting in the future.

It is therefore suggested that paragraph (b) of proposed new section 1245, "Exceptions and Limitations," be amended to incorporate a specific exception for retirements from a composite or group account in any case where, under the provisions of regulation section 1.167(a)-8 the taxpayer does not have recognized gain or loss as a result of the retirement.

The suggested amendment may be effected by adding a new paragraph No. (7) to section 1245(b), to read as follows:

"(7) Subsection (a) shall not apply to gain from normal retirements in the case of a taxpayer who uses composite or group accounts for computing depreciation under section 167, and who has consistently followed the practice of charging the reserve with the full cost or other basis of normal retirements, and of crediting it with all receipts from salvage."

It is also respectfully suggested that similar amendments be made in sections 47 and 48 to accord property depreciated under group or composite depreciation methods a proper tax treatment. Since the depreciation allowance is in respect of the group investment and not of the individual items composing the group, the life prerequisite for qualification should be the life of the group and any recapture provisions would appear to be inapplicable upon the retirement of a constituent item out of a group account.

I respectfully request an opportunity to appear before your committee, in order to answer any questions and to further clarify for the committee my views on this matter. A formal request to be heard has been made to Mrs. Elizabeth B. Springer, clerk of the Senate Finance Committee, and I have been advised that I will be on the agenda. It is requested that this letter be made a part of the record.

Very truly yours,

JAMES K. POLK.

Senator DOUGLAS. I think this concludes the witnesses for this afternoon. I want to thank you, Senator Carlson.

We will meet at 10 o'clock Monday morning.

(By direction of the chairman, the following is made a part of the record:)

HARNISCHFEGER,
Milwaukee, Wis., April 5, 1962.

Hon. HARRY FLOOD BYRD,
Senate Office Building,
Washington, D.C.

DEAR SENATOR BYRD: I have just returned from an extended business trip abroad and have completed a review of the proposed Revenue Act of 1962, H.R. 10650, on which your committee is now holding hearings.

This to me is one of the most preposterous pieces of tax legislation I have ever seen. This bill is fraught with complexities and will take an army of Government personnel to administer. There are many serious objections to the bill. I will just summarize a few:

1. The investment credit should be replaced by substantially more realistic depreciation allowances. The administration of the investment credit proposals will require a volume of regulations and bureaucratic control. We do not ask for any subsidies, which is all the investment credit is, but we do insist on adequate depreciation allowances based on realistic business considerations.

2. The proposals for the so-called tightening of travel and entertainment expenses certainly are not based on business facts of life. Vigorous enforcement of existing provisions will accomplish the objective and avoid penalizing all business taxpayers for the abuses of a relative few.

3. While the section relating to deductions for legislative activity is a slight improvement over what we now have, it is neither an adequate nor a proper solution to the problem of legislative activity deductions.

4. By far, the worst proposals in the entire bill are the sections devoted to the taxation of foreign-source income. I understand that early in March you received a copy of a telegram which we sent to a number of Members of the House, stating our objections to these proposals.

To this I want to add that it seems unbelievable that after spending billions of dollars in foreign aid, which helped substantially to build up our foreign competitors, it is now proposed that we tax American business out of the foreign markets in favor of our foreign competitors. It certainly is inconsistent that the administration is espousing free trade under the current Trade Expansion Act proposal on one hand, and restrict free trade by American business in the foreign markets by punitive tax laws by our own Government.

I do not oppose the principle of free trade, but I am concerned how a more free trade program will be administered by the present administration, especially in view of the current foreign tax proposals.

Perhaps one of the greatest dangers in the current tax proposals is the wide latitude given the administration to enforce these proposals through regulations and administrative actions.

It is my understanding that the administration is planning to introduce a comprehensive tax revision program later this year. Therefore, it seems even more imperative that H.R. 10650 should be killed in the Senate and these matters considered, along with the tax revision proposals to be submitted later in the year.

I appreciate your efforts to keep the Federal payroll down. This bill will most certainly create the need for a substantial increase in the payroll of the Treasury Department.

I have just received your statement entitled, "Crisis" in the spotlight issue No. L-523. I extend my congratulations for the sound position you have taken. Never in the history of this country have there been so many unsound bills which can only lead to the liquidation of our country.

In this connection, I am sending a copy of a testimony by Dr. Elgin Groseclose, who is a member of the Citizens Foreign Aid Committee, where I have devoted considerable time and effort. It is another case where our Government is undermining the soundness of our fiscal position.

I know we can count on you to take what measures you can to keep our Federal expenditures to a minimum and to oppose legislation detrimental to free American enterprise.

I hope everything is well with you. Best wishes.

Sincerely yours,

WALTER HARNISCHFEGER,
Chairman of the Board.

N. W. PUGH CO. INC.,
Roanoke, Va., April 6, 1962.

Hon. HARRY F. BYRD,
U.S. Senate,
Washington, D.C.

DEAR SIR: We respectfully urge that you reexamine the position you have reportedly taken on H.R. 10650 (Revenue Act of 1962).

We feel that the income tax credit on purchases of machines, tools, etc., is not a subsidy to industry, but a long-overdue partial correction of the tax load which will in a measure help American industry to compete in foreign markets and more effectively fight imported goods. In our business we had a front-row center seat to observe the severe inroads made on the American sewing machine industry, the toy industry, the transistor radio industry, the blouse and shirt industry by foreign imports. We believe that any American industry that does not have the most modern, most efficient producing equipment will soon face a similar fate.

As to the other provisions of this bill designed to recoup the losses in revenue to the Government occasioned by the tax credit provision, we can find no fault with taxing sources of revenue which have been very unfairly virtually tax free for many years. If there is any question but that these recoup regulations will not raise the revenue to offset the tax credit losses, we suggest that it is not unreasonable to tax a cooperative equally as much as a profitmaking enterprise in the same business instead of only partially, and to tax a savings and loan association equally with a savings bank instead of only partially, and perhaps the revenue problem would thus be solved.

Yours very truly,

N. W. PUGH, Jr., *President.*

MOUNT CLEMENS POTTERY CO.,
Mount Clemens, Mich., April 5, 1962.

Hon. HARRY F. BYRD,
Senate Office Building, Washington, D.C.

DEAR SENATOR: It is my understanding that the Senate Finance Committee is now holding hearings on the administration's tax bill. This measure is far from a constructive piece of legislation, and consists of proposals that will actually produce no more revenue, but will only add to the confusions of our entire income tax system.

The proposals are wonderful for the bureaucrats as it will offer many new opportunities for padding Federal payrolls at the expense of the taxpayers.

While I do not condone the failure of reporting on an income tax return either dividends on stock or interest, the fact remains that the expense of collecting the few millions that may not have been reported will be greater than the amount recovered. The extra expense load upon business to send all of these additional reports of deductions to the Treasury Department, as well as the additional burden upon the taxpayers to keep the records connected with same, are certainly not justified.

Business does not need or want the proposed investment credit, as the country is not suffering from the need of new plants and equipment. On the other hand, it would be much better to liberalize regular depreciation rates. I ask you, is it commonsense in view of the tremendous unemployment in the country, to offer this investment credit to rush the development of automation and new equipment when you definitely know that this will add to increased unemployment. In practically all industries there now exist highly efficient plant capacity, more than is now being utilized.

In my opinion the tax bill as proposed by the administration should be scrapped, and in its place Congress should concentrate its efforts on H.R. 2030, which is the Herlong-Baker tax reform bill, that has been introduced in the House of Representatives.

Yours truly,

CHAS. E. DOLL.

ALABAMA GAS CORP.,
Birmingham, Ala., April 6, 1962.

Hon. HARRY FLOOD BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: As you know, H.R. 10650 provides for an investment tax credit of 7 percent for all businesses except utilities which are given a credit of 3 percent.

I am very much opposed to the entire theory of this sort of giveaway, and knowing that you have opposed such measures throughout your long and admirable career as a Senator, I thought I would write and urge you to use your best efforts to the end that this sort of an approach will be abandoned.

As you know, businesses and business groups generally have opposed the investment credit approach and have urged the administration to substitute much needed reforms in the field of depreciation. Certainly it would not seem too late to do this, but even if so, it would appear better that there be no tax legislation this session rather than resort to this regrettable approach.

The investment tax credit approach is even worse for companies such as ours, of course, since it gives the unwanted credit to our competitors at over twice the rate granted us. Contrary to the view of some people, public utilities such as this are in very keen and direct competition for the sale of fuel, particularly with coal, oil, and electricity. Our customers, of course, are interested in obtaining fuel at the lowest available price and, in the case of large industrial customers, are equipped to change from one fuel to the other on a moment's notice. Therefore if this additional tax credit is given to the sellers of oil and coal, companies such as ours will suffer immediately in the competitive struggle. I would also call your attention to the fact that for some reason pipeline companies are given the full 7-percent credit while gas companies engaged in local distribution are given only the 3-percent credit. I am at a loss to explain this discrimination.

My purpose in mentioning the discrimination as to utilities is, let me hasten to say, not to plead for an increase of the 3-percent credit to 7 percent, but on the contrary, to plead for the abolition of the credit altogether. I think you of all people will forgive businesses for looking this so-called gift horse in the mouth. I am confident your sentiments will be in opposition to a giveaway program such as this.

Yours very truly,

R. A. PURYEAR, Jr.

(Whereupon, at 3:35 p.m., the committee was recessed, to reconvene at 10 a.m., Monday, April 9, 1962.)

REVENUE ACT OF 1962

MONDAY, APRIL 9, 1962

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to recess, at 10 a.m., in room 2221, New Senate Office Building, Senator Harry F. Byrd (the chairman) presiding.

Present: Senators Byrd, Kerr, Gore, Williams, Carlson, and Curtis. son, and Curtis.

Also present: Elizabeth B. Springer, chief clerk; and Colin F. Stam, chief of staff, Joint Committee on Internal Revenue Taxation.

The CHAIRMAN. The committee will come to order.

The first witness is Mr. Arthur J. Packard of the American Hotel Association.

Mr. Packard, will you have a seat.

Mr. PACKARD. Thank you, Mr. Chairman.

For the record may I introduce Mr. Charles Merritt, the legal counsel of the American Hotel Association.

Senator CARLSON. Mr. Chairman, may I state all of us were greatly distressed to learn last evening of the death of Bud Ryan, who has been a friend of ours and who has represented your organization so ably during the past few years.

Mr. PACKARD. Thank you, Senator. It is a terrible loss to us. Not only personally——

Senator CARLSON. It was a shock to me but he and I were associated together back in the 1930's in the Republican River Valley Conservancy District and we have been closely associated ever since. I was shocked. And I assure you it is a great loss.

Mr. PACKARD. You join us in our loss.

The CHAIRMAN. As an evidence of our sorrow we have asked Mr. Packard to be our first witness although he comes later on the list. You may proceed.

STATEMENT OF ARTHUR J. PACKARD, PRESIDENT, PACKARD HOTEL CO., REPRESENTING THE AMERICAN HOTEL ASSOCIATION; ACCOMPANIED BY CHARLES MERRITT, COUNSEL, AMERICAN HOTEL ASSOCIATION

Mr. PACKARD. I am Arthur J. Packard, president of the Packard Hotel Co., with headquarters in Mount Vernon, Ohio. I own and operate seven small hotels in that State.

I am chairman of the Governmental Affairs Committee of the American Hotel Association, and past president of that organization. I am glad to have the opportunity, once again, to appear before your committee, and to present this statement on behalf of the association. We are grateful for the time you have allowed us.

The hotel industry has frequently been referred to as the seventh largest industry in America based on capital investment and number of employees. A recent study by the U.S. Department of Labor, issued in February of this year and submitted to Congress, pointed out that the hotel and motel industry is one of the major service industries in the country.

It also pointed out that at the time of the 1958 Census of Business there were almost 29,000 hotels and 41,000 motels and tourist courts operating in this country.

Their combined annual receipts amounted to more than $3½ billion, and the industry employed nearly 500,000 persons with an annual payroll of over $1 billion. Obviously an industry of this size has an important stake in the economy and a most vital interest in any major changes in the tax laws.

The bill which is pending before your committee, H.R. 10650, proposes a number of major changes in the income tax laws which are of direct and immediate interest to the hotel industry, as some of these changes are beneficial while others, if adopted, will impose extremely heavy burdens upon it.

In the interest of time I will confine my remarks to the particular sections which are our concern. However, when I have done so, I will take the liberty of referring briefly to some of the other financial and tax problems confronting our industry. I feel that these facts will be most pertinent in your consideration of any changes in the tax laws and their impact upon the economy.

Let me deal first with the provisions in the bill relating to the proposed 7 percent investment tax credit. This is a provision which will be of substantial benefit to the hotel industry. We urge that it be approval by your committee and retained in the bill as finally recommended by your committee.

As pointed out by the President in his tax message to Congress last year, and in his Economic Report this year:

> The tax credit increases the profitability of productive investment by reducing the net cost of acquiring new equipment. It will stimulate investment in capacity expansion and modernization, contribute to growth of our productivity and output, and increase the competitiveness of American exports in world markets.

We believe this approach is sound and particularly applicable to the hotel industry. Although hotels have engaged in substantial modernization programs since World War II, there is still a vast area in which hotels could modernize even farther to meet increased competition within the industry.

This is needed to meet the needs of a growing domestic population and foreign visitors who will demand the utmost in service which can be provided only with modern equipment. The recent establishment of the U.S. Travel Service is expected to provide a great stimulus to foreign travel in this country.

The hotel industry is eager to welcome these visitors to demonstrate that the American hotels are equal, if not superior, to those anywhere else in the world.

Although faced with declining occupancies, as I will hereinafter point out, the leaders of our industry firmly believe that the way to attract more business is to provide better and more modern service. We firmly believe that the investment tax credit allowed to hotels will, in the language of the President, "stimulate investment in capacity expansion and modernization" and will result in increased business for our industry at a time when, believe me, it is sorely needed.

Opposition has been expressed to the investment tax credit upon the ground that it might be considered as a substitute for revised treatment of depreciation. We are hopeful that this is not so. The report of the House Ways and Means Committee contains a specific statement that the tax credit "is a complement to the administration's plans for revising the guidelines for the tax lives of property subject to depreciation."

The committee also indicated that "further depreciation revisions will be announced this spring" by the Secretary of the Treasury.

This is a subject of great importance to hotels because in many ways the useful life of equipment in hotels is much shorter than in the average business establishment.

For example, in the average commercial establishment, such as a retail store or an office building, the air conditioning, heating, and electrical appliances operates 8 to 10 hours a day whereas in a hotel they must operate 24 hours a day.

Similarly the useful life of furniture, carpets, and similar items is far shorter than in the ordinary business establishment. It stands to reason that hotels should be eligible for shorter useful lives for their equipment and supplies. This is merely one example for the immediate and the pressing need for revisions of depreciation practices.

The Ways and Means Committee report also quotes the Secretary of the Treasury as stating that the—

> basic objective to these revisions (in the depreciation field) is to provide realistic tax lives in the light of past actual practices and present and foreseeable technological innovations and other factors affecting obsolescence.

There can be no disagreement with this sound principle. We refer to it only because both the administration and the House of Representatives have recognized that the proposed investment tax credit is only a partial solution.

Indeed, the House committee report also points out that even such a revision in the field of depreciation is not enough by itself to provide the essential economic growth or to permit American industry to compete with other major industrialized nations in the free world.

For that reason the investment tax credit presently proposed assumes additional importance and we urge that it be retained in the bill as finally approved by your committee.

I now turn to section 4 of the bill relating to the disallowance of certain expenses as business expense for income tax purposes. It is impossible to estimate the damage which would have been done to the hotel industry if the original recommendations of the administration were to be adopted.

The provisions in the bill pending before your committee are a substantial improvement over the original language, but still leave much to be desired. If adopted they will inevitably have an unfortunate and depressing impact, not only upon the hotel business, but many other businesses as well.

This impact has already been felt. There seems to have been a common belief that only hotels and restaurants would be affected by any limitation of restrictions upon legitimate business expenses which might be classified as entertainment. Nothing could be further from the truth. The expense account dollar goes to railroads, airlines, buslines, shipping companies, retail stores, theaters, taxicabs, and numerous other types of business besides hotels and restaurants. Some of these industries will have representatives testifying on their own behalf, and so I will confine my comments to the hotel industry.

Persons traveling on business and staying at hotels may be divided into two large categories: First, those who are traveling alone as buyers, salesmen, business executives, or in similar employment, who come to a city for the purpose of dealing with their customers, business associates or prospects.

The second category includes those attending business conventions, sales meetings, trade shows, and similar gatherings.

These two categories form a segment of business without which practically no hotel could exist. The very threat of unwarranted and impractical restrictions upon the deductibility of business expenses has already had a depressing effect upon the hotel business and the profit margins of hotels are much too narrow to withstand any such shrinkage.

The American Society of Association Executives, a national organization representing 2,150 trade and professional associations, conducted a survey last fall. They found that out of a 33-percent return to the questionnaires, 245 members reported that they had had reduced attendance to their sales meetings, and their State, regional, and National conventions in 1961, as compared with the preceding year.

When asked to what they attributed this decline in attendance, 153 stated that it was the fear of subsequent disallowance of expense account items on their income tax return which caused individuals to refrain from attending meetings, and caused business establishments to reduce the number of people who attended such conferences or conventions.

It is our position that the present provisions of the law are adequate and if fully enforced would accomplish the objectives of the administration. The revision of the Treasury regulations in relation to the expense accounts, which were put into effect about 2 years ago, was an appropriate step in this direction.

The results of that action should be assayed more carefully before there is any change in the law. The report of the House Ways and Means Committee recognized that while abuses in the field of entertainment and traveling expense "should not be tolerated," legitimate expenses should be allowed.

We are not attempting to defend abuses under the present law but we firmly believe that if the provisions in the bill now before you become law, they will impose an unwarranted and unfair burden upon the taxpayer.

No reasonable person can possibly produce a written record of every expenditure, no matter how legitimate.

The so-called Cohan rule in respect to such expenses should be retained, not outlawed. No deduction is to be allowed solely upon the basis of the taxpayer's own supported self-serving testimony.

However, the committee admits that the degree of corroboration required—

will vary as respects the business relationship and purpose, the time and place, and the amount of the expense.

Particularly the committee points out that "specific evidence" would be required as to the amount of an expense and admits that this would require more detailed recordkeeping than is common today. The only excuse for failure to produce records is where they have been destroyed by fire or flood or similar circumstances beyond the taxpayer's control.

The result of these requirements will inevitably be to deprive the taxpayer of at least a part of his legitimate business expense. No human being can possibly keep written records of all expenditures and yet failure to have them may well result in the disallowance of the amount claimed.

We have pointed out only these provisions to avoid prolonging this statement unduly. However, I must state again the concern of the hotel industry. It is true that hotelmen, like all other businessmen, do spend money for entertainment and business travel and will be subject to whatever provisions of law there may be on the deductibility of these amounts.

However, our primary concern is not with the deductibility of amounts expended by the hotelmen but rather the impact upon the spending habits of the businessman who is our chief customer. The impression is created by the bill that legitimate expenses heretofore allowed are going to be disallowed in the future because of impossible recordkeeping requirements or disagreements as to the word "reasonable."

The inevitable effect will be continued reduction in spending which will have a disastrous effect upon hotels and the other industries whose prosperity depends upon this business.

As I have pointed out, this impact has already been felt for nearly a year. Unless the present bill undergoes substantial modification, the decline will continue. For reasons which I will point our shortly, the hotel industry just cannot take any further blows to its business.

The administration has continued to emphasize that all of these points in the tax bill are so-called loopholes, and that most of the proposed legislation would result in increased revenue to the Treasury.

I think that is the greatest fallacy that has come on the national scene this year.

Surely the travel has dropped and the way that business generally has already fallen just because of talk about expense account ceilings, indicates that it would result in overall revenue loss, rather than bringing about a new windfall to the Treasury.

We do want to add our voice to that of other business groups, speaking for the right of a businessman to deduct the expenses of his appearance before legislative bodies in defense of the welfare of his business.

I think that such expenses, as well as dues paid to organizations which represent his business, and that of others in his same line of work, should be properly deductible, for income tax purposes. Section 3 of the bill should be retained.

Because I have referred several times to the impact of this tax bill upon the hotel industry, I feel that it is now appropriate for me to refer briefly to some of the problems which have plagued us in recent years, some of which could be corrected by legislation. As I have appeared before congressional committees many times on some of these subjects, I will make my remarks very brief.

The recent study of rates of pay in hotels made by the Secretary of Labor points out that 35 percent of the receipts of hotels are expended for payrolls. This is a national average and in many establishments it is far higher.

It has been impossible to increase room rates sufficiently to balance increasing labor costs.

Other industries may have found it possible to turn to automation to meet this problem but in an industry where personal service is your primary product, such as the hotel industry, the solution is not that easy.

We must use every possible method to provide attractive service and facilities without pricing ourselves out of the market. You can be sure that this is not easy to do particularly in the face of declining occupancies.

Occupancy rates in hotels have dropped every year from 93 percent in 1946 to 62 percent in 1961. For your information, we have a chart there prepared by Horwath & Horwath, a national firm of certified public accountants, which shows the hotel occupancy in the last 15 years.

(The chart referred to was displayed for information of committee but not submitted for the record.)

The CHAIRMAN. Does that include the motels or only the hotels?

Mr. PACKARD. I beg your pardon?

The CHAIRMAN. Does the chart include the motels or only the hotels?

Mr. PACKARD. Yes. You see many of the fine motels are also members of the American Hotel Association. We represent both motels and hotels and included in those figures are motels and hotels but none of the so-called tourist courts.

The CHAIRMAN. You say the occupancy rates have dropped every year from 93 percent in 1946 to 62 percent in 1961.

Does that include all the motels and hotels both or what does it include?

Mr. PACKARD. That is right.

I might say that, which I say later in the setatement, there has been a great influx of overbuilding also which has made quite a problem to us. I think the biggest drop we have had, Senator, of course, has been in the hotel that needs to be rehabilitated, that is why we are asking for the tax credit. Some of our hotels——

The CHAIRMAN. I am not yet clear. These figures that you gave include the motels and the hotels?

Mr. PACKARD. That is right.

The CHAIRMAN. Both of them?

Mr. PACKARD. That is right.

The CHAIRMAN. Are the motels members of your association?

Mr. PACKARD. Yes, the majority, all of the large ones are.

The CHAIRMAN. But these include whether the members are not members, these figures?

Mr. PACKARD. Oh, no, only those who are members. But we represent, Senator Byrd, about 80 percent of the first-class hotel rooms in the United States.

The CHAIRMAN. Of course, motels, especially in small towns, endanger the hotels.

Mr. PACKARD. That is right.

The CHAIRMAN. At my home in Winchester, the people are stopping in the country, they are not coming into the small towns. So I think these figures should be verified perhaps because apparently that doesn't include all of the motels, and all the hotels.

Mr. PACKARD. Well, we limit the membership in the American Hotel Association.

The CHAIRMAN. This is just your membership?

Mr. PACKARD. Yes, sir, as to size, but also represents 85 percent of all the first-class hotel rooms in the country, the American Hotel Association.

There are many reasons for this drop in occupancy, which continues your question, such as the changing travel habits, the speed of transportation between cities, the trend of motor travel and others but they are not pertinent to our discussion here. It is sufficient to say that the decline has occurred and we must do everything we can to live with it and possibly to reverse the trends.

The hotel industry, like many others, has been burdened with additional recordkeeping requirements imposed by Federal, State, and local laws.

One Washington hotel estimated a few years ago that they had made more than 200,000 computations during the year to meet Federal Government requirements alone. We are subject to a long list of excise taxes, far longer than many other industries.

Many of these were wartime taxes which now appear to be permanent. These include taxes on alcoholic beverages, telephone service, electrical equipment, and others. Equally important are those excise taxes paid by our customers which tend to discourage business such as the continued transportation tax and the Federal cabaret tax.

Increased payroll taxes have added their burdens to us as to other employers.

The hotel industry is faced with unfair competition from many tax-exempt organizations which are permitted to engage in public catering without losing their tax exemption.

I refer particularly to country clubs, civic clubs, social clubs, veterans' organizations, fraternal organizations, and others, many of which openly solicit public lunches, dinners, banquets, wedding receptions, and other social functions completely outside of their membership.

As tax-exempt organizations they can inevitably underprice taxpaying hotels and restaurants. We have urged that the law be amended so that some of these establishments be required to pay Federal income tax on related business income to which they are not now subject.

However, the law has remained the same and this unfair competition has been allowed to continue. I am glad to say that we have had some cooperation from the Internal Revenue Service in following up some of these cases to which we have called their attention, but this has only scratched the surface. As I have said, the unfair competition still continues.

In an effort to promote business many hotels are large users of the U.S. mails and engage in direct mail advertising and correspondence with prospective customers. These hotels are faced with substantial increases in their postal bills under the pending legislation adding just one more increased expense which must be met somehow.

It has been said in some circles that there is an overbuilding in the hotel industry and this is undoubtedly true in many areas. The occupancy rates clearly indicate that there are more rooms available than will be occupied on the average night.

Notwithstanding this situation, the Federal Government itself has encouraged overbuilding in certain areas. The lending program of the Small Business Administration has frequently brought into being new hotels and motels where no supplemental facilities were really needed.

Under the urban renewal program projects have ben approved which include new downtown hotels and motels notwithstanding the fact that surveys conducted locally have indicated no need for additional transient housing facilities and the existing hotels are showing low rates of occupancy.

Apartment buildings which secured loans guaranteed by FHA have in some cases converted to transient occupancy and are openly competing with hotels and motels. Structures built by the Department of Defense have ended up as surplus motels and motor courts when the military bases have been deactivated.

I cite these problems to you in the belief that you will recognize that the impact of any legislation must be carefully considered and I am sure that your committee will so treat it.

In passing upon the present tax legislation, I urge you to keep these problems in mind as they affect our industry. We urge the investment tax credit provision be enacted, that liberalized depreciation practices be encouraged and that the law remain unchanged as regards entertainment expense. If such be the outcome of your present legislation in the field of taxes, the hotel industry will have a part of the relief to which it is entitled and which it sorely needs.

I recognize the difficult problem confronting your committee in passing a tax bill which will be for the best interests of the country and which will not harm any segment of our people or business. The witnesses who will appear before you will express many different and conflicting opinions but I am confident that your committee will reach a fair and just conclusion.

In the many years that I and my associates have appeared here on behalf of the hotel industry, we have always found that the result has been fair and in the public interest, and we again thank you for the opportunity to present our views.

The CHAIRMAN. Senator Gore?

Senator GORE. No questions.

The CHAIRMAN. Senator Williams?

Senator WILLIAMS. No questions.

The CHAIRMAN. Senator Curtis?

Senator CURTIS. Mr. Chairman, I want to say to Mr. Packard he has given us a very helpful statement here. He need not be reminded of the size of our hotel industry and how many of our citizens make their living out of it. I presume it is true, Mr. Packard, that as occupancy falls off, the hotel industry still keeps its help even if it is at a loss, but ultimately that means the destruction of jobs, does it not?

Mr. PACKARD. Unquestionably that is true. There are many people in our business who are too skilled to risk a layoff and loss. We have lots of unskilled labor, that is true. But as your declining occupancy occurs, certainly you can only carry as many people as the revenue will permit, and as the occupancy declines certainly the employment must decline with it.

I mean that is a basic matter of financial expediency, Senator Curtis, that we must do.

Senator CURTIS. Another thing that I am always reminded of while your industry has many, many very skilled people connected with it, it also provides employment for a great many people who possess lesser skills, because of the nature of the personal service and the work to be done about the properties.

Have you had an occasion to apply the proposed investment credit to many of your members to see whether or not they will get substantial benefit from it?

Mr. PACKARD. Yes, we have had a great deal of correspondence from many of our members who actually are holding off to see the results of the tax bill as to whether or not they can substantially afford to make these capital investments in the hotels.

I have a letter in this morning's mail, as a matter of fact, from Seattle from a chap who wants to completely air condition his building and one of the prime motives, of course, is whether or not he can get a tax credit for the risk capital that he expects to put into his building.

Senator CURTIS. I am not asking you to deviate from your position in favor of the tax incentive credit but I want to ask you this: In any event, you are anxious that the whole area of depreciation be recast more realistically?

Mr. PACKARD. That is correct.

Because of all the business in the world, Senator Curtis, I think the hotel business, which includes motels, that doesn't make any difference, it is the public housing, whether it is vertical or horizontal. The most important feature in our business is obsolescence, it is usage and obsolescence. Anything for us will only last one-third as long as it will last for a building because we use it 24 hours as against 8, No. 1, and we use it 7 days as against 5, and strangely enough the travel habits of a nation over a period of years are such that they are subject to certain whims and sales precepts that obsolescence becomes a very important item. Something may not be worn out but it is useless to us because it is obsolete, you have no customers as a result so we must have a realistic depreciation schedule.

Senator CURTIS. Change of airline schedule, the relocation of airports.

Mr. PACKARD. Change of habits, I might say.

Senator CURTIS. Rerouting of interstate highways, and many, many factors are very real in determining the productive life of a structure rather than just how long is this brick and mortar going to last?

Mr. PACKARD. That is correct. That is correct.

Senator CURTIS. Would you say that in the light of this present situation, which is very complex, many factors being involved, that there can be no keeping abreast of the building improvement unless some method is worked out that in a short period of time a substantial tax benefit of some kind can be taken?

Mr. PACKARD. You must have some incentive to bring risk capital into a borderline business. You must have some kind of depreciation incentive if we are going to spend our money in a business that is showing a declining occupancy. We hope to reverse the trend, but the only way we can is by a period of modernization, and to do that we must spend money and we must have some kind of tax credit to justify risk capital going in.

Senator CURTIS. That is all, Mr. Chairman.

Senator GORE. Mr. Chairman?

The CHAIRMAN. Senator Gore.

Senator GORE. I gather from your statement you really are not asking for a tax credit because of your inability to compete nationally; you are just asking for a tax cut.

Mr. PACKARD. No, Senator Gore.

I think we should say this: We are asking for an incentive to the 7 percent tax credit for people to spend money. I think it will be good for the hotel business. I think that it will be good for employment in our business.

Senator GORE. Wouldn't that be good for all of us?

How do you differ from anyone else in that regard?

Mr. PACKARD. Only that our recovery life is so much shorter. You could buy—Mrs. Gore could buy a bedroom suite that would last for 20 years. With us the suite would last 4 years. Obsolescence would be no——

Senator GORE. Adequate depreciation is what you desire.

Mr. PACKARD. Well, we certainly don't want to take 7 percent instead of a realistic depreciation schedule, that is for sure.

Senator GORE. But you would like to have both?

Mr. PACKARD. We would like to have 7 percent as, actually as an incentive to our people who are desperate now to spend money and modernize their properties. We think it would be good for the earnings of the business of which the Government takes its cut. We think it would be good for employment; certainly it would be good in the public interest for the man who travels if his accommodations are better.

Senator GORE. There are many people who advocate a tax cut as a spur to employment. Indeed, some people see the necessity of that right now. But to be effective as a spur to employment it is, it has got to be, rather widely involved.

Mr. PACKARD. Senator, if you gave a larger depreciation schedule, I don't think it would spur immediate rehabilitation of these properties as much as would this tax credit.

Senator GORE. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Mr. Packard.

Mr. PACKARD. Thank you very much.

The CHAIRMAN. The next witness is Donald C. Cook, the American Electric Power Co.

You may proceed, sir.

STATEMENT OF DONALD C. COOK, PRESIDENT, AMERICAN ELECTRIC POWER CO., INC.

Mr. Cook. Mr. Chairman, my name is Donald C. Cook. I am president and chief executive officer of American Electric Power Co., and each of its subsidiaries, and I appear on behalf of these companies.

The American electric power system is a utility system engaged exclusively in the generation, transmission, distribution, and sale of electricity in parts of Ohio, Indiana, Michigan, Virginia, West Virginia, Kentucky, and Tennessee. We produce and distribute more electric energy than any other investor-owned utility system in the United States and, I believe, in the world.

I am here to support the tax credit concept contained in section 2 of H.R. 10650 insofar as a credit is provided for public utility companies.

Section 2 is intended to encourage additional capital investment by providing for a tax credit in proportion to the amount of the taxpayer's investment in certain new facilities.

I believe that this concept—which I understand was proposed and supported by the administration—is, in the case of public utilities at least, well calculated to achieve the stated purposes.

Section 2, in the form in which it passed the House, provides that, in the case of property with a life of at least 8 years, the credit for most tapayers is 7 percent; in the case of electric utilities, however, the credit is only 3 percent.

I think it clear—and I intend to show—that, in the case of electric utilities, the tax credit will do more to increase construction and, therefore, to bring about the desired growth in the economy, than in the case of nonutilities.

Indeed, I would be here to urge the committee to provide for a substantially larger credit in the case of electric utilities than in the case of nonutilities if it were not for the unjustified discrimination that would be introduced into our Federal tax system. Hence I urge only that the credit be identical for all taxpayers.

In its original form the tax credit proposal completely excluded electric utilities. This exclusion in the original proposal and the present discriminatory treatment of electric utilities in H.R. 10650 appear to result from a lack of knowledge or understanding of the basic economic principles governing the operation of the utility business.

To support both the original exclusion of utilities and the proposed discriminatory treatment, it has been asserted (1) that the availability of the tax credit would not in fact induce greater investment by utilities, because in any event, they would have to build all the facilities necessary to enable them to meet the demand for their service; (2) that if, on the one hand, the tax reduction were retained by a utility the credit would not achieve its intended incentive to investment, and that if, on the other hand, it were passed on to consumers the credit would still not provide any incentive; (3) that the demand for electricity and, therefore, the facilities necessary to supply it are fixed and would not be increased by the tax credit; and (4) that electric utilities are not subject to competition.

Each of these assertions is invalid, and I propose to show it. In addition, at the conclusion of my testimony—to provide concrete evidence that the tax credit would, in fact, represent an important incentive to increased construction expenditures by electric utilities—I will present to the committee a list of projects, together with their estimated costs, never before included in any budgeted construction by any company in the American electric power system, which we are prepared to go forward with immediately if the tax incentive provisions of the legislation are applicable to electric utility companies.

THE AVAILABILITY OF THE TAX CREDIT WILL, IN FACT, INDUCE GREATER CAPITAL INVESTMENT BY ELECTRIC UTILITIES

The reason the tax credit proposal will operate as a strong incentive to electric utility companies to build facilities which they would not otherwise build lies in the basic economic principles applicable to the electric utility business.

These principles stem primarily from the nature of its costs and the effect those costs have on revenue requirements to support property additions.

Fundamental to the understanding of the economics of a public utility operation is the concept that all costs are divided into two categories; the first are the fixed charges associated with the investment in plant; and the second are the variable costs incurred in connection with the operation of that plant.

The electric utility business is a rate-of-return business—that is to say, a utility is entitled only to a reasonable return on its so-called rate base, which consists, generally speaking, of its depreciated property, plus an allowance for working capital.

In this business, an investment of approximately $4 in plant and equipment is required to produce $1 of revenue. This is in contrast with the situation in the case of most nonutilities, where $1 invested in plant and equipment will produce as much as from $4 to $8 of revenue. In fact, the electric utility business is the most capital intensive of all American industry.

Since the business is a rate-of-return business, and since a large investment in plant is necessary to render service, the cost of service is necessarily greatly affected by the fixed costs associated with plant investment.

The fixed charges include the fair return on the rate base, often taken at about 6 percent to 6½ percent. They include Federal income taxes, which must be paid if there are to be any earnings for the preferred and common stockholders.

And they also include charges for depreciation of the plant; a wide variety of State and local taxes; insurance on the properties; and those administrative costs incurred solely as an incident of ownership of plant.

These fixed charges aggregate approximately 14 percent per year of plant investment and the Federal income tax component of the fixed charges is approximately 4 percent per year, or about 28 percent of the total fixed charges.

The actual operation of the plan requires additional expenditures, such as those for fuel, materials and supplies, and labor, in the case of the operation of powerplants, and materials and suplies and labor, in the case of other facilities.

The total cost of rendering service, therefore, is the sum of the fixed charges and the variable operating costs. As we have seen, Federal income taxes represent over 28 percent of total fixed charges and consequently represent a material part of the cost of service.

There are two broad categories of expenditures for plant and equipment made by electric utility companies: The first consists of those expenditures which the utility absolutely must make to supply the demands of its customers for electric energy.

Here there is absolutely no discretion since the primary obligation of a public utility is to meet the demands for its service. The second category, however, is made up of optional expenditures—that is to say, expenditures the decision as to which lies entirely within the discretion of management. Such optional expenditures involve vast amounts of money and include all those expenditures made by an electric utility company other than the minimum essential expenditures necessary to meet demands for service.

Whether these optional expenditures are to be made in the present, whether they are to be delayed for many years to come or, indeed, whether they are to be made at all is wholy dependent on whether they are economically justifiable. Thus, for example, the decision whether and, if so, when, to convert a line to a higher voltage; to increase the transformer capacity of a substation; to build a new office or service building; or to build additional lines to provide two-way feeds rather than one-way feeds—all of these are decisions entirely within the discretion of management.

In deciding these matters, an economic evaluation is made of the costs associated with the proposed construction and the benefits to be obtained.

When the present value—in the technical, mathematical sense—of the sum of the benefits is equal to or greater than the present value of the sum of the costs associated with the expenditure, the project is deemed economically feasible and the decision would be made to go ahead with it.

When the present value of the sum of the costs is greater than the present value of the benefits, the project is not economically feasible and the decision would be not to go ahead with it.

There are, therefore, at any given time a large number of projects that are marginal in character, that is, the benefits fall somewhat short of equaling the associated costs.

Consequently, anything that can be done to decrease the associated costs automatically makes economically feasible additional projects. Since we have already seen that, in the case of electric utilities, the fixed charges associated with plant and equipment constitute a major portion of the cost of service, and since we have also seen that Federal income taxes constitute a material part of the fixed charges, any reduction in Federal income taxes automatically makes economically feasible additional construction projects.

Senator GORE. Then what you are really saying is what you want is a tax cut.

Mr. COOK. Yes, that is true. We want it to the same extent as it is provided for other taxpayers.

Senator GORE. So do a lot of other people.

Mr. COOK. And for understandable reasons, Senator Gore.

Senator GORE. I agree.

Mr. COOK. This fundamental concept, which is really so simple in character, so completely described in extensive literature on the subject, and so well known and accepted by everyone with experience in the public utility field, seems somehow not to have come to the attention or into the understanding of those who have so erroneously assumed and indeed represented to this committee that a tax credit would not induce any increased capital expenditures by electric utilities.

Yet the simple and vital fact is that a tax credit—which has the effect of reducing Federal income taxes and, therefore, reducing the fixed charges associated with capital investment—will necessarily make feasible and induce substantial capital expenditures for marginal projects of electric utilities which, in some cases, would otherwise not be built as soon, and, in others, would not be built at all.

2. THE AVAILABILITY OF A TAX CREDIT WOULD PROVIDE AN INCENTIVE TO OBTAIN THE TAX SAVINGS AND WOULD STIMULATE INCREASED CAPITAL INVESTMENT, WHETHER THE TAX REDUCTIONS WERE RETAINED BY THE UTILITY OR PASSED ON TO CONSUMERS

The argument has been made in support of the discriminatory treatment of electric utilities that if the tax reductions were retained by the utility, there would be little benefit to the economy and, alternatively, that if the tax reductions were passed on to consumers, the credit would not achieve its intended incentive to investment.

This argument, again, is based on fundamental misconceptions of the utility business and is completely unsound. From the point of view of whether the tax credit would operate as an incentive to construct additional plant and equipment, it is almost a matter of indifferences as to whether the tax reduction is passed on to customers or not.

This is true because as indicated above, it is the reduction in fixed charges with the resulting decrease in revenues necessary to support the expenditures for plant that operates as the incentive to build, not the receipt and retention of cash resulting from reduced expenditures for taxes.

But the fact is that just as a company is entitled to rates which will cover the taxes that must be provided for, so too is the customer entitled to receive the benefit of reductions in taxes.

He will receive this benefit either by a reduction in rates or the avoidance of an increase in rates that otherwise would have taken place as the result of increases in other expenses such as wages or fuel.

While we are among those companies having the lowest rates for power in the United States, we are nonetheless even now studying still further rate reductions which we believe will become possible if the tax credit is made available to us.

Favorable action of this committee and of the Congress on this bill will either make possible or prevent these rate decreases.

I want also to take this occasion to emphasize that, at least in my view, there is nothing better for our customers, our communities, our investors, the health of our companies, and indeed for the welfare of the country as a whole than reductions in prices of all goods and services whenever they can be justified.

We intend to continue to take advantage of every possible opportunity to reduce both our fixed charges—including our tax expenses—as well as all of our other expenses in the hope that this will enable us to offset other increased costs and to reduce rates.

Unceasing efforts to cut costs, lower rates, and increase demands is the rock upon which our system has been built and is as much a part of us at American Electric Power as is the air we breathe. The availability of the tax credit would be of great help in this connection and we would take full advantage of it.

The increase in demands for our service resulting from decreased costs will call for still further capital expenditures to enable us to meet the increased demands; and the accomplishment of the objectives of the tax credit will be achieved in a still larger measure.

3. THE DEMAND FOR ELECTRIC ENERGY IS NOT FIXED AND UNALTERABLE

Contrary to the assertions which have been made as a basis for the discriminatory treatment of electric utilities, the demand for electric energy is not fixed and it does not grow at a predetermined and unalterable rate.

Marketing electric energy is in substantial part a selling job. And the amount which can be sold depends, in very large measure, upon price.

The managers of an industrial facility have a choice between alternative heat and energy sources. A major factor which they take into account is the comparative costs. The commercial or residential customer has a similar choice and is affected by the same consideration.

But the potential market for electric energy is even more flexible than this. The managers of industrial plants often have to decide whether to convert to a new process for which the energy source is electricity or to continue an old one using another energy source.

Every type of customer has the question of whether he should raise his illumination level, or whether he should install air conditioning, or whether he should extend heating to an unheated area, such as a storage area, for which electric heating was the only obvious choice. The householder must decide whether to add a new electric appliance.

In all these cases the cost factor is important to the decision; indeed, may be decisive.

The cost of electricity is less today than it was in the depression days of the thirties. he net realization of the American Electric Power system—that is, the average price received per kilowatt-hour sold—has steadily decreased.

In 1932 it was 2.14 cents and last year it was only 1.22 cents per kilowatt-hour.

Residential use furnishes a convenient barometer of declining cost and of the resulting effect upon demand. During the past 25 years, while the Consumer Price Index has increased by 116 percent, the average price of a kilowatt-hour to the average residential customer of the investor-owned utility industry has decreased by 48 percent, so that it is only slightly more than half of what it was in the depression of the thirties.

In 1926 the average cost of electric service to residential customers in the United States was 7 cents per kilowatt-hour; in 1961 the average cost of residential electric service from the investor-owned utility industry had been reduced to 2.6 cents per kilowatt-hour. In 1926 the average residential use was only 427 kilowatt-hours; in 1961 it was 4,017 kilowatt-hours.

The relationship between decreasing cost and increasing use is obvious. In fact, this has been stated many times by representatives of public power agencies, such as the TVA.

In speaking of public power systems at the University of Chicago in 1954, Gordon R. Clapp, then Chairman of the TVA Board of Directors, stated that, "A policy of low rates has encouraged greater use of electricity; and this in turn has reduced costs and increased revenues and earnings."

The 1958 Annual Report of the TVA states (p. 47) that the low rates established from the beginning by TVA were "frankly promotional" and were "intended to stimulate a rapid growth in the use of electricity."

A TVA booklet published in 1959, called "Facts About TVA Operations," says that—

> electric rates in the valley region are based on the principle that low prices produce greater sales which lead to economies in production, transmission, and distribution, and hence to lower costs per unit.

This booklet states that from 1933 to 1958 the average residential use in the TVA area increased nearly 13 times.

In 1961 average residential use in TVA territory was 9,135 kilowatt-hours, in contrast with the national average of 4,017 kilowatt-hours. No argument can be made that the higher consumption in the TVA area is not due to the lower rates.

It is also clear to me that the executive branch of the Government in fact knows that lower rates lead to increased demand. And I think that this knowledge requires greater candor with congressional committees than has yet been shown.

4. ELECTRIC UTILITIES ARE SUBJECT TO VIGOROUS COMPETITION

The electric utility industry is, in fact, engaged in vigorous day-to-day competition with other industries for which the 7-percent credit is available and, we believe, it is particularly unfair to make the 7-percent credit available to our competitors and not to us.

Electric energy competes actively with all other fuels to provide space heating for residential, commercial, and industrial purposes, and for schools, churches and public buildings.

I want to make special mention of residential heating. This is a market being pursued vigorously by the electric utility industry. More than 1 million homes in the United States are now electrically heated compared with just over 300,000 in September 1956.

But the residential heating market is being pursued just as vigorously, and I think it is a good thing, by the gas utility industry.

There is also sharp competition with oil and coal. And, as the committee knows, H.R. 10650 makes the 7-percent credit available for oil and coal and for gas pipelines, while providing only a 3-percent credit for electric utilities.

In the household, electricity and gas compete not only in space heating, but as the fuel source for air conditioning, cooking, heating water, and drying clothes.

The gas industry is also doing intensive research on smaller units, fired by gas, for the generation of electricity. Some experimental units for large buildings or housing developments have already been scheduled for installation.

There is growing talk of private generation for nonindustrial purposes, such as for office and apartment buildings.

For example, the New York Times of January 21, 1962, carried a long article stating that many builders and owners of large office and apartment buildings in New York City were exploring the economic feasibility of installing individual power plants in their buildings.

There are innumerable industrial applications in which heat can be suppled by an electric process,or alternatively by some other process using coal, gas, or oil.

Moreover, in the case of large industrial users, competition through private generation has long existed. Today many industrial plants generate all or part of their electric energy requirements.

It is true that the proportion of the total energy supplied in this way has declined in the last four decades, as a result of technological advances which have made possible more economical electric supply from increasingly larger and more efficient central stations.

However, industrial customers, including particularly those engaged in electrometallurgical and electrochemical operations, where electric energy is in fact a raw material, are eligible for the full 7-percent credit.

A competitive disadvantage to electric utilities from a smaller tax credit would tend to overbalance technological and economic factors and encourage industrial customers to generate their own supply of power—from smaller and less efficient facilities—solely because of the larger tax incentive available to them.

We are not complaining about competition. As a matter of fact, we like it and we wish there were a whole lot more of it.

We think this would be a good thing for the American public.

We have, on our part, vigorously pursued every feasible technological and management development to achieve reductions in costs and rates in order to maintain and improve our competitive position relative to other energy sources.

But a larger tax credit for our competitors would be grossly unfair in providing a competitive cost advantage that could not possibly be otherwise obtained on the basis of technology or initiative, or under free-market conditions.

I want to make it clear that we are not complaining about the availability of the 7-percent credit to our competitors in the oil, coal, and gas pipeline industries. They should certainly not get a smaller credit than other businesses. But it is highly discriminatory and clearly contrary to the basic objectives of the tax credit proposal to deny a 7-percent credit to electric utilities.

There is, moreover, another form of competition which is already heavily weighted against the investor-owned electric utility industry—the several forms of governmentally owned or financed power systems.

Federal agencies such as TVA and Bonneville, State and municipal agencies, and electric cooperatives pay no income tax. Also, capital for investment is available to these competitors at a much lower cost than to investor-owned utilities.

As a consequence of these two factors, they now have a substantial cost advantage. Surely this situation offers an additional basis for not discriminating against the taxpaying utilities when a tax reduction is being considered for business in general.

I know that this committee and I suppose most congressional committees are accustomed to getting from witnesses the broad generality and the glib estimate that is intended, perhaps, to captivate and move, but without any performance. And, with this in mind, I want to demonstrate in concrete terms, by specific reference to the American electric power system, the basis for my conclusion that the tax credit will provide an incentive for substantial additional capital investment by electric utilities.

We have given consideration to the immediate effect that the availability of a tax credit would have upon capital expenditures of companies in the American electric power system.

In this connection we have considered only projects never before budgeted or scheduled, which we would be prepared to authorize and go forward with immediately, first, with a 3-percent tax credit, and, second, on the assumption that a 7-percent tax credit were available as in the case of the nonutility taxpayers.

I can state to the committee that a 3-percent credit would result in the immediate increase of our budgeted capital expenditures in amounts totaling $8,964,000.

Further, the stimulus to our capital expenditures would be more than twice as great with a credit of 7 percent, the credit proposed for other taxpayers.

If the credit available to electric utilities were 7 percent, rather than 3 percent, the American Electric Power System would forthwith embark upon additions to its scheduled construction projects in a total amount of $21,020,000.

The CHAIRMAN. Mr. Cook, I would like to ask you a question.

Mr. COOK. Yes, sir.

The CHAIRMAN. Is this table only for 1 year or is it for continuing years as long as—the 3-percent tax——

Mr. COOK. This table covers projects which we would be prepared to go forward with immeditely, Senator, and if the tax credit remains a permanent part of the tax structure—as long as it does remain a permanent part—we will have additional projects every year as far ahead as we can see.

The amount would necessarily vary with the amount of the available tax credit.

The CHAIRMAN. This is for 1 year?

Mr. COOK. This is for 1 year only and it is predicated on the basis that for every dollar of tax credit relief which we would receive in the year 1962 we would expend at least $2 for construction which we never had theretofore budgeted.

The CHAIRMAN. What would be your tax credit, do you reckon for 1 year?

Mr. COOK. I have assumed, for the purpose of making this commitment to the committee, that our tax cerdit would approximate $10½ million in 1962.

Senator KERR. At 3 percent?

Mr. COOK. On a 7 percent basis, Senator.

It would be three-sevenths of that on a 3 percent basis, approximately $4,500,000.

Senator GORE. How does that compare with your tax liability for 1961?

Mr. COOK. Our aggregate provision for Federal income taxes in 1961, Senator, is approximately $50 million.

Senator KERR. Federal?

Mr. COOK. Federal; yes, sir.

Senator GORE. Then you would get a tax credit which would give you a tax cut of approximately 20 percent.

Mr. COOK. That is correct, Senator.

Senator GORE. I am not sure——

Senator KERR. I don't understand it.

Senator GORE. Well, his tax liability for 1961 is approximately $50 million. He said the tax credit would amount to $10 million.

Senator KERR. That is the 7 percent. The 7 percent tax credit would be $10 million.

Mr. COOK. That is correct.

Senator GORE. So a 7 percent tax credit would give you a 20 percent tax reduction?

Mr. COOK. That is correct.

Senator GORE. Do you understand it now, Senator?

Senator KERR. I do.

Mr. COOK. And, as I have previously testified, these projects have never before been budgeted by any company in our system and we have budgeted capital expenditures for the years 1962, 1963, and 1964. So that these expenditures would be made for facilities that under no conceivable circumstance would have been considered by the company prior to 1965.

And since, as I have earlier testified, the fixed charges associated with making the expenditures amount to 14 percent per year, the aggregate fixed charges over a 3-year period would amount to 42 percent, and 42 percent of the $21 million of the expenditures is fairly close to the aggregate amount of the entire tax credit.

I have also testified that we have under consideration immediate rate reductions to our customers made possible by the tax credit, so that in no sense will this tax reduction in the aggregae be retained by our companies.

Now, I would like to state to the committee where these amounts would be spent. And this is on the basis of a 7 percent credit.

Approximately $4,479,000 would be spent in the State of Indiana. Approximately $976,000 would be spent in the State of Kentucky. Now, it happens that our service area in the State of Kentucky is in the eastern portion, and the eastern portion of Kentucky is a very seriously depressed area.

We have a relatively modest operation in the State of Michigan. Our additional expenditures there would aggregate $418,000.

We would spend $6,462,000 in the State of Ohio.

We again have a very small operation in the State of Tennessee, Senator Gore; namely, in Kingsport, and environs. Our expenditures there would aggregate something over $300,000.

Our expenditures in the State of Virginia would aggregate something over $5 million, and in the State of West Virginia approximately $3,289,000, or a total for all States of something over $21 million.

I want again to emphasize to the committee that we have budgeted construction expenditures for 1962, for 1963, and for 1964, and there is no single project included within this $21 million that has ever been contained in any budget prepared by any company in the American electric power system.

I have attached—so there will be no question about the details—I have attached an appendix to my statement and reference to that will indicate the amount of our existing budgets, the respective companies in the system which will make the expenditures, the States in which they are to be made, and will go further to give the details with respect to each specific project that we will go forward with.

Now, if the committee will indulge me, I would just like to summarize my testimony.

To limit investor-owned electric utilities to less than half the investment tax credit available to other businesses would be highly discriminatory, and grossly unfair. It would be particularly unfair to the millions of customers of electric utilities all over the country.

Electric utilities are in fact highly competitive with other industries which would be entitled to a 7-percent credit.

The demand for electric energy is not fixed and does not grow at some unalterable rate, but is greatly influenced by price.

A "half" or "less than half" credit for electric utilities is entirely inconsistent with the objectives of the tax credit.

The electric utility industry not only spends more on capital investment than any other industry, but is the most capital intensive of all industries. The stimulus to capital expenditure would thus be more effective in the case of electric utilities than in the case of any other industry.

A credit for electric utilities of the same magnitude as for other taxpayers would lead to an increase in the demand for electric energy, which would stimulate investment for expansion and modernization.

It would also materially stimulate capital investment in the depressed coal industry. The electric utility industry is the biggest consumer of coal. In 1961 it burned 178 million tons, representing 45 percent of the total consumption. Of this our own system burned over 14 million tons. The electric utility industry presents the coal market with its greatest growth potential.

An equal credit for electric utilities would, therefore, more probably than in the case of any other industry, contribute to the stimulation of capital expenditures and to the creation of more jobs, and would represent an important forward step in promoting the long-term growth and development of the American economy.

Because of time restrictions, this has necessarily been a highly condensed presentation. I would welcome any questions from the members of the committee and I want to thank you very much for hearing me.

(The appendix referred to follows:)

American Electric Power System

Study covering projects never before budgeted or scheduled which would be authorized and would proceed immediately on the alternative assumptions that the proposed tax credit legislation was to be adopted and was to be applicable to electric utilities, first, at 3 percent, and second, at 7 percent

This study covers the following operating electric utility companies in the American electric power system:

Appalachian Power Co. (operating in the States of Virginia, West Virginia, and Tennessee).

Indiana & Michigan Electric Co. (operating in the States of Indiana and Michigan).

Kentucky Power Co. (operating in the State of Kentucky).

Kingsport Utilities, Inc. (operating in the State of Tennessee).

Ohio Power Co. (operating in the State of Ohio).

Wheeling Electric Co. (operating in the State of West Virginia).

SUMMARY OF ADDITIONAL CAPITAL EXPENDITURES IF TAX CREDIT AVAILABLE

Below is a summary of the estimated expenditures for projects upon which American electric power system companies would immediately embark, under the alternatives of a 3-percent credit and a 7-percent credit.

The total 1961 construction budget for American electric power system companies was $100 million. As of December 31, 1961, construction budgets for later years were as follows:

1962	$152,000,000
1963	118,000,000
1964	64,000,000

None of the expenditures listed below appears in the budget for 1962 or any other year.

The estimated expenditures, by companies, if a tax credit is available, total as follows:

	With 3 percent credit	With 7 percent credit
Appalachian Power Co	$3,766,000	$8,160,000
Indiana & Michigan Electric Co	2,591,000	4,897,000
Kentucky Power Co	448,000	976,000
Kingsport Utilities, Inc	110,000	305,000
Ohio Power Co	1,669,000	6,032,000
Wheeling Electric Co	380,000	650,000
Total	8,964,000	21,020,000

The estimated expenditures, by States, if a tax credit is available, total as follows:

	With 3-percent credit	With 7-percent credit
Indiana	$2,407,000	$4,479,000
Kentucky	448,000	976,000
Michigan	184,000	418,000
Ohio	2,099,000	6,462,000
Tennessee	110,000	305,000
Virginia	2,408,000	5,091,000
West Virginia	1,308,000	3,289,000
Total	8,964,000	21,020,000

The following sheets show the detail for each company.

APPALACHIAN POWER CO.

New expenditures if tax credit available

	With 3-percent credit	Additional projects if credit is 7 percent
Distribution reconductoring, Virginia and West Virginia	$100,000	$100,000
Relay modernization, Virginia and West Virginia:		
138 kilovolt	120,000	
Subtransmission	100,000	165,000
Transformer replacement at Glen Lyn, Va.: 30,000 kilovolt-ampere		100,000
Circuit breaker replacement, Virginia and West Virginia:		
3 138 kilovolt	150,000	
5 69 kilovolt	110,000	
20 69 kilovolt		440,000
5 34 kilovolt	92,000	
12 34 kilovolt		218,000
25 15 kilovolt	135,000	
150 15 kilovolt		850,000
Distribution stations:		
Barboursville, W. Va., 34/12 kilovolt, 5,000 kilovolt-ampere	40,000	
Montgomery, W. Va., 46/12 kilovolt, 3,750 kilovolt-ampere and line conversion		64,000
Abingdon, Va., bank No. 2 regulator	15,000	
Cana, Va., station: 69/12 kilovolt, 5,000 kilovolt-ampere and line conversion	484,000	
Willis, Va., station: 69/12 kilovolt, 2,500 kilovolt-ampere and line conversion		370,000
Moneta, Va., station: 138/12 kilovolt, 7,500 kilovolt-ampere and line conversion		300,000
Clearbrook, Va., station: 138/12 kilovolt and line conversion		197,000
Kanawha-Chemical, 138-kilovolt line, 23.7 miles (West Virginia)	250,000	
Sporn-Darrah, 138-kilovolt line, 7 miles, and switching (West Virginia-Ohio)	550,000	
Galax, Va., area, 88/69-kilovolt transformer and 69-kilovolt line conversion	1,200,000	
Distribution and subtransmission capacitors, 60,000 kilovolt-ampere rating (Virginia and West Virginia)	300,000	
Fieldale, Va., area, conversion to 69 kilovolts		250,000
Mullin, W. Va., 138/46/12-kilovolt station		350,000
Chemical, W. Va., 138/46-kilovolt transformer		300,000
Portable stations (Virginia and West Virginia)		150,000
Supervisory and monitoring equipment:		
Charleston, W. Va., and Roanoke, Va	120,000	
Huntington, W. Va., and Lynchburg, Va		60,000
Microwave extensions:		
Huntington-Big Sandy-Ashland (West Virginia-Kentucky)		[1] 130,000
Smith Mountain-Lynchburg-Danville (Virginia)		145,000
Kingsport-Beaver Creek-Huntington (Tennessee-Kentucky-West Virginia)		[1] 65,000
Replacement of radio frequency at Coal Fork, Lick Knob, and Flat Top (West Virginia)		140,000
Total	3,766,000	4,394,000
Total expenditures (col. 1 plus col. 2), 7-percent credit		8,160,000

[1] Represents only amounts to be spent in West Virginia.

INDIANA & MICHIGAN ELECTRIC CO.

New expenditures if tax credit available

	With 3-percent credit	Additional projects if credit is 7 percent
Circuit breaker replacement:		
10 34.5 kilovolt, Indiana and Michigan	$160,000	
11 34.5 kilovolt, Indiana and Michigan		$154,000
Hartford City, Ind., 4 kilovolt		54,000
West End, Ind., 4 kilovolt		15,000
Relay modernization, 138 kilovolt, Indiana and Michigan	45,000	
Relay modernization subtransmission, Indiana and Michigan	20,000	102,000
Transformer replacement, South Bend, Ind		150,000
Transmission reconductoring:		
Reconductor 5.8 miles of Elkhart Hydro (Ind.)		
Reconductor Bristol, Ind., 34.5-kilovolt line and add static wire	65,000	
Reconductor 6.2 miles of Lakeside, Mich., 34.5-kilovolt loop and add static wire	64,000	
Reconductor 8 miles of Hartford City-Montpelier 34.5-kilovolt line (Indiana)	80,000	
Distribution reconductoring:		
Marion-Muncie division, 21.7 miles (Indiana)	245,000	
Marion-Muncie division, 22 miles (Indiana)		225,000
Fort Wayne division, 13.2 miles (Indiana)	137,000	
Fort Wayne division, 13.12 miles (Indiana)		132,000
South Bend division, 36 miles (Indiana and Michigan)	335,000	
South Bend division, 36.2 miles (Indiana and Michigan)		329,000
Distribution and subtransmission capacitors:		
100,000 kilovolt-ampere rating (Indiana and Michigan)	600,000	
50,000 kilovolt-ampere rating (Indiana and Michigan)		300,000
Albion-Churubusco 69-kilovolt line, 13 miles (Indiana)	400,000	
South Bend, Ind., extension of underground network facilities	250,000	
Portable stations, Indiana and Michigan		300,000
Microwave extensions:		
Deer Creek-Muncie-Madison-Tanners Creek (Indiana)		385,000
Fort Wayne-Fostoria (Indiana-Ohio)		[1] 35,000
Supervisory and monitoring equipment:		
Fort Wayne and South Bend (Indiana)	190,000	
Marion, Muncie, Elkhart (Indiana)		125,000
Total	2,591,000	2,306,000
Total expenditures (col. 1 plus col. 2), 7 percent credit		4,897,000

[1] Represents only amounts to be spent in Indiana.

KENTUCKY POWER CO.

New expenditures if tax credit available

All projects listed below are in Kentucky except as otherwise noted.

	With 3-percent credit	Additional projects if credit is 7 percent
Circuit breaker replacement:		
2 69 kilovolt		$40,000
3 34.5 kilovolt	$54,000	
2 34.5 kilovolt		36,000
20 15 kilovolt	110,000	
10 15 kilovolt		50,000
Relay modernization:		
138 kilovolt	20,000	
Subtransmission	20,000	
Distribution reconductoring	75,000	75,000
Ashland business district: Add 2 feeders	49,000	
Distribution and subtransmission capacitors, 20,000 kilovolt-ampere rating	120,000	
Microwave extensions:		
Huntington, Big Sandy, Ashland (West Virginia-Kentucky)		[1] 150,000
Kingsport, Beaver Creek, Huntington (Tennessee-Kentucky-West Virginia)		[1] 177,000
Total	448,000	528,000
Total expenditures (col. 1 plus col. 2), 7-percent credit		976,000

[1] Represents only amounts to be spent in Kentucky.

KINGSPORT UTILITIES, INC.

New expenditures if tax credit available

All projects listed below are in Tennessee except as otherwise noted.

	With 3-percent credit	Additional projects if credit is 7 percent
Distribution reconductoring	$50,000	$50,000
Highland line conversion, 4 kilovolt to 12 kilovolt		100,000
Distribution and subtransmission capacitors, 10,000 kilovolt-ampere rating	60,000	
Microwave extension: Kingsport, Beaver Creek, Huntington (Tennessee-Kentucky-West Virginia)		[1] 45,000
Total	110,000	195,000
Total expenditures (col. 1 plus col. 2), 7-percent credit		305,000

[1] Represents only amounts to be spent in Tennessee.

OHIO POWER CO.

New expenditures if tax credit available

All the projects listed below are in Ohio except as otherwise noted.

	With 3-percent credit	Additional projects if credit is 7 percent
Transformer replacement at Sunnyside: 2 50,000-kilovolt-ampere, 138/69/23 kilovolts	$300,000	
Circuit breaker replacement:		
20 15-kilovolt	240,000	
30 15-kilovolt		$360,000
Relay modernization:		
138-kilovolt	170,000	
Subtransmission	65,000	195,000
East Lima 138-kilovolt line to Rockhill, 10 miles, and switching		1,000,000
West Lima 138/69/34.5-kilovolt and 138/12-kilovolt transformers and associated Central Ave. improvements	300,000	150,000
North Lima 138/12-kilovolt transformer		250,000
Distribution and subtransmission capacitors, 80,000-kilovolt-ampere rating	480,000	
Elimination of radial service		1,400,000
Supervisory and monitoring equipment:		
Canton, Lima	114,000	
Zanesville, Portsmouth, Newark		98,000
Portable stations		300,000
Microwave extensions:		
Lima, Fostoria, Howard, Massillon, Canton		300,000
Kammer-Clarington-Sporn (West Virginia-Ohio-West Virginia)		[1] 200,000
Fort Wayne-Fostoria (Indiana-Ohio)		[1] 110,000
Total	1,669,000	4,363,000
Total expenditures (col. 1 plus col. 2), 7-percent credit		6,032,000

[1] Represents only amounts to be spent in Ohio.

WHEELING ELECTRIC Co.

New expenditures if tax credit available

All the projects listed below are in West Virginia.

	With 3-percent credit	Additional projects if credit is 7 percent
Rebuild Moundsville bus for sectionalizing	$100,000	
Distribution reconductoring	75,000	$75,000
Circuit breaker replacement: 15 15-kilovolt	85,000	95,000
Distribution: 12 kilovolt Brues and Benwood		100,000
Distribution and subtransmission capacitors 20,000 kilovolt-ampere rating	120,000	
Total	380,000	270,000
Total expenditures (col. 1 plus col. 2) 7-percent credit		650,000

The CHAIRMAN. Mr. Cook, I would like to ask this question. Is it your belief that your company would not make these capital expenditures unless you get the 7 percent or 3 percent?

Mr. COOK. Yes. I can state to the committee categorically that these expenditures are not in any budget of any of our companies through 1964.

The CHAIRMAN. Well, you earn how much on your investment now?

Mr. COOK. I will give it to you on two bases, Senator. We have amounts accumulated for deferred taxes, and, excluding those amounts from the rate base, our earnings aggregate approximately 5.9 percent.

Senator WILLIAMS. That is after taxes?

Mr. COOK. That is after taxes. Including the amounts accumulated for deferred taxes in our rate base, our earnings aggregate approximately 5.5 percent of our total assets.

The CHAIRMAN. When you borrow money in the market, what do you pay?

Mr. COOK. It depends on the company, and whether it is long or short term. Short-term borrowings today are at the prime rate which is 4½ percent, long-term borrowings on an AA bond, and all our companies now have an AA rating for a first mortgage bond, the rate would be approximately 4⅜ percent.

The CHAIRMAN. Your rates are fixed by the agencies of the States in which you operate?

Mr. COOK. Yes. There is a regulatory body with plenary control over rates in every jurisdiction in which we operate, Senator.

The CHAIRMAN. And the average is about 6 percent?

Mr. COOK. Our return?

The CHAIRMAN. Yes.

Mr. COOK. As I have indicated, excluding accumulated amounts invested in the business arising from deferred taxes from any part of the rate base, our earnings on total assets are 5.9 percent, approximately.

The CHAIRMAN. Well, these regulatory agencies, how would they regard this tax credit?

Mr. COOK. In my opinion, Senator——

The CHAIRMAN. As an income—they couldn't regard it as an income because it is more than an income.

Mr. Cook. I think you may get differences of opinion but I am going to make a very categorical statement. If this tax credit is obtained, and when we have the regulatory experience behind us, if what I say today does not turn out to be the fact, I will eat the hat of every member of this committee.

Senator Williams. We only have one hat, don't start eating it. [Laughter.]

Mr. Cook. Well, I won't have to eat any, Senator. What I say is this, as Senator Gore has indicated, this operates in truth and in fact as a tax reduction. There is no question about it.

Now, Federal income taxes for a public utility company are an operating expense. This tax reduction will reduce operating expenses and there is no question, in my opinion, but all of the State regulatory bodies will regard it as such, and, therefore, the amount of the revenues which will be necessary to obtain from the customers in order for the utility company in question to earn a fair return on its rate base is going to be that much less.

However, we need to recognize that there are all kinds of other expenses incurred by utility companies and that the magnitude of these expenditures is always varying.

For example, wages are constantly increasing. Fuel costs are constantly increasing. It may be that these increased expenses will offset the reduction in taxes. But all that means, Senator, is that if there are no rate reductions, the net effect has been to avoid what otherwise would have been rate increases.

The Chairman. In simple language, it seems to me what it means is that you get a tax reduction whereby you use that money for capital expenditures.

Mr. Cook. We don't need the money for that purpose—excuse me.

The Chairman. You just have said you are going to use the money for capital expenditures.

Mr. Cook. What I have tried to say to the committee, Senator, is that the reduction in taxes will reduce our fixed charges, and by reducing the fixed charges it will make marginal projects feasible. We do not need the cash that would become available, although some industries may, we do not need the cash that would become available from this tax reduction in order to finance the additions to our plant. If we can reduce our fixed charges, we would be in a position to finance out of our own resources or by going to the capital markets all of this plant and any other plant that we need to construct.

The Chairman. But you have pinpointed these particular investments in these particular States.

Mr. Cook. Yes, sir.

The Chairman. Upon the premise that you get the tax reduction.

Mr. Cook. That is correct, sir.

The Chairman. And my State is the second State, and I think your company has a very efficient operation in Virginia. But I would like you to clear my mind, if I am not correct, that this tax reduction which comes out of the Treasury of the United States; is that right, any tax reduction——

Mr. Cook. That is correct.

The Chairman. Reduces revenue?

Mr. Cook. That is correct, Senator.

The CHAIRMAN. That money goes to you.

Mr. COOK. That is true.

The CHAIRMAN. And you undertake these new capital investments?

Mr. COOK. That is correct.

The CHAIRMAN. And you earn money on them, I assume?

Mr. COOK. Yes.

What I was saying to the Senator is that even though we were to pass on to the customers of our companies 100 percent of the amount of this tax reduction that, because the tax reduction has cut our fixed charges, and, therefore, has decreased the amount of revenue which we need to support an expenditure for plant and equipment, we could and would go ahead with these expenditures.

The CHAIRMAN. Have you given any thought to the fact that this credit is estimated in 10 years to cost the Federal Government $20 billion, and if it does——

Mr. COOK. Have I——

The CHAIRMAN. Wait just a minute.

If it does do it, other taxes may be necessary in order to make up for that loss of $20 billion. Those taxes, of course, would fall on you as well as everybody else.

Mr. COOK. Yes. I think it was Justice Holmes who said that taxes are the price of civilization, and I think that we all need to be reconciled to that.

The administration has put forward this legislation on two bases, as I understand it: One, to enable our industry to compete more effectively abroad and, secondly, to assist in the expansion of industry at home, and what I have testified to is that in truth and in fact—insofar as the electric utility industry is concerned—this legislation is calculated to produce more construction at home.

The CHAIRMAN. There is a great difference of opinion about that if you have kept up with these hearings.

Mr. COOK. I know that, Senator, but I can only testify to my own opinion, and I can only state the reasons that I hold for that opinion and give to the committee a concrete manifestation of our good faith by putting $21 million of new projects on the table.

The CHAIRMAN. I submit, though, it is quite remarkable, for you to say you will only build these particular capital investments providing you get a gift, because that is what it is, from the Federal Government in the way of reduction of taxes.

Mr. COOK. Well, I think it is a point which has needed making for a long time, and I am glad the Senator has observed that and I hope that the Senator, and I know he has, has observed that there is very sharp conflict between my testimony and the testimony which has been given to the committee by the Secretary of the Treasury.

The CHAIRMAN. As I understand, the Secretary of the Treasury's position is he was not in favor of any tax credits for utilities.

Mr. COOK. That is correct and for reasons——

The CHAIRMAN. And the House put in 4 percent at the beginning and then reduced it to 3, and he came before this committee and he urged that that 3 percent be eliminated.

Mr. COOK. He did, and for reasons which were set forth voluminously in an appendix to his statement. Without knowing who prepared the statement, I think that I would be prepared to say categorically to the Senator and to the committee that whoever it was, that individual or individuals are not completely informed with respect to the electric utility business.

The CHAIRMAN. The U.S. Chamber of Commerce opposes the tax credit, the National Association of Manufacturers opposes the tax credit, the AFL-CIO opposes it. The American Farm Bureau and the National Farmers Union oppose it.

They represent the four big segments of industry, the farmers, the laboring people, and the business people.

Mr. COOK. Yes, that is a very formidable——

The CHAIRMAN. They have no reservations in opposition whatever; they are straight out against the tax credit.

Mr. COOK. I understand that, Senator. I can only speculate as to why they oppose it but if my speculation is of any interest to the committee I would be glad to do it.

The CHAIRMAN. You say somebody wrote a report for Secretary Dillon and it was not correct. Did I understand you to say that?

Mr. COOK. Yes, I do so state.

The CHAIRMAN. Well, isn't he responsible for what he reads to this committee?

Mr. COOK. I believe he is.

The CHAIRMAN. If—will you send to this committee a memorandum showing wherein what he said was incorrect?

Mr. COOK. Yes, I will, and indeed some of my testimony this morning, Senator, indicated where it was incorrect. I think it was particularly incorrect—and the part that bothered me the most—in the position taken that reductions in rates would not increase the use of electric energy, when there is within the executive branch of the Government, to my certain knowledge, clear information that the facts are to the contrary.

(The memorandum referred to will be inserted in the record upon its receipt at a later date.)

The CHAIRMAN. I would like to say this about Secretary Dillon, however.

While I don't agree with him in some things, he is one of the best informed witnesses that we ever have had before this committee. Now, you say somebody has written a report for him which is not accurate.

Mr. COOK. Well, Senator, I am sure that the Secretary didn't write it himself, and I am sure that he had entire trust and confidence in whoever prepared it but that cannot change the fact that there are statements made in that report that are not correct.

Senator WILLIAMS. Did you write your own report?

The CHAIRMAN. I think it is quite a reflection on the Secretary to say he didn't know what he was testifying about.

Mr. COOK. Well, Senator, one either has to assume that he was imposed on or that he knew that the facts were not correct and I know that the Secretary or any Secretary would not represent to this or any other committee something that he knew was incorrect.

The CHAIRMAN. You will furnish a memorandum as to that?

Mr. COOK. I will be glad to do that.

The CHAIRMAN. Senator Kerr?

Senator KERR. Well, Mr. Cook, I want to express my appreciation to you for the presentation of a very forthright and vigorous and, I think, effective statement.

Now, as I understand it you are not making the proposal here to do certain things in the way of construction projects in return for a tax reduction.

If I understand your presentation you are telling this committee that if you get this specific tax reduction that it will be economically feasible for you to construct these projects and if you don't get it they won't.

Mr. COOK. That is exactly my testimony, Senator.

Senator KERR. You are not trying to make a trade with the Congress. You have called attention to the fact that the recommendation of this tax credit proposal has two basic underlying justifications in the statements by the administration.

No. 1, to make more American industry able to compete more effectively in the world market, and in the Common Market, and No. 2, to increase the tempo of the expansion of our own domestic industry.

Mr. COOK. Senator, we are in no position to make a trade with anyone and I would regard it as unseemly and improper for me or for anyone else to come before this committee or before Congress in that kind of a posture.

Senator KERR. I would say this to you, I wish every industry would come before this committee and if they favor this tax credit say, if it is passed, it will enable their industry to do the following things, which are consistent with the objective of expanding the domestic economy.

Mr. COOK. Senator, speaking for myself, I grow very weary of the broad brush, the vague generality, the promise without the performance. I think that candor requires one to come before a committee such as this in these circumstances and not speak generally but to state concretely what it is they propose to do if thus and so happens and that is what I have tried to do before this committee today.

Senator KERR. On the basis that the doing of a certain thing would make certain programs possible under the rules or under the specifications which your industry operates.

Mr. COOK. That is true, Senator.

What I am saying is that if Congress in its wisdom decides that these shall be the rules, then this is what Congress may expect in the way of performance from us under those rules.

Senator KERR. This is what it will make possible for your company to do?

Mr. COOK. Yes, sir; that is true.

Senator KERR. Now, I was quite interested in what you were about to say and I don't know what it was, but I will stay to the committee that I have a very high respect for this witness. I have known him a long time, and the Senator from Oklahoma had a part in writing the present law for the financing of TVA.

Members of this committee are quite well aware of the fact that when that bill was before the Congress there were a number of conflicting interests that manifested very much opposition. There was the administration's viewpoint; there was the viewpoint of the representatives of the valley; there was the viewpoint of the utilities in the surrounding area served by the valley. In order to get a bill it seemed to the Senator from Oklahoma, who was chairman of the subcommittee that had jurisdiction of the bill, that it was necessary to resolve the differences between those three viewpoints to the extent that would secure the passage of legislation by the Congress.

I want to say to the committee it was this witness more than any other who very effectively represented the viewpoint of the utilities surrounding the valley and who was to a large degree responsible for an attitude on their part of give and take compromise as between their basic objectives and those of the administration and those of the representatives of the valley which made possible the bill that was finally evolved and passed.

That is just one of the experiences I have had with him that has developed within me a great respect for him.

Now, with reference to your company, you tell us it is largest, the largest electric utility system in the country that is engaged exclusively in the generation, transmission, distribution, and sale of electricity.

Mr. COOK. Yes. The largest investor-owned electric utility system—as measured by the amount of electric energy which we generate and distribute.

Senator KERR. What is the total, and I assure you if any of these figures are not public anyway, you advise me and I will withdraw the question. What is the total present depreciated investment figure for your company?

Mr. COOK. I have that figure here, Senator. Our electric utility plant at original cost is $1,818 million.

We have accumulated provisions for depreciation of $431 million, so our electric plant less depreciation is $1,387 million.

Senator KERR. What is the present debt structure?

Mr. COOK. We have outstanding, Senator $751 million of long-term debt securities approximately, $101.5 million of preferred stock and the balance consists of common stock equity.

Senator KERR. Now, you tell us that you have your 1962, 1963, and 1964 budgets?

Mr. COOK. We have, and——

Senator KERR. What are the annual expenditures in the budgets exclusive of this bill, the effect of the bill?

Mr. COOK. For 1962 we have budgeted construction of $152 million. For 1963, $118 million and for 1964, $64 million.

Senator Kerr. Now, would the 1963 and 1964 budgets probably be increased as you approach them or is this a 3-year program that you feel, taken together, will probably represent the ultimate expenditure for the 3 years?

Mr. COOK. 1962 is fixed, 1963 will include some modest increases.

It is inevitable that during the course of a year, Senator, when we are planning as far ahead as we are here, that other things will come along that we will wish to build. The figure for 1964 in my opinion will be substantially increased and may aggregate in the area of $90 million to $100 million when 1964 gets here.

Senator KERR. Your 1962 is how much?

Mr. COOK. $152 million.

Senator KERR. How much of that would be paid out of cash flow generated by your operation and how much of that would be taken care of necessarily by additional financing?

Mr. COOK. I would judge that approximately $82.5 million would be generated internally and that would leave approximately $69.5 million which will have to be financed externally.

Senator KERR. You refer in your prepared statement to the situation that you describe as follows: The demands for electric energy is not fixed and it does not grow at some unalterable rate but is greatly influenced by price and, of course, nobody recognizes the accuracy of that statement more than the Senator from Oklahoma.

Is there available an accurate chart showing the annual requirements of electric power in this Nation beginning with 1920 and down to and including this year?

Mr. COOK. I believe that those figures are available, Senator.

Senator KERR. Are they readily available?

Mr. COOK. Well, let me put it this way——

Senator KERR. Could they be put into this record?

Mr. COOK. I can quickly find out whether they are readily available and if they are I will get them and make them available for this record and if they do not go back to 1920 I will make available whatever figures are available.

Senator KERR. Are readily available?

Mr. COOK. Yes, sir.

Senator KERR. Could you give us what I would refer to as an off-the-cuff opinion of what the record will reflect as to the average period of time, if there has been one, in which the consumption of electrical energy in this country has doubled?

Mr. COOK. It is approximately 10 years, Senator, although on our own system it has been doubling in a somewhat shorter period.

Senator KERR. Well, now, that is a very interesting statement.

I have asked that question of many utilities and without exception they tell me that the record is that electric consumption has doubled approximately every 10 years. Yet without exception the one speaking has said in our own experience it has doubled at the rate of every 7 to 8 years.

Now, that is the case in Oklahoma. It is the case in Arkansas, and now you tell me that is the case in your area.

Mr. COOK. That is true.

Senator KERR. Therefore, I am quite anxious to have the accurate record for the years that are readily available.

Mr. COOK. I have here, Senator, this has just been handed to me, a document called "Statistical Yearbook of the Electric Utility Industry for 1960," prepared by the Edison Electric Institute, which is our statistical gathering and disseminating trade association, and table 8 on page 13 of this document sets forth the information which the Senator desires.

It happens to start exactly with 1920 and it ends with 1960 and I offer this for the record.

Senator KERR. That is very good and I don't want the record to have the entire book in it but that part of it which reflects the information or answers to the question I asked I would like to have inserted in the record.

(The information referred to follows:)

Item I

[From Edison Electric Institute "Statistical Yearbook of the Electric Utility Industry for 1960"]

Table 8.—*Electricity made available in the United States*

[Kilowatt-hours in millions]

Year	Generation: Investor-owned utilities	Generation: Government and cooperatives	Generation: Total electric utility industry [1]	Generation: Other sources [2]	Generation: Total	Net imports of electric energy	Total available in contiguous United States	Alaska and Hawaii	Total available in United States	Estimated population [3] (thousands) (June 30)	Kilowatt-hours per person
1960 (preliminary)	578,360	174,501	752,861	87,596	840,457	4,528	844,985	3,180	848,165	[4] 179,977	4,713
1959 (revised)	544,234	165,772	710,006	85,245	795,251	3,607	798,858	2,846	801,704	[4] 177,131	4,526
1958	490,402	154,696	645,098	79,654	724,752	3,318	728,070	----------	----------	173,232	4,203
1957	480,943	150,564	631,507	84,849	716,356	3,601	719,957	----------	----------	170,293	4,228
1956	459,015	141,653	600,668	84,136	684,804	4,548	689,352	----------	----------	167,259	4,121
1955	420,869	126,169	547,038	81,972	629,010	4,068	633,078	----------	----------	164,303	3,853
1954	370,970	100,716	471,686	72,959	544,645	2,340	546,985	----------	----------	161,183	3,394
1953	354,272	88,393	442,665	71,504	514,169	2,008	516,177	----------	----------	158,320	3,260
1952	322,126	77,098	399,224	63,831	463,055	2,269	465,324	----------	----------	155,767	2,987
1951	301,845	68,828	370,673	62,685	433,358	2,187	435,545	----------	----------	153,383	2,840
1950	266,860	62,281	329,141	59,533	388,674	1,786	390,460	----------	----------	151,228	2,582
1949	233,112	57,988	291,100	53,966	345,066	1,588	346,654	----------	----------	148,665	2,332
1948	228,231	54,467	282,698	54,110	336,808	1,545	338,353	----------	----------	146,093	2,316
1947	208,106	47,633	255,739	51,661	307,400	1,915	309,315	----------	----------	143,446	2,156
1946	181,020	42,158	223,178	46,431	269,609	2,391	272,000	----------	----------	140,054	1,942
1945	180,926	41,560	222,486	48,769	271,255	2,562	273,817	----------	----------	132,481	2,067
1940	125,411	16,426	141,837	38,070	179,907	2,114	182,021	----------	----------	131,954	1,380
1935	89,330	5,957	95,287	23,648	118,935	1,337	120,272	----------	----------	127,250	945
1930	86,109	5,003	91,112	23,525	114,637	1,592	116,229	----------	----------	123,077	944
1925	58,685	2,766	61,451	23,215	84,666	1,273	85,939	----------	----------	115,832	742
1920	37,716	1,689	39,405	17,154	56,559	940	57,499	----------	----------	106,466	540

[1] Not including industrial plants contributing to the public supply and imports.

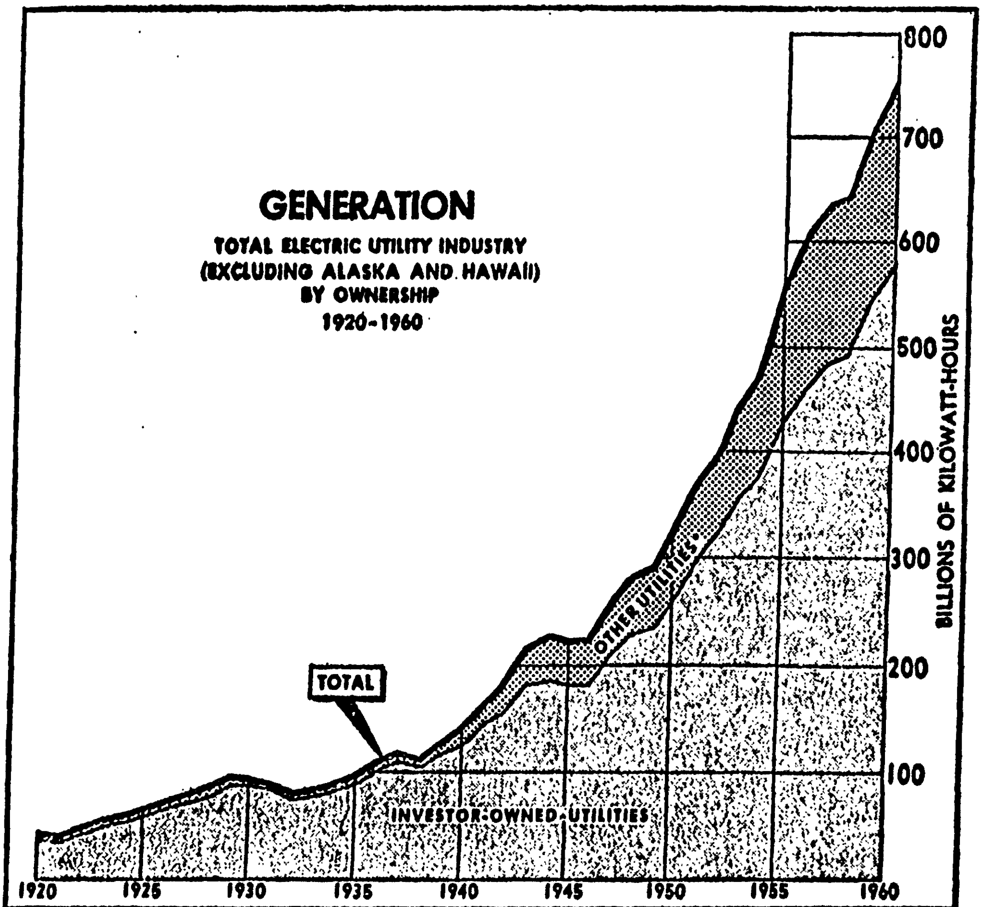
[2] Includes generation of industrial, mine, and railway electric powerplants whether or not contributing to the public supply. Does not include the generation of isolated plants in institutions, hotels, apartment houses, office buildings, amusement parks, etc., for which information is not available.

[3] U.S. Bureau of Labor estimates; excludes Armed Forces overseas.

[4] Including Alaska and Hawaii.

Source: Federal Power Commission.

Complete data from 1920–45 in "1952 Statistical Bulletin."



*Cooperative-Owned and Government-Owned Utilities Based on Table 9, page 14.

TABLE 7.—*Electricity available in the United States*

[Kilowatt-hours in millions]

Year	Generation: Total electric utility industry	Generation: Other sources [1]	Generation: Total	Net imports	Total available	Estimated population [2] (June 30)	Kilowatt-hours per person
1952	398,924	63,665	462,589	2,275	464,864	155,767,000	2,984
1951	370,673	62 685	433,358	2,187	435,545	153,383,000	2,840
1950	329,141	59,533	388,674	1,786	390,460	151,228,000	2,582
1949	291,100	53,966	345,066	1,588	346,654	148,665,000	2,332
1948	282,698	54,110	336,808	1,545	338.353	146,093,000	2,316
1947	255,739	51,661	307,400	1,915	309,315	143,446,000	2,156
1946	223,178	46,431	269,609	2,391	272,000	140,054,000	1,942
1945	222,486	48,769	271,255	2,562	273,817	132,481,000	2,067
1944	228,189	51,336	279,525	2,515	282,040	132,885,000	2,122
1943	217,759	49,781	267,540	2,497	270,037	134,245,000	2,012
1942	185,979	47,167	233,146	2,418	235,564	133,920,000	1,759
1941	164.788	43,518	208,306	2,331	210,637	133,121,000	1,582
1940	141.837	38,070	179,907	2,114	182,021	131,954,000	1,380
1939	127,642	33,666	161,308	1,894	163,202	130,880,000	1,247
1938	113,812	28.143	141,955	1,808	143,763	129,825,000	1,107
1937	118,913	27,563	146,476	1,827	148,303	128,825,000	1,151
1936	109,316	26,690	136,006	1,556	137,562	128,053,000	1,074
1935	95,287	23,648	118,935	1,337	120,272	127,250,000	945
1934	87,258	23,146	110,404	1,234	111,638	126,374,000	883
1933	81,740	20.915	102,655	967	103,622	125,579,000	825
1932	79,393	19,966	99,359	644	100,003	124,840.000	801
1931	87,350	22,023	109,373	1.209	110,582	124,040.000	892
1930	91,112	23,525	114,637	1,592	116,229	123,077,000	944
1929	92,180	24,567	116,747	1,423	118,170	121,770,000	970
1928	82,794	25,275	108,069	1,573	109,642	120,501,000	910
1927	75,418	25,972	101,390	1,619	103,009	119,038.000	865
1926	69,353	24,869	94,222	1,493	95,715	117,399.000	815
1925	61,451	23,215	84,666	1,273	85,939	115,832,000	742
1924	54,662	21,230	75,892	1,290	77,182	114,113.000	676
1923	51,229	20,170	71,399	1,331	72,730	111,950,000	650
1922	43,633	17,572	61,205	965	62,170	110,055,000	565
1921	37,180	15,945	53,125	1,009	54,134	108,541,000	499
1920	39,405	17,154	56,559	940	57,499	106,466,000	540

[1] Includes generation of industrial, mine, and railway electric power plants. Does not include the generation of isolated plants in institutions, hotels, apartment houses, office buildings, amusement parks, etc. for which information is not available.

[2] Population excludes Armed Forces overseas.

Senator KERR. It just happens that our Water Resources Committee asked that particular identity to forecast the requirements through 1980, and they submitted it to that committee, and I wonder if the document you have in your hand has a portion of it which gives that information.

Mr. COOK. I will have that checked, Senator.

Senator KERR. If it does not, I would like to have that forecast which this institute, I believe, or some of its leading members, and I think they made it through this institute as a vehicle available to the water resources committee that forecast placed in the record at this same point.

Mr. COOK. To be sure would the reporter be good enough to read Senator Kerr's request?

Senator KERR. It is that the forecast which was made by that identity or the certain members of that and given to the Senate Select Committee on National Water Resources of which I was the chairman forecasting electrical requirements through 1980.

Mr. COOK. Yes, I understand, Senator.

(The information referred to follows:)

ITEM 2

[From "Water Resources Activities in the United States, Electric Power in Relation to the Nation's Water Resources," Select Committee on National Water Resources, U.S. Senate (Committee Print No. 10, 86th Cong., 2d sess., 1960)]

Table III gives peakloads in megawatts and energy in million kilowatt-hours for the years 1959, 1970, and 1980 for the total industry by FPC regions.

TABLE III.—*Peakloads and energy requirements, total electric utility industry,*[1] *forecasted by Edison Electric Institute*

FPC region	1959		1970		1980	
	Peakload (megawatts)	Energy requirements (million kilowatt-hours)	Peakload (megawatts)	Energy requirements (million kilowatt-hours)	Peakload (megawatts)	Energy requirements (million kilowatt-hours)
I	27,312	138,846	49,815	268,468	82,851	458,776
II	23,839	140,644	45,507	267,200	84,093	493,600
III	23,909	138,220	55,105	310,093	110,209	612,062
IV	[2] 14,744	80,649	[2] 29,147	151,757	[2] 53,125	276,768
V	[2] 14,185	69,967	[2] 40,315	197,023	[2] 88,580	440,406
VI	2,613	13,102	7,020	35,583	14,791	72,425
VII	9,867	57,021	19,500	108,624	35,700	193,158
VIII	[2] 12,139	68,465	[2] 25,383	142,318	[2] 44,445	247,665
Total	[3] 129,000	706,914	[3] 265,000	1,481,066	[3] 501,000	2,794,860

[1] Includes investor-owned systems, Federal and non-Federal Government agencies and cooperatives. Does not include industrial, mine, railway electric powerplants, and isolated plants in institutions, hotels, apartment houses, office buildings, etc.

[2] Designates a summer peak.

[3] This total peakload is not the sum of the individual regional peaks because the regional peaks do not necessarily all occur at the same time whereas the total peakload shown is the estimated annual maximum for the country as a whole.

The manner in which the total industry load is being supplied, by regions, for the year 1959, is shown in table IV.

TABLE IV.—*Capability types used to supply total electric utility industry load,*[1] *estimated by Edison Electric Institute, 1959*

FPC region	Peakload (megawatts)	Capability at time of regional peak (megawatts)				
		Conventional thermal	Nuclear thermal	Hydro[2]	Other sources[3]	Total
I	27,312	29,074		3,375	472	32,921
II	23,839	29,543	60	471	241	30,315
III	23,909	22,331		6,425	(48)	28,708
IV	[4] 14,744	16,550		835	200	17,585
V	[4] 14,185	16,582		1,072	285	17,939
VI	2,613	2,524		1,194	36	3,754
VII	9,807	1,038		11,182	193	12,413
VIII	[4] 12,139	9,030	5	5,382	55	14,472

[1] Includes investor-owned systems, Federal and non-Federal Government ag[illegible]es and cooperatives. Does not include industrial, mine, railway electric powerplants, and isolated plant[illegible]n institutions, hotels, apartment houses, office buildings, etc.
[2] Median hydro conditions.
[3] Other sources include firm capability available to the region from nonutility facilities within the region plus firm receipts from outside the region minus firm commitments to others outside the region.
[4] Designates a summer peak.

These capability figures for the total industry for the year 1959 are available from the semiannual survey of the Electric Power Survey Committee of the Edison Electric Institute.

Forecasts for investor-owned utility companies

As previously indicated, the institute does not have complete information on how power suppliers other than the investor-owned utility companies will expand their capicity requirements in the future years of 1970 and 1980. Consequently, the following section on recommended means of serving future loads has been confined to investor-owned systems.

Before discussion the anticipated ways (conventional, nuclear, and hydro) that the investor-owned systems propose to use in serving their loads in 1970 and 1980, however, it is well to describe briefly factors that affect the installation of capacity and load growth in the various FPC regions. It should be noted that the individual regional peakloads occur in both the summer and December periods. Thus, peakloads are customarily reported on a summer and December basis, but it must be realized that local conditions can alter the exact time of the peak for individual systems.

New capacity is always scheduled for installation just ahead of the peakload period for the year. Thus, companies with summer peakloads plan their capacity additions for initial operation in the spring, while companies with December peaks plan to have their new capacity additions go into service in the fall. An inspection of table V at the end of this section indicates that the estimated rate of load growth is by no means uniform as between the regions. The resulting figures are related to the probable population shifts to the southern, southwestern, and western sectors of our country and the nature of anticipated economic changes.

These growing loads have an effect on the type of capability installed in the future. For instance, hydro capability may currently provide cheaper power than thermal means at the load center in certain sections of the country. But this situation may not continue as loads increase and the number of economic hydrosites decrease.

While the electric industry makes long-range forecasts extending over 10 years or more, programing of specific plans, design, and actual construction falls within a 5-year range. Thus, actual construction closely precedes and is related to the growth patterns in any region as they are about to take place. The result is a longstanding record by the investor-owned utilities of anticipating and adequately meeting the electric power needs of the public served.

Senator KERR. I was quite interested in your statement that the electric utility industry not only spends more on capital investment than any other industry, because I have had other statements which are not consistent with it, and I have no higher respect for any from whom I have heard a statement on this matter than I do from this witness, but if this is not a heavy burden, and if it is for this witness, I shall ask the Congressional Library Reference Service to provide it, a tabulation showing annual investments by American transportation industry, American agricultural industry, American public utilities, electric utilities, total American public utility investment and total investments by the American oil and gas industry.

Mr. COOK. I am sure that I can readily provide most of these figures, Senator. I am not sure with respect to agriculture, and just to insure that the completion of the record is not held up it might be useful if the Senator could use Government sources for the figures on agriculture.

Senator KERR. I wonder, then, if the chairman would agree that the committee address a communication to the Legislative Reference Service of the Congressional Library to advise us as to the annual investment equipment by American agriculture.

The CHAIRMAN. Without objection.

(The material subsequently submitted by Mr. Cook and the latter data referred to follow:)

ITEM 3

[From SEC Statistical Series, Release No. 1813, Mar. 13, 1962]

[TABLE 2.—*Expenditures on new plant and equipment by U.S. business,* [1] *1960–62*]

[Billions of dollars]

	1960	1961	1962 [1]	1960				1961				1962	
				January–March	April–June	July–September	October–December	January–March	April–June	July–September	October–December	January–March [2]	April–June [2]
All industries	35.68	34.37	37.16	7.89	9.28	8.98	9.53	7.57	8.61	8.65	9.54	8.14	9.44
Manufacturing industries	14.48	13.68	14.90	3.09	3.76	3.62	4.01	3.00	3.46	3.34	3.88	3.18	3.75
Durable goods industries	7.18	6.27	7.29	1.55	1.88	1.80	1.95	1.41	1.58	1.50	1.79	1.54	1.82
Primary iron and steel	1.60	1.13	1.48	.33	.42	.42	.43	.28	.28	.26	.30	.28	.35
Primary nonferrous metal	.31	.26	.31	.07	.08	.07	.09	.07	.07	.06	.07	.06	.07
Electrical machinery and equipment	.68	.69	.67	.12	.16	.17	.23	.15	.17	.17	.20	.14	.16
Machinery except electrical	1.10	1.10	1.24	.25	.28	.26	.30	.25	.28	.25	.32	.29	.30
Motor vehicles and parts	.89	.75	.90	.17	.23	.25	.23	.15	.20	.19	.21	.16	.20
Transportation equipment, excluding motor vehicles	.42	.38	.46	.10	.10	.10	.11	.09	.10	.09	.11	.09	.10
Stone, clay, and glass	.62	.51	.59	.14	.17	.15	.16	.11	.12	.12	.16	.14	.15
Other durable goods [3]	1.56	1.45	1.65	.36	.43	.37	.40	.30	.35	.36	.43	.38	.47
Nondurable goods industries	7.30	7.40	7.62	1.54	1.88	1.81	2.06	1.59	1.88	1.84	2.09	1.64	1.92
Food and beverage	.92	.98	1.00	.21	.25	.23	.23	.23	.25	.24	.27	.23	.26
Textile	.53	.50	.50	.12	.13	.14	.14	.12	.12	.12	.14	.13	.15
Paper	.75	.68	.68	.16	.18	.20	.21	.16	.17	.16	.18	.15	.17
Chemical	1.60	1.62	1.71	.33	.40	.40	.46	.33	.42	.40	.46	.36	.42
Petroleum and coal	2.64	2.76	2.82	.53	.69	.63	.78	.56	.70	.70	.80	.54	.67
Rubber	.23	.22	.28	.05	.06	.06	.06	.05	.05	.06	.07	.06	.06
Other nondurable goods [4]	.64	.65	.65	.15	.17	.16	.18	.14	.17	.16	.18	.17	.18
Mining	.99	.98	1.01	.22	.27	.25	.24	.21	.26	.25	.26	.24	.27
Railroad	1.03	.67	.80	.25	.29	.24	.25	.17	.18	.16	.16	.19	.22
Transportation other than rail	1.94	1.85	1.34	.47	.55	.47	.46	.41	.48	.47	.50	.41	.50
Public utilities	5.68	5.52	5.60	1.18	1.42	1.50	1.58	1.09	1.39	1.50	.154	1.07	1.31
Communication	3.13	3.22	13.00	.71	.80	.77	.85	.75	.81	.78	.88	3.05	3.40
Commercial and other [5]	8.44	8.46		1.98	2.19	2.13	2.14	1.94	2.04	2.16	2.32		

[1] Data exclude expenditures of agricultural business and outlays charged to current account.

[2] Estimates are based on anticipated capital expenditures reported by business in late January and February 1952. The estimates for the 1st and 2d quarters of 1962 have been adjusted when necessary for systematic tendencies in anticipatory data.

[3] Includes fabricated metal, lumber, furniture, instrument, ordnance, and miscellaneous industries.

[4] Includes apparel, tobacco, leather, and printing and publishing.

[5] Includes trade, service, finance, and construction.

NOTE.—Details may not add to totals due to rounding. Data for earlier years were published by the Department of Commerce in June 1957, March 1958, 1960, and 1961 issues of the Survey of Current Business.

EXPENDITURES ON NEW PLANT AND EQUIPMENT BY ELECTRIC AND GAS UTILITIES

The foregoing SEC table shows only an aggregate for public utilities other than railroads, other transport and communications. The following figures for the investor-owned electric utilities and for gas utilities have been obtained from the Edison Electric Institute and the American Gas Association, respectively.

[Billions of dollars]

Year	Electric utilities	Gas utilities
1960	3.33	1.85
1961 [1]	3.256	1.774

[1] Estimated.

(Mr. Woodworth, of the Joint Committee on Internal Revenue Taxation, subsequently supplied the following for the record:)

Investment in farm equipment (producers durable equipment)

[In millions of dollars]

1955	$2,500	1959	2,890
1956	2,200	1960	[1] 2,446
1957	2,277	1961	[1] 2,367
1958	2,847		

[1] Preliminary.

Source: National Income Unit, Department of Commerce.

Senator KERR. I was quite interested in your information about the electric utility industry consuming 178 million tons of coal for 1961.

Does that include the amount consumed by the TVA—Tennessee Valley Authority?

Mr. COOK. My recollection, Senator, is that these are the figures for the private utility industry but I will have it checked and I will send the Senator a letter.

Senator KERR. For the record.

Mr. COOK. For the record, yes.

Senator KERR. And if it does include the Tennessee Valley Authority specify the amount of their consumption and if it does not, then provide the committee with that information.

Mr. COOK. The committee can assume that it does not, that the figure is for the private utilities, the investor-owned utilties alone, but I will obtain the information with respect to TVA coal consumption and make it available for the record.

(The information referred to follows:)

ITEM 4

Coal consumption for steam electric generation

[Millions of tons]

Year	Total industry [1]	TVA [2]
1960	176.60	18.61
1961	182.14	19.15

[1] Source: Federal Power Commission, as reported in Feb. 26, 1962, issue of Electrical World.
[2] Source: TVA 1961 annual power report.

Senator KERR. And I was interested in the statement of the amount consumed by your system and would like for you to advise us the amount of other energy fuel used by your system.

Mr. COOK. We are almost exclusively a steam system, Senator.

Senator KERR. I understand, but then you might even use some gas or oil?

Mr. COOK. No. We use oil, Senator, only for lighting off the boilers and only for maintaining combustion when some of the units are operating at a very low load level, but we do not use either oil or gas as a regular fuel in our powerplants.

Senator KERR. In other words, your primary and practically your exclusive energy fuel is coal.

Mr. COOK. That is correct, Senator. I should state the reason for that. Our system lies in the central industrial area. It is in the heart of the coalfields. We have vast amounts of coat in Virginia, in West Virginia, in Kentucky, and our system not only serves that area but draws its fuel resources from the area.

Senator KERR. I heartily approve of that policy. I was only seeking information.

Of course, the answer to the question that could raise in the mind of anyone as to how it might be that your system which serves how many people——

Mr. COOK. Something over 5 million people, Senator.

Senator KERR. Which is a larger number than are served by the Tennessee Valley Authority, would have considerably less fuel requirements, especially in view of the fact that their steam generated coal is augmented by a vast amount of hydroelectric energy, but I presume the answer to that is found in the figure that you gave us that for 1961 the average residential use of energy was 4,017 kilowatt-hours.

Is that the figure for your area or is that the national figure?

Mr. COOK. That is the national figure, Senator.

Senator KERR. What is the figure for your area?

Mr. COOK. I will have it in just 1 second.

Senator KERR. You indicated in your statement that for the Tennessee Valley area it was 9,135 kilowatt-hours.

Mr. COOK. In 1961, Senator, the residential usage on our system averaged 4,476 kilowatt-hours.

Senator KERR. Which is 10 percent above the national average.

Mr. COOK. That is correct, sir.

Senator KERR. Does that overall national average include all rural homes as well as urban?

Mr. COOK. It does, Senator, yes.

Senator KERR. On page 11 of your prepared statement you gave the cost per kilowatt-hour in 1932 and in 1961.

Does that include the cost per kilowatt-hour to rural homes included in the average?

Mr. COOK. Yes, it includes everything, Senator.

Senator KERR. And naturally, it would include as a factor the average cost per kilowatt-hour not only in the Tennessee Valley, but also in the Pacific Northwest?

Mr. COOK. The figure in my statement is the figure for the American Electric Power system. The figures which I gave in my statement are figures for the customers served by the investor-owned companies and does not include the figures served by Government-owned power instrumentalities.

Senator KERR. That is it, you say, the Consumer Price Index has increased 116 percent, but the cost per kilowatt-hour has decreased by 48 percent?

Mr. COOK. Yes, sir.

Senator KERR. I can understand that. In the next paragraph you state the cost of residential electric service from the investor-owned utility industry has been reduced to 2.6 cents.

Mr. COOK. It has been reduced from 7 cents per kilowatt-hour, Senator, in 1926 to 2.6 cents in 1961.

Senator KERR. Yes.

Now, that is 2.6 cents per kilowatt-hour average cost of residential electric service from the investor-owned utility industry while on page 11 the national average is 1.22 cents per kilowatt-hour.

Mr. COOK. 1.22 cents per kilowatt-hour, Senator, is the average amount which the American Electric Power system receives for each and every kilowatt-hour that it sells, that is for commercial, industrial, and residential sales to customers.

Senator KERR. And the 2.6 cents is——

Mr. COOK. Solely residential.

Senator KERR. Solely residential?

Mr. COOK. Yes, sir.

Senator KERR. And the other includes every other source?

Mr. COOK. All energy sold.

Senator KERR. This is all electrical energy?

Mr. COOK. That is correct, sir.

Senator KERR. Are the figures on page 11 applicable exclusively to the cost of electrical energy service from investor-owned electric utilities?

Mr. COOK. The figures on page 11, the final paragraph; namely, 2.14 cents in 1932 and the 1.22 cents in 1961 are exclusively for American Electric Power.

Senator KERR. That is American privately owned companies?

Mr. COOK. No, figures are for the American Electric Power Co.'s subsidiary utility companies.

In other words, they are figures of our system.

Senator KERR. Of your system.

Mr. COOK. Yes, sir.

Senator KERR. I see.

In your statement you had a discussion of the effect of reduction in fixed charges with reference to the expenditures for plants from the standpoint of reduction in fixed charges being an incentive to build.

If I understood what you were telling us, that amounted to saying that this tax credit would result in the construction of more production facilities and the question I would like for you to answer is is it your opinion that this tax credit would result in the construction of more efficient generating facilities at an earlier date than that which would otherwise occur?

Mr. COOK. I know that to be the case.

Senator KERR. Because if that is the case, I would assume that you are telling us that the construction of more efficient generating facilities would mean your ability to generate electrical power at lower cost which of itself would result in economy to your domestic or residential customers and also result in an overall incentive for an acceleration in the overall economy which would be the beneficiary of lower operating costs particularly in the area of the cost of this energy source.

Mr. COOK. That is correct, Senator. And I believe that we are entitled to speak on that subject. In almost every year the American electric power system has had the most efficient powerplant in the United States.

Senator KERR. Say that again?

Mr. COOK. I say in almost every year the American electric power system has had the most efficient powerplant in the United States as measured by the number of B.t.u.'s required to generate a kilowatt-hour which is the way efficiency is measured and, although we provide only approximately 4½ percent of the electric energy consumed in the United States, we have regularly had either 5 or 6 of the top 10 most efficient powerplants in the United States each year.

So that while we are 4½ percent of the industry, we have had from 50 to 60 percent of the 10 most efficient powerplants in the United States.

So we think, in our system, that we know something about efficient generation and how to get it, and what the consequences of it are.

Senator KERR. Well now, if you have 4½ percent of generating capacity, is that what you are telling us?

Mr. COOK. Of the energy generated.

Senator KERR. Does that imply that you probably have 4½ percent of the generating capacity?

Mr. COOK. No. We have somewhat less than that, Senator, because we have a higher load factor on our system. But not much less than that.

Senator KERR. What would it be?

Mr. COOK. We have at the present time approximately 6 million——

Senator KERR. I mean 4 percent or what?

Mr. COOK. No; it would be more than that, I don't think it would reduce that 4.5 percent by anything more than, say, 0.1 or 0.2.

Senator KERR. In other words, probably then you would have 4.3 or 4.4 of the total generating capacity?

Mr. COOK. Yes, sir.

Senator KERR. Now, yours has cost $1,800 million?

Mr. COOK. Yes, sir; that includes the transmission, the distribution, and the other general property, too.

Senator KERR. Well, all others certainly would average costing as much proportionately as yours, because the overall average would be in areas less congested than yours; wouldn't it?

Mr. COOK. No. We are in an uncongested area, Senator. We are a system that serves the smaller communities.

Senator KERR. The estimate I am trying to make is whether or not total utility and electrical private-owned American electrical investment in the United States would not approximate something like 25 times what yours is?

Mr. COOK. It should be approximately that.

Senator KERR. But you are going to furnish that figure?

Mr. COOK. Yes, sir.

(The material referred to follows:)

INVESTMENT IN ELECTRIC UTILITY PLANT

As of December 31, 1961, the estimated of investment in electric utility plant was at least $64 billion, of which the investor-owned industry accounted for slightly under $49 billion.

This estimate was arrived at as follows:

		Billions of dollars
Investor-owned:		
Actual at Dec. 30, 1961 [1]		46.010
Estimated 1961 additions [2]	3.256	
Less estimated 1961 retirements (15 percent of additions)	.489	
		2.767
Total		48.777
Other:		
Class A and B publicly owned estimated, at Dec. 31, 1960 [3]		6.199
Federal power projects, at Dec. 31, 1959 [4]		5.232
REA borrowers, at Dec. 31, 1960 [5]		3.420
Total		63.628

[1] Source: Edison Electric Institute Statistical Yearbook of the Electric Utility Industry for 1960 (p. 58).
[2] Source: "Electrical World," Jan. 29, 1962 (p. 28).
[3] Source: Federal Power Commission, "Statistics of Electric Utilities in the United States, 1960, Publicly Owned" (FPC S–152) gives a figure of $4,339,000,000 for those class A and B publicly owned utilities reporting to the FPC, which the FPC estimates requests 70 percent of total investment by publicly owned agencies other than Federal projects and REA cooperatives. Adjusting to 100 percent produces a figure of $6,199,000,000.
[4] Source: Bureau of the Census, Statistical Abstract of the United States, 1961 (p. 527).
[5] Source: 1960 Annual Statistical Report, Rural Electrification Borrowers, U.S. Department of Agriculture (REA Bulletin 1–1) (p. XVI).

Senator KERR. You made a statement that I don't understand, even if it is grammatically correct. You say "or to build additional lines to provide two-way feeds rather than one-way feeds."

Mr. COOK. Yes, well——

Senator KERR. Do you suppose you could explain to a fellow with as limited a knowledge as I have got of operation of electric generation what two-way feeds mean and what one-way feeds mean?

Mr. COOK. Yes, sir.

Well, let's assume that we are providing service to a large industrial establishment. That service could be provided by having a single line or feeder go to that industrial establishment. If that line were down or were inoperative for any reason, that plant would not be able to obtain electric power.

A two-way feed would be an example of providing service to that plant from two different direction from independent lines.

Senator KERR. You don't need to go any further.

Mr. COOK. And it improves the reliability of the service.

Senator KERR. One other question: You indicate that you have set forth a number of projects here which you tell us this tax credit at 3 percent would make possible or tax credit at 7 percent would make possible.

Assuming that this tax credit is written into the law either on the basis of 3 percent or 7 percent or 4 percent tax credit for utilities, what effect, if any, do you think that would have upon the timetable for the development of atomic reactors in this country?

Mr. COOK. I think it will have some effect, Senator, although I wouldn't regard myself as sufficiently expert in the field to be able to express a judgment as to the time.

These additional expenditures which can be made are expenditures which will become possible because of the reduction of the fixed charges applicable to them.

Senator KERR. You have made that very clear.

Mr. COOK. Now, the capital investments required in connection with nuclear facilities are very large. They are much larger, I think as the Senator knows, than in the case of conventional steamplants.

Senator KERR. Yes.

Mr. COOK. Since those capital requirements are so large and since this tax credit proposal, if enacted, would have the result of decreasing the fixed charges, the whole tendency of this legislation will be to bring closer the time when nuclear power will be economically feasible.

I should point out that, if I may just add this, Senator, so I don't leave a misleading impression—insofar as the tax credit legislation also results in promoting the efficiency of conventional generation, conventional steamplants, then it makes the target that nuclear power has to shoot at a little more difficult target.

Senator KERR. That was the next question I was going to ask you.

Mr. COOK. Yes, sir.

Senator KERR. I am glad you provided the answer ahead of the question.

Mr. COOK. But, finally, I would like to say that the amount of the improvement in efficiency in conventional steamplants year by year, it seems to me, inevitably will be of a much lower magnitude than the possible improvement in the nuclear power field.

Senator KERR. In other words, due to the fact that you now have the benefit of nearly a hundred years of improvement you are in about the same situation compared to the nuclear-powered possibilities as the owner of the finest herd of beef cattle in the country is in in relation to the owner of a bunch of scrub stock who can find a bull to improve his herd a lot easier than you can find one to improve your herd.

Mr. COOK. Senator, I wouldn't know how to express it any better. It is a case of an old technology versus a new technology. And the new technology always has more possibilities, because by definition it has been less fully exploited.

Senator KERR. Now, this forecast that I asked you to put in here, and I think it was from the Edison Institute—is that what you called that?

Mr. COOK. Edison Electric Institute.

Senator KERR. Did you find it?

Mr. COOK. Yes; I have it.

Senator KERR. I mean, did you find the forecast?

Mr. COOK. We do not have the forecast for the future here, Senator, but we will provide it for the record.

Senator KERR. Here is what I was going to say about that. As I recall, they estimated that the relationship of 1980 to 1960 would be something over four times as great.

They also estimated that, I believe, approximately 20 percent of what would be used in 1980 would be generated from nuclear-powered generating facilities, and if that—if my recollection is accurate, and if those estimates are reasonably accurate, it would mean that in 1980 there would be nearly as much electric power generated from atomic energy sources as is now generated from all electric generating facilities.

Mr. COOK. I am not familiar with those figures, Senator. But accepting them, it strikes me as being somewhat optimistic, but certainly not impossible.

Senator KERR. If the consumption doubles each 10 years it will be four times as much in 1980 as it is in 1960, wouldn't it?

Mr. COOK. I think that anything that doubles at that rate must necessarily sooner or later reach a point where it will cease to double at that rate because the figures become too fantastic to be either believable or attainable.

How soon that period will arrive with regard to the consumption of electric energy, I don't think it is possible to say.

Looking ahead 20 years is one thing. Looking ahead 40 years as has been done in some forecasts and projecting on this ruler-and-pencil basis, I think is very dangerous——

Senator KERR. I am only talking about a 20-year forecast.

Mr. COOK. The 20-year forecast should be reasonably accurate.

Senator KERR. I want to say this, so far as I am concerned, at the rate of research growth and expansion which I think is something like 10 or more times per year now than it was 10 or 12 years ago, and with the results that have been made manifest of what can happen through research, scientific investigation, I must say that the statement you have just made in my judgment influences me less than any other one you have made, because I think that the indications are that rather than having approached the time of the slowdown, we are on the brink of the time of the greatest acceleration.

Mr. COOK. Acceleration of total usage of electric energy, Senator, or a greater proportion of nuclear energy?

Senator KERR. Oh, no, both.

Mr. COOK. I want to make clear that my——

Senator KERR. Total acceleration, primarily.

Mr. COOK. Well, I think that there are some forecasts going to the year 2000 that are rather exaggerated.

Senator KERR. I am not talking about the year 2000, I aim to be here in 1980.

Mr. COOK. They would be quite different.

Senator KERR. I haven't yet moved the objective date up to the year 2000.

So not that I don't contemplate the possibility of it, but I haven't done it yet, and, therefore, I am very interested in forecasts up to 1980.

Let's take an industry such as the General Electric Co.: What percentage of their output today would you say is of products that were unknown 15 years ago?

Mr. COOK. A very, very high percentage, Senator, although I do not know the exact percentage. It is bound to be very high.

Senator KERR. You would say it would be at least 50 percent, wouldn't you?

Mr. COOK. I would think so.

Senator KERR. My own opinion is that the advances and innovations of the future, due to the fact that we are now spending 15 times as much per year in scientific research and investigation as we were

12, 14 years ago, will be at an increasing tempo percentagewise, rather than a diminishing tempo. But then that is a discussion you and I will pursue when we are not burdening the record or an audience with it.

Mr. COOK. Senator, I could hope that what you believe will come true and more so. I don't think the difference between us as to the forecast is very great. But I would feel that if I did not run up the flag on a straightedge projection, on a geometric basis, that I would not be giving the committee my best judgment.

Senator KERR. Every chart that I have seen shows that the overall acceleration is increasing rather than decreasing.

Mr. COOK. Yes, I have seen those charts, Senator, and what I have told the committee is in the light of what I know is represented by those charts.

Senator KERR. Thank you very much, Mr. Cook.

Mr. COOK. One thing I might add, however, on the proportion of nuclear power to conventionally generated power. As I at least intimated in my testimony, a reduction in any expense makes possible an increase in another expense. If there is no adjustment in rates, certainly one of the things that the tax credit proposal, if implemented, would do, would be to enable significantly greater expenditures for research and development in the nuclear power field.

Senator KERR. That is all, Mr. Chairman.

The CHAIRMAN. Senator Williams?

Senator WILLIAMS. Mr. Cook, on page 18 of your statement you list approximately $21 million which would be spent in additional improvements over a seven-State area, as I understand it, if the 7-percent credit is approved in the bill.

Mr. COOK. Yes, Senator.

Senator WILLIAMS. Do I understand that it is your feeling that these expenditures would not be made if the 7-percent credit is not approved?

Mr. COOK. I so state categorically they will not be made.

Senator WILLIAMS. Now, if the 7-percent credit is approved would they be made this year or over the next 2 or 3 years?

Mr. COOK. These projects are not complicated projects, Senator. The details are set forth in the appendix to my statement——

Senator WILLIAMS. I have examined them.

Mr. COOK. And because they are not complicated projects it should be possible for the modest engineering required and the modest amount of design work required to go forward promptly.

Senator KERR. Well, your statement a while ago was to the fact of effect that would be a 1-year result?

Mr. COOK. That is correct, sir.

Senator KERR. That was your statement to the chairman.

Senator WILLIAMS. That is my question, "Would they be approved in addition this year?"

Mr. COOK. The answer is "Yes."

Senator WILLIAMS. Would they be spent this year or would they be approved?

Mr. COOK. They would be approved, they would be engineered and designed and construction would be started this year, but I cannot represent categorically to the committee that they will all be completed in 1962.

Senator WILLIAMS. That was my understanding that they would be planned and started but perhaps completed over this year, next year, and maybe over in 1964.

Did you have anything further to add on that?

Mr. COOK. The chances are that they would not be completed this year, and, therefore, the expenditures would extend over 1962 and 1963 with a significant amount being spent in 1963.

Senator WILLIAMS. Yes.

Now, what are your projected expenditures for 1962 without this improvement?

Mr. COOK. Without this credit?

Senator WILLIAMS. Without the credit.

Mr. COOK. That is set forth on the second page of the Appendix at $152 million.

Senator WILLIAMS. What are your projected expenditures for 1963?

Mr. COOK. $118 million.

Senator WILLIAMS. And I think you said in 1964, well you have $64 million, it would no doubt be $100 million anyway?

Mr. COOK. I would guess in the neighborhood of $90 to $100 million.

Senator WILLIAMS. That is the 3-year period, that is $370 million of your expenditures that you are planning to make without any investment credit?

Mr. COOK. Yes, sir.

Senator WILLIAMS. If your investment credit is approved you will spend an additional $21 million?

Mr. COOK. Yes, sir; in the period indicated.

Senator WILLIAMS. How much would this investment credit be worth on the $370 million expenditures at 7 percent?

Mr. COOK. If it were applicable to $370 million at 7 percent it would aggregate for that 3-year period approximately $26 million.

Senator WILLIAMS. That you would receive as a tax credit?

Mr. COOK. That is correct.

Senator WILLIAMS. Now, as I understand it, what you are telling the committee is that it is the plans of your company to spend $370 million over the next 3 years without any investment credit?

Mr. COOK. That is correct, sir.

Senator WILLIAMS. But if we approve an investment credit which will give you a $26 million tax reduction you will spend $21 million of it in additional capital——

Mr. COOK. No, that would be $21 million that would be spent immediately, Senator, but if the tax credit remains as a permanent part of the tax structure we would have added to that by quite similar amounts in future years.

Senator WILLIAMS. But you are speaking now, as I understand it, you can only outline $21 million which would not be spent if you don't get it. Am I to understand that the financial condition of your company is such that you cannot afford to spend this $21 million if you don't get the $26 million tax credit?

Mr. COOK. No, Senator, I have not testified to that. As a matter of fact, I testified to the contrary and I would like to state it categorically here.

Senator WILLIAMS. I didn't think you wanted to leave that impression but that was the impression I was getting.

Mr. COOK. No.

My testimony is specifically that it really is almost a matter of indifference as to whether we retain in the company the amount of cash that would be generated by a reduction in the tax rate.

The point is that we could pass these amounts on to our customers but by virtue of the basic economics of our industry. The fact that our revenue requirements are greatly influenced by the extent of the fixed charges applicable to plant investment and the fact that Federal income taxes represent a major part of those fixed charges and the further fact that as a result of the elimination of those fixed charges represented by the Federal income tax component, makes economically feasible many, many marginal projects.

And this is true regardless of whether we would retain the tax reduction or pass it on to our customers in whole or in part.

Senator WILLIAMS. Are these projects which you have outlined in the $21 million category essential to your company in order to provide adequate service in the communities which you serve?

Mr. COOK. They are not in the essential category, Senator, but they are desirable projects which otherwise would not come along until 1965 or thereafter.

Senator WILLIAMS They would be, but they would be furnished at a later year anyway, is that correct?

Mr. COOK. It is likely as to most of them that sometime, whether it is 1965 or 1966 or 1967 or whenever, at some time most of these projects would be carried forward. But I call to your attention the fact that if we advance a project by as much as 3 years the fixed charges in that 3-year period applicable to that construction amounts to 42 percent of the total expenditure for the construction. So that in the case of the $20 million of projects which we have here, the fixed charges would amount to, at 14 percent, would amount to $2,800,000 a year and for 3 years would be $8,400,000, and my estimate is that the tax credit would amount to about $10½ million. So that in approximately 3.6 years the fixed charges which would be associated with the $21 million of investments which we would have would be equal to 100 percent of the tax credit without making any adjustment whatsoever for rate decreases which we would give to our customers.

Senator WILLIAMS. Do you think that this formula of a tax credit is better than it would be to just change the formula for computing depreciation in general, and liberalizing the present formula; for instance, using the accelerated formula, say if we use a triple declining balance?

Mr. COOK. Yes.

Senator WILLIAMS. Or as someone suggested, a 10-percent writeoff the first year and depreciate the other 90 percent over a period of years?

Mr. COOK. Well, the Senator, I think, is now touching on what I regard to be the—one of the—two basic objections made to this tax credit bill, sometimes stated, sometimes not stated.

Senator Byrd stated earlier there has been an interesting assortment of opposition to this legislation, the tax credit concept. Part of the opposition has come from labor groups.

Senator WILLIAMS. I am familiar with all of that and to save repeating it would you give me your opinion?

Mr. COOK. Yes, I will do that.

Senator WILLIAMS. I have their opinions.

Mr. COOK. But what I would like to say is merely a predicate for the opinion which I would like to give the Senator.

Part of the opposition has come from, without any doubt, the sincere belief that the encouragement of capital expenditures will lead actually to the putting in of more efficient plant and equipment and to more technological unemployment.

The other half of the opposition is coming from a source that I think adheres to the views which the Senator has not espoused but has stated; namely, that depreciation reform is far to be preferred.

My feeling about it, Senator, is this: There is no impediment to depreciation reform at the present time. All we need for depreciation reform is for the Secretary to decide—the Secretary of the Treasury, and his staff—that the Bulletin F lives are completely inadequate, as I would suggest to the Senator they are, and to so direct the administration of the activities of the Bureau of Internal Revenue and particularly the activities of the field agents examining corporate tax returns and considering particularly depreciation allowances, and we could have depreciation reform. We do not need legislation for depreciation reform. We do need legislation for the implementation of this kind of a proposal to expand the economy through inducing additional expenditures for plant.

Senator WILLIAMS. Do I understand you to think, and I am in complete agreement, that schedule F should be revised? I am hoping the administration will come up with a revision, they can do that by executive action, but do I understand you to say that you think that would be adequate?

Mr. COOK. Adequate for what purpose, Senator?

Senator WILLIAMS. To eliminate any further change in depreciation schedules. I don't think that is what you meant.

Mr. COOK. Well, I am not sure that I understand the Senator.

Senator WILLIAMS. The mere revision of the schedule F is not in itself enough, in your opinion, to take care of the changed——

Mr. COOK. No, I am concerned about it for another reason, Senator, and I have no hesitation in putting it right out on the table so far as an electric utility is concerned or, indeed, so far as any utility operation is concerned, including a telephone operation.

I am concerned that if we do not have a tax credit to stimulate capital investment, but instead have nothing but a change in the Bulletin F lives, there will be a good deal of commotion about whether the increased depreciation allowances should be charged to the customers or whether they should not. If they are passed on to the customers it is going to mean higher rates and, so far as the philosophy of the American electric power system is concerned I want to state it, categorically, that we are opposed to it.

We favor constant rate reductions wherever possible, and we are interested in anything that will bring that about; and the other route, in my opinion, leads to an entire contrary result.

Senator WILLIAMS. Beyond this changing schedule F and the necessity for such a change we are in agreement.

The other part of my question was, though, your opinion as regards a liberalization of the present formula under which you can depreciate— and that will take congressional action; that cannot be done by the Treasury Department unless we act. Of the two methods, which would you prefer?

Mr. COOK. If I had a choice between the two methods, Senator, I would take the tax credit as being the method which will result in the most immediate and the most fruitful effect on plant expansion.

Senator WILLIAMS. Would you suggest that this tax credit be taken into consideration in the overall depreciation, with a 100-percent limitation on the amount which can be depreciated?

Mr. COOK. I would regard that, Senator, as nothing but a depreciation reform proposal in a disguised form.

The great merit of the tax credit proposal is that it has no relationship to the aggregate investment in plant and equipment except insofar as that aggregate investment is a measuring stick.

Senator WILLIAMS. As I understand it, the reason you are endorsing the investment credit formula is that you think that industry is entitled to be able to depreciate 116 percent of the cost of any equipment.

Mr. COOK. No, sir; I do not.

Senator WILLIAMS. Do you think it should be limited to 100 percent?

Mr. COOK. It is widely urged in some quarters that we have what is known as economic depreciation which would result in depreciation allowances in excess of 100 percent. I personally do not believe in them. I believe that depreciation should be confined to the amount of capital invested in the assets and should be limited to 100 percent.

Senator WILLIAMS. Well that was the point I was raising. If you agree that the amount of depreciation which is allowed on any equipment should be restricted to 100 percent, do you recommend that if this investment credit is left in this bill and broadened to 7 percent, as you recommend, that we put an overall limitation of 100-percent recovery for any industry?

Mr. COOK. I think the two are unrelated, Senator, and I think to the extent that that limitation is placed on it, by the same token, it will limit the effectiveness of the tax credit device as a means of expanding plants and equipment in the United States.

Senator WILLIAMS. I am having difficulty in reconciling your statement. As I understand it, a moment ago you said you thought that the depreciation schedule should be limited to 100 percent.

Mr. COOK. I do.

Senator WILLIAMS. Do I understand except as it would apply to this case you can get 116 percent now. Either we——

Mr. COOK. I am sorry.

Senator WILLIAMS. I do not quite understand your reasoning.

Mr. COOK. I will be glad to try to explain it.

Senator WILLIAMS. Under this formula——

Mr. COOK. The tax credit, Senator, and there is no disguising it, and there is no reason why anyone should not be candid about it, the tax credit proposal is a tax reduction.

Senator WILLIAMS. It is a subsidy.

Mr. COOK. The only significance of the plant account in connection with it is that it is used as the measuring stick, if you will, to determine the amount of the tax credit.

Senator WILLIAMS. Would you characterize it as a subsidy?

Mr. COOK. Well it is rather hard for me—and I say this with all due respect, Senator—it is rather hard for me to see that when the sovereign, which has imposed these taxes in the first instance, concludes in the interests of the national welfare that it should no longer impose so large a tax burden, that that can be regarded as a subsidy.

Now, unless all industry is treated fairly in connection with this tax reduction, there will be brought into the code a highly discriminatory provision; but I would not, even under those circumstances, speak of it in terms of a subsidy.

Senator WILLIAMS. But, as I understand—and I will not labor the point, we want to close—that you are planning to spend $370 million over the next 3-year period anyway.

Mr. COOK. That is true.

Senator WILLIAMS. You will spend an extra $21 million if this 7-percent credit is included in this bill.

Mr. COOK. In this initial period, Senator.

Senator WILLIAMS. In this period.

Mr. COOK. But if the incentive is a permanent part of the tax structure, there will be similar amounts spent over the years.

Senator WILLIAMS. This amount would be spent over the 3-year period. How much additional expenditures will be made? I thought that is what you were confining it to.

Mr. COOK. That is not my testimony. My testimony is that if we are given a 7-percent tax credit applicable in the year 1962, that we will immediately put under engineering, design, and construction $21 million of additional projects.

Senator KERR. Even if the 7 percent ended at the end of 1962.

Mr. COOK. Even if it ended at the end of 1962. If that credit continues into the following year, Senator, 1963, we will then put under engineering, design, and construction additional amounts not included in our present budget, and in addition to the $21 million to which I testified.

Senator WILLIAMS. What were your capital expenditures in 1960 and 1959?

Mr. COOK. In 1960—one moment, sir—I do not have the exact figure here, Senator. My recollection was that it was about $100 million in 1960.

Senator KERR. In 1961?

Mr. COOK. It would be approximately the same amount—in 1961 our expenditures were approximately $97 million.

Senator WILLIAMS. Approximately $100 million, yes. You have a 50-percent expansion in this year's expenditures which were budgeted before you were advised of the possibility of the incentive credit.

Mr. COOK. Yes, Senator; that is correct.

Senator WILLIAMS. And there would be another 6 or 8 percent expansion if you get the tax credit, which would give you, as you say, $26 million over the 3-year period.

Mr. COOK. It would be somewhat more than that; $21 million would represent, I would guess, approximately 13 percent.

Senator WILLIAMS. You do not figure that this investment credit should in any way be described or thought of in terms of depreciation?

Mr. COOK. I do not think so.

Senator WILLIAMS. You think it is a tax reduction?

Mr. COOK. Unquestionably.

Senator WILLIAMS. And you would not want it called a subsidy, but just call it a reduction.

Mr. COOK. If any tax reduction is a subsidy, then it is a subsidy. But when the sovereign reduces the burden, the tax burden, that is placed on the citizens, I do not regard it as giving the citizens a subsidy.

Senator WILLIAMS. And then if the sovereign——

Mr. COOK. I regard a subsidy as taking the proceeds of taxes and giving them to somebody else.

Senator WILLIAMS. If the sovereign decides not to reduce it, you would consider it proper that they made that decision?

Mr. COOK. That is a decision that is preeminently for this committee and Congress.

Senator WILLIAMS. Thank you.

Senator KERR. I would like to ask a question if you do not have any questions, Mr. Chairman.

The CHAIRMAN. I have a question.

Mr. Cook, I want to ask you whether you favor the tax credit provision as written in the bill.

Mr. COOK. Whether I favor it as it appears in the bill? I believe it is highly discriminatory to utility companies.

The CHAIRMAN. Assuming that that discriminatory feature is not corrected and you, of course, know the opposition to correcting it, you have the Treasury against you. Even though this committee may correct this, the Senate may correct it, it would have to go to conference.

Mr. COOK. Yes, sir.

The CHAIRMAN. And with the opposition of the Treasury, you would not favor it unless this inequality was corrected; is that correct?

Mr. COOK. That is a very difficult question, Senator.

The CHAIRMAN. Let me just ask——

Mr. COOK. I will answer it if you wish me to do so.

The CHAIRMAN. I would like to have an answer to that because that is what we have to consider.

Mr. COOK. I think that while the provisions are inequitable, I believe that the overall effect will, as a fact, be to stimulate construction, and if that is a desirable purpose, if Congress feels that stimulation of construction and buoying up the economy is a desirable purpose, I would feel even in its present discriminatory form it is calculated to produce the desired result in part, even though the burdens and the benefits are not fairly distributed. Therefore, it deserves to pass.

The CHAIRMAN. Then you would favor it?

Mr. COOK. Yes, sir.

The CHAIRMAN. As it is written?

Mr. COOK. As I have stated.

The CHAIRMAN. We have a letter here from the Detroit Edison Co., a very able letter, and which we will put into the record. The concluding paragraph says:

> The problem as we view it, is whether your committee is in favor of the discrimination against utilities. If it favors discrimination, we feel the legislation

should provide that other industries should not by indirection do what utilities cannot, namely, construct utility-type facilities for their own use and receive a preferential investment credit.

It goes on in other parts of the letter to say:

In the area of finance, * * * if this discriminatory legislation was adopted, it would be only natural for investors to prefer investment in manufacturing businesses receiving the benefit of the investment credit over those manufacturing businesses not having the benefit of the credit. The result of such preference would be to increase the cost of capital in the utility industries, a result diametrically opposed to the objectives of the credit, with the resultant depressing effect on job opportunities, competitive position, and growth in the utility industries and in the electric equipment manufacturing and supplies industries.

Mr. Maihofer, the Secretary, I think, apparently thinks discriminatory legislation of this kind would be very disastrous to the utility companies. You say you would prefer to have that than to have no tax credit?

Mr. COOK. Yes, Senator. The question is not an easy one, and I think that on any poll of X people, it is inevitable that you would get different answers.

The Detroit Edison people are able utility people. They operate a great company and a great sytem. But I just happen to hold a different viewpoint than the viewpoint expressed in this letter or, perhaps, they just happen to hold a different viewpoint than I do, but I have given you my judgment. I give it to you sincerely. I have tried to deal in specifics, not in generalities in the testimony that I have given. I would not, in the face of this letter or a dozen like it, change it.

The CHAIRMAN. The Chair would like to place in the record a letter from the Detroit Edison Co., a portion of which has been read, which was submitted in lieu of their appearance.

(The letter referred to follows:)

THE DETROIT EDISON CO.,
Detroit, Mich., March 26, 1962.

Re H.R. 10650.

Hon. HARRY FLOOD BYRD,
Chairman, U.S. Senate Committee on Finance,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: We would call your attention to H.R. 10650, the proposed Revenue Act of 1962, section 2 of which provides a general credit on depreciable property of 7 percent of the qualified investment and the credit available to regulated public utilities for such investment of 3 percent.

We submit that the idea of differentiating in the credit for investment in depreciable property between general and utility property is (1) ill-conceived, (2) not founded upon fact, (3) would unjustly favor one user of depreciable property over another, and (4) would give an unjust and uneconomical competitive advantage to general manufacturing over public utilities.

Basically all manufacturers in the Nation, including utilities, have found it economically necessary to continue the use of inefficient and obsolete machinery and equipment in lieu of investing in new and more efficient machinery and equipment, because of the inflated costs of such new equipment and the failure of depreciation allowances on the old investment to provide sufficient internally generated funds for such new investments. Utilities are in no different position than other manufacturers in this respect and should be treated the same.

Certainly the objective of the proposed investment credit, when coupled with depreciation reform, is to increase the rate of discardment of old, obsolete machinery and investment in new, efficient machinery with the resulting prospect of more production, more jobs, better competitive position, and a higher rate of economic growth. It should be apparent that we cannot discriminately bypass a large segment of manufacturing, such as the utility industry, without guaranteeing failure in obtaining our objectives.

The following are some of the unhealthy prospects of a discriminatory investment credit:

1. The present healthy competition between electric power utilities and the coal, oil, and bottled-gas industries would be uneconomically disrupted with overall depressing effects on the economy.

2. Other manufacturers would be encouraged to make uneconomic investments in electric power facilities. This would mean uneconomic duplication and substantial investment in inefficient facilities compared with the more efficient central station power facilities of electric power utilities. The net effect could only be to depress the economy.

3. In the area of finance, it would be only natural for investors to prefer investment in manufacturing businesses receiving the benefit of the investment credit over those manufacturing businesses not having benefit of the credit. The result of such preference would be to increase the cost of capital in the utility industries, a result diametrically opposed to the objectives of the credit, with a resultant depressing effect on job opportunities, competitive position and growth in the utility industries and in the electric equipment manufacturing and supplies industries.

The problem as we view it, is whether your committee is in favor of the discrimination against utilities. If it favors discrimination, we feel the legislation should provide that other industries should not by indirection do what utilities cannot, namely, construct utility type facilities for their own use and receive a preferential investment credit.

Because of the voluminous requests for appearance received by your committee, I am submitting my statement in writing and thus releasing the time set aside for my appearance for other witnesses.

Respectfully submitted.

A. G. MAIHOFER, *Secretary.*

The CHAIRMAN. I have no question whatever, Mr. Cook, of your sincerity. I have a great admiration for you. I am familiar with your activities in Virginia.

I think you are one of the greatest electric companies in the world. In fact, you have stated that you distribute more electric energy than any other utility system in the United States.

What you have done has been in competition with Government-owned electric companies, you have had a wonderful record, and you have done it by good management.

But I am concerned about your willingness to accept a discriminatory taxation if it has to come to that, and my opposition to this comes largely from the fact that there will be inequalities created all through the tax system.

Some plants are not going to want to modernize, some are going to want to, and they will get not a tax credit, but it will certainly postpone indefinitely modernization of the depreciation system, and that is what I favor when we have the funds to do it.

We are hoping some day to have a balanced budget. It looks to me very far in the distant future, but this tax credit will lose $1,4 billion the first year, based upon a 5 percent depreciation credit, and when it gets 10 years from now it will lose over $2 billion a year. It will be a permanent fixture and, in my judgment, that will prevent any modernization of the depreciation which, I think, is far more important than the tax credit because it will be uniform in its application, and the tax credit cannot be uniform by reason of its operation, namely, that it is only to be given to those companies that install new machinery, and so forth.

My position—I would be glad to hear your side of it because I have great confidence in you, and maybe I am completely wrong about it, and maybe we ought to go to the subsidiary, and it is a subsidiary, and you have convinced me today that it is a subsidiary, because you say you will not build certain extensions and installations unless you get the tax credit to stimulate your doing it, so it certainly comes in the class of a subsidy.

Now we are subsidizing enough in our country today, and I think it would be a mistake to go further into it, and I think the modernization of our depreciation will be far more advantageous to the industry as a whole.

I assume you do not agree with that.

Mr. COOK. Senator Byrd, you are very generous in your comments, and it is very painful to me to have to seem in opposition to that viewpoint.

But I would add only this: I am aware of no demonstration on the part of anyone, including the Treasury Department, that a 7-percent rate is an appropriate rate for nonutilities. As a matter of fact, I had hoped that the kind of analysis which we made and presented to the committee today, would show beyond peradventure of a doubt that the one industry in the country that is in the very best position to accomplish the purpose which the administration has stated it desires to have accomplished is the utility industry.

Now, if that is true, and if the problem is a problem of revenue loss, I cannot understand, and I must say that I have never been able to understand, from the beginning, the insistence of those people in the administration who have been advancing this proposal, to have this discrepancy between the utility industry and the nonutility industry.

It would seem, on the contrary, that if there is only a permissible amount of revenue which can be lost that the tax credit should be viewed as applying uniformly to all industry, and it should be fixed at such a percentage, whether it is 1 percent or 2 percent or 6 percent or whatever, it should be fixed at such a percentage across the board as would result in no more than the permissible revenue loss.

The CHAIRMAN. Of course, you cannot fix it equitably because some industries—I mean eliminating the utilities—other industries that are modernizing their plants, some have already modernized them and have not got the benefit, and will not get the benefit, so it cannot be equal in that respect.

It disturbs me a lot to think that the future benefits, so to speak, for business will be in the way of a tax credit instead of a modernization of depreciation which, I think, will reach everybody on the same basis and will be far preferable to stimulate business activity of the country.

That is my reason why I am so strongly opposed to this tax credit, and I want you and the other utility people to understand that you have great odds against you in trying to get a 7-percent or 8-percent, whatever it may be, provision because the Treasury is strongly opposed to it.

The House only gave 3 percent, and even if the Senate raised it, it is very questionable whether it would be enacted into law. You realize that?

Mr. COOK. I do, Senator, and my plea is not for 7 percent for the utility industry. My plea with the committee is only for such percentage uniformly made applicable to all industries, utility and nonutility alike, as will result in a loss of revenue no more than is a permissible loss in the judgment of the committee and the Congress.

The CHAIRMAN. What you want is equality, is it not?

Mr. COOK. We want not to be discriminated against.

The CHAIRMAN. I know you do not. But what I am trying to point out to you is that the facts that exist today are going to make it practically impossible to get equality because the Treasury opposes it and the House evidently gave it careful consideration and they fixed it at 3 percent.

If the Senate put it back to 7 percent or whatever the final figure may be and passed it, then it would have to go to conference and so forth.

It has been my experience up here, which has been for some years, 29 years, on the Finance Committee, and I would say there is a very poor opportunity to bring that about. We have got to look facts in the face, I think, about these matters.

Mr. COOK. Yes, Senator.

The CHAIRMAN. Have you got any reason to think even if the Senate would put it back to 7 percent that the House would accept it?

Mr. COOK. My feeling is a little differently, and that is that the past errors of the executive branch and, indeed, of the House, if that is the case, are not binding on the Senate, a great independent body—probably the greatest legislative forum on the face of the earth. I think that it is free to do whatever, in its best judgment, it regards as fair and equitable without any let or hindrance from the Treasury Department or anybody else.

The CHAIRMAN. Well, that is not the way it operates. The Treasury Department comes up here and gives their views. There is pressure put upon Members of Congress constantly. There is nothing very wrong about it. It has been done every since I have been here. Mr. Roosevelt did it, Mr. Truman did it, Mr. Eisenhower did it, and Mr. Kennedy is doing it.

We are only free to the extent that we can resist those pressures that come, and sometimes they are correct in their views and sometimes Congress is wrong. So I am just speaking of this particular matter.

I just wanted to make a statement that if you are basing your approval of this bill on your thought that it is going to be equality in this particular item, I fear that you are going to be mistaken on it.

Mr. COOK. No, it is not based on that, Senator, although naturally I regret that it cannot be based on that.

The CHAIRMAN. I thank you, Mr. Cook. I do not want you to understand, Mr. Cook, there is anything of criticism of you in what I am saying. I am unalterably opposed to this tax credit and I will do everything in my power to defeat it. I do not know whether it can or cannot succeed, but I think it will be a very harmful departure because it is an inducement to put in new machinery or whatever it may be, and that inducement should come from modernizing the whole existing depreciation schedule and give everybody, the little people as well as the big people, a chance to get benefits from it.

Mr. COOK. The country has always been the beneficiary of the Senator's great integrity, and we understand fully his viewpoint.

The CHAIRMAN. One thing I think is very objectionable, and I hope the Congress will certainly strike that out, whatever they do, and that is this retroactive part of it. I have personal experience with that.

I modernized my packing plants. I was not stimulated by the thought of getting any tax credit. I started way back in January, and I would get a windfall, without desiring it and without making the investment because of the windfall.

Why they should start it back in January first and have a windfall, total windfall, about $600 million, is unbelievable to me, it is unbelievable that such a thing has ever been advocated.

Mr. Cook. Well, the fact that such a thing has been advocated as you have described, Senator, may very well indicate that some of the other things that have been advocated should not be taken at face value either.

The Chairman. Senator Kerr, any further questions?

Senator Kerr. Just one observation, Mr. Chairman. I am at a loss to understand the reaction that this tax credit is a subsidy any more than other tax reductions have been in the past.

I remember in 1951 we passed a law which contained in it the provisions that certain taxes would terminate at certain dates. Some of them were in 1951 and some were in 1952, to a total amount of $7.5 billion a year.

I did not regard those tax reductions as subsidies, but rather as reductions of what could be described by those who pay them as penalties.

Now, the distinguished Senator from Delaware has offered a proposal with which I know he is especially enamored, on the one hand, to reduce the depletion factor on oil and gas and, on the other hand, reduce present graduated taxes on personal income from whatever the present top level is. What is it, Stam?

Mr. Stam. Eighty-seven percent.

Senator Williams. Eighty-seven percent.

Senator Kerr. Eighty-seven to sixty percent.

If a tax credit of 3 percent or 7 percent of the amounts spent by an industry which would, in effect, be a tax reduction of the amount of money that would thereby result from the tax credit is a subsidy, then I would say that the application of the same principle to the reduction of the top bracket of taxation of individual income from 87 to 60 percent would be a subsidy to the extent of the reduction thereby brought about.

That just makes me look with less favor upon the proposal of the Senator from Delaware, because he seeks to increase the penalty on the oil and gas industry in order that he might provide a subsidy to those now paying up to 87 percent of their income in the form of taxes. I am delighted that he has made his position clear, that he now advocates a subsidy to those who pay 87 percent on their personal income tax, and he proposes to pay for that subsidy that he is going to give to those of us who pay up to 87 percent taxes on our personal income by increasing the penalty on one of America's great industries, and I am happy that he has made his posiiton clear, and we now have it forthrightly before us.

Senator Williams. I want to thank the Senator from Oklahoma for his understanding.

I am sorry I have lost him as a supporter of my amendment.

Senator Kerr. You cannot lose that which you never had. [Laughter.]

Senator WILLIAMS. I call his attention to the fact that there is this vast difference. In the proposal to reduce the rates on individual incomes from 87 to 60 percent, we are only reducing a part of what might be described as a penalty, if you want to, on taxes. But we do not propose to give back to a man more than 100 percent of that which he has paid in. We are only reducing his obligation when we reduce depreciation, and I am joining the chairman in favor of liberalization of depreciation schedules.

I do think, however, they should be limited to 100 percent of the recovery of the original investment.

I would wholeheartedly support an acceleration of the present formulas wherein they can depreciate that, but when you allow an industry or an individual to recover in depreciation more than 100 percent of the cost as in the instance of this proposal of the Treasury Department, he can recover 116 percent of the cost of the new machinery being installed, I feel that 16 percent is a subsidy, just as I feel that the depletion allowance in oil, when you can recover 8 and 10 times your investment, is a subsidy, even though the Senator from Oklahoma may disagree.

Senator KERR. Under present law they would recover 100 percent of their investment in the depreciation account.

Senator WILLIAMS. Yes, and I would give them an opportunity to recover it at a rapid——

Senator KERR. The acceleration of the depreciation factor does not change the amount they recover from what it is now. It is now 100 percent, is it not, Mr. Cook?

Mr. COOK. That is true, Senator.

Senator KERR. Over a certain period of time.

Senator WILLIAMS. That is correct.

Senator KERR. And the reformation of the depreciation or the application of the depreciation factor by accelerating it merely shortens the time in which the depreciation factor is fully realized, and I know of no one who has regarded this tax credit as a part of the program of accelerating depreciation. That is an entirely different matter; it is a different element of the tax law.

Whatever reform you might make in acceleration of the depreciation application—would not change the amount to be recovered through depreciation. This is a different——

Senator WILLIAMS. Subsidy.

Senator KERR (continuing). Proposal. Call it a subsidy, if you will, but that does not change the accuracy of the statement of what it amounts to, which is a tax reduction and not an increase in depreciation.

Senator WILLIAMS. If it were a tax reduction, reducing corporate rates from 52 to 50 percent, we could afford to do it, and if that is so I would go along with it. I am looking forward to the time when we can go that low or lower.

But when we allow in the formula—and this is connected and so recommended to us as a part of depreciation schedules by the administration.

Senator KERR. I have seen no such recommendation, I will say to the Senator. I have heard it referred to as nothing but a tax credit, because the Secretary of the Treasury made it entirely clear here that he was going to do two things or he recommended two things, one of which he was going to do, the other of which he recommended we do. No. 1, he was going to revise schedule F, to accelerate depreciation whereby the 100 percent would be recovered in a shorter period of time. He made it very clear that that was the treatment of the depreciation time period.

He made it equally clear that the 7 percent or the 3 percent was a tax credit, and I cannot understand how one as brilliant as the Senator from Delaware could interpret what the Secretary said as meaning that he included the tax credit as a vehicle to more quickly recover depreciation, because that was not his recommendation; that was not his statement. That was not his presentation, as I understood it, at all.

Senator WILLIAMS. I will not delay the discussion, because I do not have too much faith in my ability to persuade the Senator from Oklahoma.

I will conclude with just this question, since we are back now to the position of the Secretary of the Treasury:

If this committee, and I might say, first, you made an excellent point—if we are going to do anything here it should not be discriminatory, but assuming this committee decided to accept the recommendations of the Treasury Department in connection with the tax incentive credit, will you approve the bill being passed?

Mr. COOK. Would the reporter be kind enough to read that question back?

Senator WILLIAMS. I will repeat the question.

I asked you, Should this committee decide to accept the reccomendations of the Treasury Department in connection with this investment credit, would you endorse the bill and recommend that it be passed?

Mr. COOK. I would feel——

Senator WILLIAMS. You understand that eliminates utilities, that is the Secretary's recommendation. My question is—and I am recognizing the points you made—but just getting back to this question: Assuming that this committee was persuaded by the all-powerful arguments of the Secretary of the Treasury to accept his bill as recommended on investment credit, are you in favor of the bill in that form or would you recommend it not be enacted?

Mr. COOK. I would believe, Senator, that it would be so highly discriminatory and would introduce what I would regard as such a dreadful concept into the Internal Revenue Code that the bill would not deserve to pass.

Senator WILLIAMS. Thank you.

The CHAIRMAN. You have not said whether you would favor it.

Senator WILLIAMS. I understood you would not favor it as the Secretary of the Treasury recommended it to this committee; is that correct?

Mr. COOK. It would not deserve to pass because of its discriminatory character and because of the introduction of a principle into tax legislation that I believe is an entirely inappropriate and very dreadful principle.

Senator WILLIAMS. Assuming we did make the changes that you have recommended now, do you think that those industries, a substantial part of whose investments is in buildings or other type of replacement, which would not come under the provisions of the bill, have a valid argument that it is discriminatory in connection with them?

Mr. COOK. I am not familiar with the facts as to those industries, Senator, and I do not feel qualified to express an opinion.

I can only say generally that if the committee received evidence on the question and came to the conclusion that it was, in fact, discriminatory, then they would be entitled to relief.

Senator WILLIAMS. Thank you. You made a very excellent witness, and you are very cooperative. I will conclude with this observation: If the committee, as I understand it, did include the utilities as well as the amendments being sponsored by the Senator from Oklahoma and myself in connection with oil depletion, it would still be a good bill.

Thank you.

The CHAIRMAN. Thank you very much, Mr. Cook.

Mr. COOK. Thank you.

The CHAIRMAN. The next witness is Mr. Charles E. Oakes, chairman of the board, Pennsylvania Power & Light Co. Please proceed, Mr. Oakes.

STATEMENT OF CHARLES E. OAKES, CHAIRMAN OF THE BOARD, PENNSYLVANIA POWER & LIGHT CO.

Mr. OAKES. My name is Charles E. Oakes. I am chairman of the board of Pennsylvania Power & Light Co., an electric utility owned by some 97,000 stockholders and serving more than 700,000 customers in the central eastern part of Pennsylvania. I appear before your committee to express our position in respect to the provision in H.R. 10650 relating to the investment credit.

The bill as it passed the House, in essence provides for a deduction from taxes of 7 percent of the cost of new machinery and equipment in the case of industry in general and a lesser amount of 3 percent as applied to certain regulated public utilities. Waiving the basic question as to the relative merits of the tax credit principle as opposed to other means of stimulating capital expenditures by industry, our position is first—that if the investment credit is to be adopted, the regulated public utilities should be included along with other industry and not singled out for exclusion as has been proposed; and second—that there be uniformity in the amount of the credit allowed.

Extending to the regulated public utilities uniform treatment with other industry would at once be consistent with the President's April 1961 tax message to the Congress which emphasized tax fairness and the elimination of tax inequities as a means of realizing the basic objective of more uniform distribution of the tax burden. Obviously either the complete exclusion of a large and important segment of the Nation's industry or insertion into the law of a substantial lower level of the investment credit would be a step away from tax fairness and a step toward further inequities. The point is that we are seeking no preferential treatment as against other competitors but rather avoidance of further discriminatory imposition of the tax burden.

The claim is made that public utilities as regulated monopolies are a noncompetitive industry enjoying an assured rate of return on investment after tax. The fallacy that the electric utility industry is noncompetitive arises from a disregard of the fact that because of basic economic reasons it operates within franchised areas and that for this reason competition is not present. The present utility is in the business of selling energy and thus faces intense market competition from other forms of energy, including coal, gas, and oil, and in addition, the competition of self-generation by industry. While the regulatory process may establish allowable rates of return after taxes, the resulting level of rates must be such as to meet the cost of competitive sources of energy available to the customer. Thus to extend preferential tax treatment to the utilities, competitors acts as a deterrent to the sale and demand for electric power and brings about a lower level in electric utility plant and equipment expenditures. The artificial influence through setting up differences in the tax treatment of competing industries results in a malallocation and utilization of resources. The result, too, in tipping the scales to tax-preferred competition is to lower the opportunity to realize the allowable earnings level under regulation—and today we have before us the grave railroad transportation problem the country faces as a result of such conditions.

Another assertion that has been made for exclusion of the utility industry from the investment credit is that public utility capital expenditures are based on demand and thus controlled by such requirements. This argument in effect says that electric utility plant and equipment expenditures are independent of economic consideration. In a statement made earlier to this committee in connection with the investment credit, Mr. Dillon pointed out:

> Throughout our economy, there will be thousands of investment decisions involving billions of dollars during the remainder of this year and in succeeding years which may hinge on the outcome of this legislation. There is often a thin line between a "yes" and "no" decision in the investment area. With the credit we will have affirmative actions where there would otherwise be none.

Certainly there can be no question but agreement that throughout our economy there exists this line of "yes" and "no" investment decisions. And like other industry these decisions are met, considered, and resolved by the electric utility in much the same way as in other industries.

The public utility responsibility to provide all service required is a responsibility to do so at cost—not at a given price. Electric utility plant and equipment expenditures represent both addition to capacity and the substitution of more efficient facilities for obsolete plant. Prolonged use of old service facilities long beyond the point of obsolescence would meet the technical reponsibility to serve the public, but implies a much lower level of capital expenditures than programs that combine capacity expansion and cost reductions through the substitution of more efficient for less efficient service facilities. The reduction in electric utility capital expenditures and the prolongation of use of obsolete facilities would in time lead to price increases for service. The responsibility to serve would continue to be honored but at higher costs and service prices.

The exclusion of the utilities from the tax credit proposal, however, would have the insidious effect of adversely affecting the efficient use of resources in the economy and, therfore, is inimical to the growth objective. This would operate in several ways.

Assume an energy-intensive industry gets the tax credit. The effect would be to reduce the price of generating facilities 7 percent—to 93 cents on the dollar. But the excluded electric utility must pay 100 cents on the dollar. Here we are measuring alternative investments of real resources with two different kinds of money—two different sets of prices. Now if the price system is to perform its function as an efficient allocator of resources, it can only do so if $1 worth of resources is the same for all prospective users. This difference may be the margin between self-generation and purchase from an electric utility. Because of the tax credit an industrial plant may install a less efficient unit because it buys with 93-cent dollars instead of 100-cent dollars, with the result that inefficiency is promoted by the tax mechanism.

Looking at this question broadly, electric energy is but one of many alternative energy sources. As a result, there is the urgency to achieve advances in the technology of generation, transmission, distribution, and otherwise to strive for efficiency throughout the operation. The development of high voltage interconnection which has been going on for many years would be stepped up. And as we approach closer to the point where large-scale nuclear power generation becomes economically feasible, the practical realization timewise of this objective is closely related to the position of the thin line of "yes" and "no" decisions. There is no doubt that these constructive and beneficial changes will be achieved. Whether they will occur over an extended period of time or in a much shorter period is dependent upon hard economic factors. The only valid conclusion that seems possible is that to a very considerable degree electric utility capital expenditures are not wholly dependent on consumer demand. Tax policies which tend to slow down rather than stimulate these processes of resource development are not in the public interest.

There is the argument against inclusion of the utility industry that if the credit were passed on to the consumer through lower charges for service the results would not have a stimulative effect on expenditures for new equipment. Looked at in another way this is to deny the relationship between price and consumption. Certainly it would seem reasonable to expect that if declining costs are reflected in price, use would expand, ultimately lead to enlarged demand, and finally to the stimulation of equipment construction and the expansion of the capacity of the industry.

In its application to industry generally, it is suggested that any taxpayer be given the option either of applying the investment credit as any other discount would be applied against expenditures for capital equipment, or by taking it as a tax reduction in the year the expenditures are made. Thus, under either option current Treasury revenues will be reduced. However, in the first option the revenue is returned over the life of the discounted investment by a lesser allowable depreciation deduction, whereas, in the second option the revenue is lost.

Finally, let me add emphasis to the observation of the Secretary of the Treasury, that "investment decisions are influenced as well by the availability of funds." If the incentive credit results in the substantial construction of equipment and productive machinery that is expected, there will be need for a flow of capital beyond that generated by the credit alone. It is as important to encourage a flow of investment capital as it is to stimulate the construction of new and more efficient productive equipment for the latter cannot be fully achieved without the other. And so it seems strange that again the proposal is made to repeal the provisions enacted in 1954 which permit individual investors to exclude from their taxable income the first $50 of dividends and to take a credit against tax of 4 percent of the dividends in excess of the exclusion.

It seems essential that these somewhat limited incentives should be retained to attract funds for the expansion we now look for rather than to adopt steps which tend to restrict the flow of equity capital and discourage such investment and thus unnecessarily hamper the productive growth desired.

In conclusion may I say—if the investment credit proposal is adopted, the regulated public utility industry should be included on the same basis as its competitors in other industry for the utility industry will then be in the position to contribute as much, and probably more, to the objective sought as any other segment of industry in the American economy.

The CHAIRMAN. Thank you very much, Mr. Oakes.

We will recess until 2:30.

(Whereupon, at 1 p.m., the committee was recessed, to reconvene at 2:30 p.m., the same day.)

AFTERNOON SESSION

Senator KERR. Charles H. Mann.

STATEMENT OF CHARLES H. MANN, TREASURER, THE COLUMBIA GAS SYSTEM, INC., ACCOMPANIED BY MURRAY ZWEBEN, ATTORNEY

Mr. MANN. I would like to introduce Murray Zweben, also of the Columbia Gas System.

My name is Charles H. Mann. I am treasurer of the Columbia Gas System, Inc., a public utility holding company with offices at 120 East 41st Street, New York, N.Y.

The operating companies of the Columbia Gas System are primarily engaged in the production, purchase, transmission, storage, and distribution of natural gas.

In 1961, 3½ million homes and industrial plants used natural gas delivered by the Columbia Gas System. Almost 1½ million customers were served by distribution facilities of Columbia companies in the States of Kentucky, Maryland, New York, Ohio, Pennsylvania, Virginia, and West Virginia. The other 2 million were indirectly served through sales by Columbia companies to other public utilities.

Columbia companies have a total of more than $1.4 billion invested in property. In 1961, they invested $66 million and expect to invest another $100 million in 1962 for modernization of existing facilities and for additional facilities needed to meet the demands of their customers.

Thus, Columbia companies are vitally concerned with legislation which would have a substantial effect, either direct or indirect, on their ability to finance capital expenditures.

We heartily agree with those who have testified before this committee in opposition to the incentive credit and in favor of immediate reform of depreciation policies. This view is based on the fact that the incentive credit provision as passed by the House, is inequitable and does not meet the real needs of the economy.

In the dynamic world of today it is imperative, if our Nation is to maintain its place as a first rate industrial power, that depreciation policies permit the prompt adoption of new and improved techniques and the construction and maintenance of the most modern facilities. Because of the impact of the present high income tax rates, such depreciation policies must be recognized in the tax laws. This is as important to a regulated utility as to other segments of our business world; in some respects because of the vast capital needed by utilities, a respectable argument can be made that the need for realistic depreciation policies is even more important for utilities than for other types of businesses.

Freedom of action with regard to depreciation allowances would provide an incentive for industry to modernize; it would benefit the economy generally through increased employment and in the long run would result in an increase in revenue to the Treasury. This would be a simple method of dealing with the problem.

However, since it seems unlikely that freedom of action will be implemented at this time and that an incentive credit will be provided, we urge that this committee recommend an amendment to that part of H.R. 10650, which would, in effect, allow a credit of 3 percent in the case of property used predominantly in a local gas distribution system while allowing a credit of 7 percent to most other taxpayers, including nonutility companies with which local gas distribution companies must compete. If the remedy is to be a tax incentive there is no basis for the dissimilar treatment of utilities and other businesses.

At this point, I would like to add one additional thought with respect to discrimination. That is if public utilities are to be treated differently than other companies, where do we stop?

Senator KERR. Repeat that.

Mr. MANN. If utilities are to be treated differently than other companies, where do we stop?

Senator KERR. Well, are you asking me that question?

Mr. MANN. No. I think the committee should answer that one.

Senator KERR. I see.

Mr. MANN. President Kennedy, in his tax message of April 20, 1961, stated that one of his objectives was to eliminate injustice and inequity from our taxing system to the end of providing a more uniform distribution of the tax burden. The tax credit provided by H.R. 10650 not only fails to meet this objective, but definitely adds further inequity and discrimination because it gives preferential tax treatment to certain groups of taxpayers and to individual taxpayers within those groups.

Secretary Dillon, in a statement to this committee on April 2, 1962, stated, that the original recommendation that the credit not apply to regulated public utility corporations was—

based on the fact that public utilities are regulated monopolies with substantial assurance of a given rate of return on investment after tax.

We would agree with the Secretary only that most public utilities are regulated; we do not agree that they are monopolies, or that they are assured a given rate of return.

Let us examine two points made by the Secretary.

First, regulated public utilities should no longer be considered monopolies. The implication in the Secretary's statement is that utilities are not subject to competition. This utterly misleading conception has been prevalent in this country for many years. If my testimony succeeds in doing nothing else, I hope that it will correct this impression. The truth is that utilities have become highly competitive.

Public utility regulation provides no protection against price competition from products of either other regulated utilities—gase versus electricity—or from nonregulated companies—gas versus oil or coal. Thus, utilities are faced with the same competitive situation as exists in other industries.

For example, Columbia companies compete vigorously and continuously with nonregulated oil and coal companies for space heating and all classes of industrial loads.

Senator KERR. Let me interrupt just a minute, Mr. Mann. Is your company a transportation company or a distribution company?

Mr. MANN. We are both. We are a producer, transporter, and distributor.

Senator KERR. The bill treats your distribution system investment differently than your transportation system investment?

Mr. MANN. That is correct.

Senator KERR. Now put that into the record right here, will you?

Mr. MANN. The bill, as passed by the House, would, in my opinion, allow a credit of 7 percent to the producer of gas and to the transporter of gas, but would allow only 3 percent to the distributor.

Senator KERR. I understand it; you are against all three of them?

Mr. MANN. That is right. We are opposed, in principle, to the proposed incentive credit.

Senator KERR. That is what you say on page 2 of your statement if I read it, or understand it, correctly.

Mr. MANN. You are right.

Senator KERR. You are opposed to all three of them.

Mr. MANN. Yes.

Senator KERR. All right. We sure ought to be able to satisfy you.

Mr. MANN. In fact, in every class of customer served, our companies are subject to competition from at least one other fuel or source of energy. If the proposed incentive credit is to be adopted, gas distribution companies should be treated in the same way as other corporate taxpayers—competing industries should not be given a tax credit more than twice that allowed such gas companies.

Such a tax advantage could result in a regulated gas distribution company losing a part of its business to nonregulated competitors—not on the basis of economy or efficiency, but solely on the basis of discriminatory tax legislation. For instance, it has been reported to me that one of our companies operating in Ohio is in jeopardy of losing several industrial customers to other fuels because of the competitive price situation. The annual revenue involved totals about $328,000, revenue which must be recouped from other customers if this company is to earn a fair rate of return.

Second, regulated public utilities are not assured a given rate of return. Although regulatory commissions permit a utility to charge rates designed to provide a limited rate of return, there is no guarantee that the utility will be able to sell its product in sufficient volume to produce the allowed rate of return, or that the rates designed for the future will bring a return at all.

We can show, by specific example, that during the relatively prosperous years following World War II certain of our companies earned a return less than the return which the applicable regulatory agency said they were entitled to earn. Furthermore, the overall earnings of Columbia System in 2 of these years were inadequate to cover the regular dividend the system had been paying, and it must also be noted that the return we are talking about was based on original cost dollars, not on inflated dollars and not on the true value of the property involved.

I have included in my statement a quote from the March 16 report of the Committee on Ways and Means in which the committee states that the investment credit for regulated public utilities is 4 percent because the regulated utilities will actually pass this on in lower rates to consumers and second, that they do not have any choice with respect to expansion.

I will not bother to read the quote.

(The quote referred to is as follows:)

The investment credit in the case of most regulated public utilities is in effect 4 percent rather than 8 percent (4 percent later changed to 3 percent and 8 percent later changed to 7 percent). The smaller credit is provided in such cases because much of its benefit in these regulated industries is likely to be passed on in lower rates to consumers, thereby negating much of the stimulative effect on investments. Moreover the size of the investment in regulated public utilities, such as electric companies, local gas companies, telephone companies, etc., will in large part be determined by the growth of other industries, rather than their own.

Mr. MANN. Each of the above grounds is without merit.

First, it should not be assumed that the tax reduction resulting from the investment credit must be passed on to the customers of regulated utilities. The provision's purpose could be achieved with respect to utilities if the report of your committee made it clear that the objectives of the legislation would not be met if regulatory commissions insist that the tax reduction be treated as applicable to the year in which plant expenditures are made.

The committee report should make clear that the investment credit is designed to supply capital for modernization and expansion of plant and is not intended to immediately reduce utility rates.

The second argument against full credit for utility companies is that such companies have no choice but to spend additional dollars for plant expansion and that such expenditures would not be affected by the incentive credit.

This is not completely valid for the following reasons:

(1) While we recognize that a local gas distribution company is required by law to meet all requests for service in its franchise area, we also know it must have sufficient capital to enable it to fulfill this legal obligation. By the same token, you must recognize that the ability to attract this capital would be adversely affected by the incentive credit provision, as passed by the House, for the reason that a 3-percent credit would make securities of a gas company less attractive than those of companies entitled to the full 7-percent credit.

To illustrate this point, I have had prepared the following computation to show the difference in income tax payable to a gas distribution company with that payable by a company granted the full 7-percent credit. In each case I have assumed taxable net income of $20 million and qualified investment of $35 million.

	Local gas distribution company	Company granted full 7-percent credit
1. Taxable net income (assumed)	$20,000,000	$20,000,000
2. Federal income tax, before credit	$10,394,500	$10,394,500
3. Amount of qualified investment in plant (assumed)	$35,000,000	$35,000,000
4. Investment credit:		
Rate (percent)	3	7
Amount	$1,050,000	$2,450,000
5. Federal income tax payable	$9,344,500	$7,944,500
6. Additional tax paid by local gas distribution company	$1,400,000	
7. Effective tax rate (percent)	46.7	39.7

The effective tax rate of the local gas distribution company after deducting the investment credit, is 46.7 percent; that of other companies is 39.7 percent. I doubt that any of you want to approve legislation which would result in such discriminatory tax rates.

Although it is incumbent upon a gas distribution company to obtain the capital required to construct additional facilities to meet the needs of its customers, there is no such requirement with respect to expenditures to replace and modernize plant so as to improve the quality of service, reduce costs in order to meet competition, and provide reserve capacity for future growth. For example, Columbia is currently making investments in its seven-State distribution area for microwave equipment, automatic and remote control equipment, and advanced types of data processing and data transmission equipment. These expenditures, and the replacement of property, are designed to improve service and not to take on additional customers or additional load. Thus, determining whether or not to make this type of capital expenditure is within management's immediate control. As an example, because of the difficulty of raising capital, Columbia companies have frequently been required to cut back their construction program to the absolute minimum necessary to meet service requirements.

In conclusion, Columbia System companies are in favor of immediate reform of depreciation policies.

Summarizing the position of the Columbia System companies with respect to the incentive credit provided by H.R. 10650, it is as follows:

(a) Local gas distribution companies vigorously compete with nonregulated oil and coal companies, and, therefore, should be allowed the same tax credit as their competitors.

(*b*) It should not be assumed that the reduction in taxes must be passed on to the customer. The report of this committee could play a large part in preventing this.

(*c*) Local gas distribution companies compete with all other industries in the financial market; thus, a 3-percent tax credit for a local distribution company would make its securities less attractive than securities of other companies entitled to the 7-percent credit.

Before closing I want to reiterate that public utilities are not monopolies and are not guaranteed a return or profit.

Gentlemen, I thank you for the opportunity to present the views of the Columbia Gas System.

Senator KERR. Thank you, Mr. Mann, for your statement.

Mr. P. E. MacAllister.

STATEMENT OF P. E. MacALLISTER, PRESIDENT, MacALLISTER MACHINERY CO., INC., INDIANAPOLIS, IND.

Mr. MACALLISTER. Mr. Chairman and members of the committee, my name is P. E. MacAllister. I am president of MacAllister Machinery Co., Inc., located at 2118 North Gale Street, Indianapolis, Ind. I am appearing on behalf of the Associated Equipment Distributors, of which I am chairman of the national affairs committee.

Our association consists of over 800 retailers of construction, mining, logging, and road maintenance equipment, with headquarters at 30 East Cedar Street, Chicago, Ill.

I would like to thank the committee on behalf of our industry for the opportunity of presenting its views on the so-called tax credit incentive proposal which your committee is considering.

Like other small and medium sized businesses, our industry has found growth under existing tax laws a major problem. Our association has advocated tax adjustment to permit growth of smaller businesses since 1956.

No matter how one views the administration's tax credit incentive proposal, it is a clear recognition of the fact that our present high tax rates retard or stifle modernization and expansion of our productive facilities. Why the administration has not recognized the same stifling effect of our present tax structure on the distribution and service industries is an enigma.

As we understand it, the administration's tax credit incentive plan has two basic objectives:

Modernization of our industrial facilities to make them competitive in world markets, and

Acceleration of economic growth to meet the needs of our expanding population and labor force.

We agree that to achieve these goals we need a high and rising level of capital formation. We must, however, take exception to the administration's limited application of the tax credit proposal.

We do not question the need for modernization of our industrial facilities but this need should not be considered only in the light of our competitive position in the world markets. If, through the modernization of our industrial facilities, we solve the problem of producing more and better goods at a lower price for domestic consumption, we at the same time solve this phase of our world market problem.

To justify the needs for the modernization of our industrial facilities on the basis of world markets is putting the "cart before the horse." In spite of the fact that our exports of goods and services have increased approximately 55 percent since 1954, they represent only 5½ percent of our current gross national product and approximately the equivalent of 9 percent of our domestic personal expenditures for goods and services.

One of our national goals, of course, should be to increase exports, but in attempting to achieve this objective we should not blind ourselves to another phase of our economy which is equally, if not more important and requiring immediate attention. We are referring to the effect of the present tax structure on small- and medium-sized business and particularly to the independently owned concerns in the distribution system.

The proponents of the tax credit incentive proposal before this committee premise their argument on a popular economic misconception—namely, that the process of physical production is the only creator of value. Too often we give exclusive credit to mass producton techniques for the fast growth of our economy. The very vital factors of distribution and service—directly affecting production—are often overlooked. We are sure that the members of the committee are aware of the importance of distribtuion to our economy, but a comparison of the employment trends in the manufacturing industry and those in the wholesale, retail, and service industries, provides a striking example of the relative positions of these two segments of the economy.[1]

Of the 35,147,000 employees in manufacturing, wholesaling, retailing, and service trades in 1961, 16,268,000 were employed in manufacturing, or approximately 46 percent, and 18,879,000 were employed in wholesaling, retailing, and service industries, or approximately 54 percent.

From 1950 to 1961, increases in employment in these industries were: Manufacturing from 15,241,000 to 16,268,000, or less than 7 percent, and wholesaling, retailing, and service industries from 14,768,000 to 18,879,000, or nearly 28 percent.

From these figures it can be seen that distribution and service industries are providing a far larger potential labor market than manufacturing. Equally interesting is the fact that of the total 9 million increase in employment in all nonagricultural establishments during this same period, the distribution and service industries absorbed 4 million, or approximately 44 percent, of the total increase.[2] By limiting the tax credit incentive proposal to the modernization of plants and equipment, these basic economic facts have apparently been ignored.

The manufacturing industry today is devoting much of its research and talent to the development of means of reducing labor costs. The President's tax credit incentive proposal will at least accelerate industry's effort in this area. In the absence of other unforeseen factors, this is going to necessitate a shift in the areas of employment.

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[1] In making this comparison, we have excluded employment figures in mining; contract construction; transportation and public utilities; finance, insurance, and real estate; and government.

[2] Bureau of Labor Statistics on Employment and Earnings, 1962, U.S. Department of Labor, vol. 8, No. 8, p. 11, February 1962.

With increased population and more expendable income, the American public will continue to require more goods and services. The independently owned distribution and service concerns are not now able to finance modern marketing techniques required to promote the sale of their goods and services. The distribution and service industry, like ours, can, if given the proper incentive, modernize and adopt progressive marketing techniques and services, thus expanding and absorbing those employees released by more efficient manufacturing facilities. The total effect will maintain the required high increase in employment needed for a growing economy.

Since distribution is a major factor in relation to manufacturing output, and consequently affects the whole economy, it is logical that serious tax consideration should be given to service and distribution industries which have contributed equally to our national growth. The proposal you are considering is of little or no help to this important segment of the business community which needs and wants the assistance apparently being rejected by those to whom it is offered.

The following are some problems that distributors face in trying to expand their business and merchandise the products produced by the manufacturer:

1. Distributors seldom, if even, have any control over the prices which are established by, and must be paid to, the manufacturer.

2. The distributor is quite frequently caught between the high cost of manufacturing and the sales resistance of the consumer.

3. The increased costs of labor and other items of distribution have further reduced the margin of profit for the distributor.

To offset these handicaps, the distributor attempts to increase his total volume in order to realize a reasonable dollar profit. Additional volume, however, requires larger inventories and larger investments in accounts receivable. We emphasize inventories and receivables because in our industry they currently represent 85.16 percent of a distributor's assets as compared to 6.02 percent in fixed assets. Although the relationship between inventories and receivables as compared to fixed assets may vary among the various segments of the distribution and service industries, the problem is substantially the same.

Due to technological developments in the industry, the equipment we handle has become larger and more complex. This, coupled with growth in the national economy, has necessitated a substantial dollar increase in our inventory and receivables. Retained earnings after taxes are not adequate to finance these required inventories and receivables. Equity capital is not available because of our low profit position. In the 7-year period, 1954 through 1960, the net worth of the average equipment distributor increased from \$339,055 to \$356,829, or less than 5½ percent.

During this same period total net worth and liabilities of the average company in our industry increased from \$644,000 to \$833,518, or an increase of nearly 30 percent. The liabilities, however, increased from \$304,934 to \$476,688, or over 56 percent. Of the \$171,754 increase in liabilities, \$113,588, or 66 percent, represented increases in notes payable, which generally represent obligations for inventory and working capital in our industry. With less than a 5½ percent increase in net worth during this 7-year period and liabilities increasing 56 percent, it is obvious that this condition did not permit payment of dividends except in isolated instances. In view of these facts, it is apparent that retained earnings, after taxes, are not sufficient for growth in our industry.

The percentage relationship of the other items in the assets-and-liability columns of the associated equipment distributors' cost-of-doing-business survey have remained relatively constant during this 7-year period. If the committee requires copies of the association's cost-of-doing-business surveys, which contain the statistical data just referred to, we will be glad to make them available.

The inability of independent concerns in practically all segments of the distribution and service industries to retain, after taxes, earnings required for modernization and expansion is one of the reasons manufacturers have opened direct outlets and eliminated the independent entrepreneur. Manufacturers generally having access to equity capital can employ specialists and executive talent which are necessary to mass production and distribution. Because of their access to the equity capital market, many manufacturing companies are diversifying horizontally and vertically integrating manufacturing and distribution.

It strikes us as odd that we have antitrust laws designed to keep companies from becoming monopolies, while we have tax laws that discourage the growth of small and medium sized companies that might compete with the larger companies. The present tax laws practically deprive us of our sole source of growth, while larger companies are able to grow through the use of both retained earnings and equity capital.

Although the distribution and service industries have grown since the advent of high taxes, their growth has been far short of that of other industries in the economy. Much of their growth has been accomplished through the assumption of dangerous short-term liabilities. They have now reached the end of the rope and unless positive tax measures are adopted to permit the retention of a greater portion of their earnings for modernization and expansion, we can only anticipate a higher acceleration of concentration of business by those who can reach the equity market.

In 1956 we suggested tax reforms based on the principles which were later embodied in bills sponsored by Senator Sparkman (S. 2), and Congressman Ikard (H.R. 2) and Curtis (H.R. 2003). Our position has been supported by previous and current testimony of businessmen, financiers, and economists and we have found nothing in the testimony presented so far on the present proposal to cause us to alter our position.

Dr. Dexter Keezer, economist for the McGraw-Hill Publishing Co., in his appearance before the Subcommittee on Tax Policy of the Joint Committee on the Economic Report in 1955 observed that the existing tax structure was very definitely preventing the accumulation of capital for expansion and growth of smaller companies. This was corroborated by the exhaustive study made by Drs. Butters and Lintner, of Harvard University, on the "Effect of Taxes on Concentration" [3] which

[3] Hearings before the Subcommittee on Tax Policy of the Joint Committee on the Economic Report, Dec. 14, 1955, pp. 567–581, 84th Cong., 1st sess.

Dr. Lintner presented for inclusion in the record of the session. In this definitive investigation it was observed that—

> new firms are needed to replace existing business units that fall behind or drop out of the competitive race * * * to develop new ideas, techniques and products that can potentially offer effective competition to established firms.

And in considering the need for increased investment in these smaller firms, this study noted—

> such investments are of the greatest social consequence.

They are—

> the investments that are particularly significant from the viewpoint of a dynamic competitive structure—i.e., from the standpoint of both industrial concentration and competitive behavior.

So far as the alleged loss in revenue is concerned, we pose the question of whether the country can any longer afford to delay action in this area, both from the standpoint of survival of the small and medium sized businesses and growth in the national economy.

In our opinion, the Sparkman-Ikard-Curtis bills (S. 2, H.R. 2 and H.R. 2003) approach the problem more realistically and provide the growth incentive at the level where the largest potential is possible and will provide the greatest national benefit.

It is our opinion that there should be more realistic depreciation rates available to the taxpayer, with a choice of lives within a range of years, to afford flexibility corresponding to conditions. The definitions of "useful life" should be clarified and the question of salvage value should be eliminated. A clearer policy on depreciation would allow the taxpayer to plan his business without the threat of a subsequent assessment resulting from review by Treasury agents.

Again, I wish to thank the Chairman and members of the committee for the opportunity of presenting our position on the tax credit incentive proposal. We hope we have contributed to the committee's deliberations.

Senator KERR. Thank you, Mr. MacAllister.

Mr. Jerrold Q. Abel.

STATEMENT OF JERROLD Q. ABEL, CONTROLLER AND TREASURER, SOUTHERN COUNTIES GAS CO. OF CALIFORNIA

Mr. ABEL. Mr. Chairman, my name is Jerrold Q. Abel. I am controller and treasurer of Southern Counties Gas Co. of California, which is a natural gas public utility distributing company and a subsidiary of Pacific Lighting Corp.

My business address is Los Angeles, Calif.

In my appearance here today, I am representing all of the companies in the Pacific lighting system which together comprise the largest natural gas distribution system in the United States.

These companies render gas service to over 2.5 million customers in southern California, in an area with a population of nearly 9 million people. In addition, we supply San Diego Gas & Electric Co. with the gas which it serves to about 280,000 gas customers. We also supply some gas to the city of Long Beach, which has another 114,000 customers.

We appreciate the opportunity to appear before your committee to present this statement in opposition to the investment tax credit for certain regulated utilities as proposed in the Revenue Act of 1962, H.R. 10650. In our opinion, allowing local gas distribution systems a credit of 3 percent or less than half as great as the 7-percent credit for other industries is discriminatory. It would put our companies—the local gas distribution utilities—at a competitive disadvantage with other energy sources which would be eligible for the higher tax credit.

President Kennedy in his "Message on Taxation" of April 20, 1961, stated:

> Whenever one taxpayer is permitted to pay less, someone else must be asked to pay more.

The report of the House Committee on Ways and Means quotes from the Economic Report of the President as follows:

> We must scrutinize our tax system carefully to insure that its provisions contribute to the broad goals of full employment, growth, and equity.

It is axiomatic that a 7-percent tax credit for most industries with only a 3-percent tax credit for local gas distribution companies is not equitable and can only mean that while others are paying less, our industry and ultimately our millions of customers are being asked to pay a greater share of the tax burden.

The House committee report states with regard to the investment credit in the case of most regulated public utilities:

> The smaller credit is provided in such cases because much of its benefit in these regulated industries is likely to be passed on in lower rates to consumers, thereby negating much of the stimulative effect on investments. Moreover, the size of the investment in regulated public utilities, such as electric companies, local gas companies, telephone companies, et cetera, will in large part be determined by the growth of other industries, rather than their own.

Accepting this to be the criteria upon which the lower credit for regulated public utilities is based, let us consider these two points.

First, with respect to much of the benefit being passed on in lower rates to customers.

This observation is based, I believe, on the common misconception that regulated utilities always earn the rate of return found reasonable so that any benefit which would enable a utility to earn more than the authorized return must be passed on immediately to customers in the form of lower rates. Obviously under such a situation the money would not be available to the utility for expansion purposes.

While it is true that utility rates to customers are designed to yield a fair rate of return, this return is an upper limit. In recent years, the rate of return actually experienced by our companies has been substantially less than the return found reasonable.

We do not operate in a vacuum and there is no guarantee that a fair rate of return can be earned even under the most advantageous circumstances and in the absence of any tax discrimination. For example, the rate of return established by the California Public Utilities Commission in 1960 as fair and reasonable for the future for the two Pacific Lighting distribution subsidiaries was 6.6 percent. During 1961, however, one subsidiary was able to earn only 5.1 percent while the other earned only 5.8 percent. I believe it is unlikely under such conditions that any of the tax credit benefit would promptly cause our rates to be lowered.

We are not a monopoly in supplying energy. In our certificated territory we must sell our product in a highly competitive market. The regulated gas utilities which I represent have for many years been experiencing severe competition from nonregulated oil and natural gas suppliers.

Senator KERR. I am going to interrupt you from time to time, and other witnesses, since I may be the only one to question you here this afternoon.

If you do not mind, I will interrupt you here.

Mr. ABEL. Yes, sir.

Senator KERR. Where do you get the gas you sell?

Mr. ABEL. Well, the majority of the gas that we sell comes from outside of the State. It is purchased from El Paso Natural Gas Co. and from Transwestern Gas Co.

Senator KERR. Have they not now been combined, or are there two companies?

Mr. ABEL. There are two companies.

Pacific Northwest was combined with El Paso Natural Gas Co.

Senator KERR. That gas comes from where?

Mr. ABEL. It comes from the Four Corners area around Colorado, New Mexico, and from the Permian Basin.

Those are the two major areas.

Senator KERR. Your next sentence "Oil in the Los Angeles area is about $2.10 a barrel"—do you mean fuel oil?

Mr. ABEL. Yes; I mean fuel oil.

Senator KERR. You do not mean crude oil? The product with which you compete is $2.10?

Mr. ABEL. That is right; it is the type of oil which is used by the large steam-electric generating plants.

Senator KERR. Insofar as your residence customers are concerned I guess you have the competition of home-heating oil?

Mr. ABEL. Well, to a certain extent from the oil business, but that is not a major competitor. Our major competitor there is the electric competition, which is very strong and very vigorous.

Senator KERR. But now they are in the same category in this bill that you are.

Mr. ABEL. That is correct; yes.

Senator KERR. So that insofar as your competition as for the residence market, you have the same treatment?

Mr. ABEL. Insofar as those customers, yes. There is a very vigorous competition there, though. However, the unregulated suppliers of energy to the electric companies will be entitled to the full 7-percent credit and therefore will be able to lower the price of such fuels sold to the electric companies. This, of course, will benefit our electric competitors and make our competitive position with respect to the residential market more difficult.

Senator KERR. What percentage of your market is the residence market?

Mr. ABEL. Speaking volumewise, more than 50 percent of our volume is large-volume customer business.

Senator KERR. Then, you are answering my question by eliminating the rest of it and then going to tell me that the residence takes what you have not otherwise specified?

Mr. ABEL. That is correct, sir.

Senator KERR. All right. Fifty percent of that is industrial; is that what you are telling me?

Mr. ABEL. That is about right; volumewise.

Senator KERR. And the other 50 percent is residence?

Mr. ABEL. On a volume basis; that is approximately correct.

Senator KERR. What is the situation revenuewise?

Mr. ABEL. All right, sir. I will be glad to tell you that.

For the 12 months ended December 31, which is the year 1961, of the total revenue of $400 million, approximately $249 million was so-called domestic and commercial, which would include the residential customers.

It is a little more than 50 percent on a revenue basis.

Senator KERR. You say domestic and commercial. Does that mean there is that much from residential consumption?

Mr. ABEL. That is not all residential, sir, because there would be small business, restaurants and any other type of small business that might use this.

Senator KERR. In other words, that is the revenue you receive from other than industrial customers?

Mr. ABEL. That is right, sir. The rest of that is industrial of various types, and we also have this wholesale business which I mentioned at the beginning of my statement with regard to San Diego and the city of Long Beach.

Senator KERR. All right, proceed.

Mr. ABEL. I might say with respect to this competitive situation, we do have a very vigorous competitor in the natural gas producers and I will get into that a little further along.

Senator KERR. You do not have that in the area where you have a franchise, do you?

Mr. ABEL. Yes; we do; we do, very definitely.

Senator KERR. You mean other sources are available to a residence or a consumer in your area?

Mr. ABEL. They have not moved into the residential, sir.

Senator KERR. That is what I asked you.

Mr. ABEL. With respect to the residential, no; but we do have that with respect to the large electric-steam generating plants.

Senator KERR. Yes; you had it with reference to your industrial customers.

Mr. ABEL. Yes, sir.

Senator KERR. But not with reference to your residential and small commercial?

Mr. ABEL. No, sir; not with respect to those.

Senator KERR. All right.

Mr. ABEL. Oil in the Los Angeles area is about $2.10 a barrel. At the accepted conversion rate, the equivalent price for gas is about 35 cents per thousand cubic feet.

From September 1960 to November 1961, the average rate for the lowest price gas sold to our nine largest volume industrial customers, under basic contract rates authorized by the regulatory authority, was 38.3 cents per thousand cubic feet.

Senator KERR. This 35 and 38 cents are industrial rates?

Mr. ABEL. That is correct, sir. That is these large industrial customers.

Senator KERR. I know.

Mr. ABEL. Certain volumes of gas in excess of the basic contract volumes were available to these customers at 37.6 cents. In November 1961, in order to meet competitive fuel conditions, and only after the necessary approval of the California Public Utilities Commission, we offered six of these nine customers a special contract providing for a rate as low as 34 cents for excess volumes over and above certain additional long-term contractual obligations. At the present time, even with these lower rates, only three such customers have entered into this new agreement. The lowest price currently available for approximately the next 25 largest volume industrial customers is 39.5 cents.

Recent court decisions—I am referring to California court decisions—have upheld the unregulated sale of substantial quantities of gas to large-volume users by nonregulated natural gas producers in direct competition with our regulated local gas distribution utilities. We have lost one large electric steam generating installation, which we were willing and able to serve.

Senator KERR. May I ask you what they are paying for their gas, approximately?

Mr. ABEL. I am sorry, Senator, I do not have that particular figure in mind.

Senator KERR. Would you say it is 35 cents a thousand cubic feet?

Mr. ABEL. No; I think it is around 40 cents, but I would prefer to double check that and furnish it to you.

Senator KERR. I would like for you to put it in the record, and, also, the comparative value. Do you guarantee to have a thousand B.t.u.'s per thousand cubic feet of gas?

Mr. ABEL. Most of it is around 1,050 or 1,100.

Senator KERR. 1,050 to 1,100.

Mr. ABEL. That is correct, sir.

Senator KERR. Do you know the B.t.u. content of a barrel of fuel oil?

Mr. ABEL. No, sir, I do not.

Senator KERR. I wish you would put into the record the price that this customer that you lost is now paying for his gas, how much his cost per thousand B.t.u.'s is; what it would be if he used fuel oil at $2.10 a barrel.

Mr. ABEL. I will be glad to furnish that information.

(Mr. Abel subsequently submitted the following for the record:)

SOUTHERN COUNTIES GAS CO. OF CALIFORNIA,
Los Angeles, Calif., April 11, 1962.

MRS. ELIZABETH B. SPRINGER,
Chief Clerk, Senate Finance Committee,
Washington, D.C.

DEAR MRS. SPRINGER: In connection with my appearance before the Senate Finance Committee on April 9, 1962, Senator Kerr requested certain additional information relative to the steam electric generating installation referred to by me as being served by a nonregulated gas supplier. This is in response to his request.

During 1961, the costs reported to the Federal Power Commission with respect to this installation were as follows:

	Oil		Gas	
	Amount	Unit	Amount	Unit
Average heat content of fuel, B.t.u	154,632	Gallon	1,070	Cubic feet.
Average cost of fuel	$2.023	Barrel	$0.3820	Thousand cubic feet.
Average cost per million B.t.u	$0.3115		$0.3569	

On the same basis as shown above with fuel oil at $2.10 per barrel the average cost per million B.t.u. would be about $0.324.

We understand that at the present time the price charged by the nonregulated gas supplier for gas delivered to this installation is the average price paid by the California gas utilities for all gas delivered at the California border plus 4 cents per thousand cubic feet. Therefore, the price charged by the nonregulated supplier can fluctuate from year to year.

Very truly yours,

JERROLD Q. ABEL.

Senator KERR. I cannot conceive of—well, I will not say it.

Go right ahead.

Mr. ABEL. I was just referring here to a note that I had. We use a conversion factor of 6,000 cubic feet of gas equal to about one barrel of oil. That, I believe, is based on 1,100 B.t.u.'s.

Senator KERR. 6,000 cubic feet of gas at 40 cents would be $2.40.

Mr. ABEL. At 40 cents, that is correct, yes. This $2.10 that I mentioned is a very recent price.

It was offered on March 28 to another large electric steam generating plant in the city of Los Angeles in connection with some bids that were opened on that date.

Senator KERR. That $2.10 oil, is that what we call residual oil, or is that—that is certainly not in the form of viscous oil?

Mr. ABEL. That is the very heavy viscosity oil. That is $1.97, roughly, per barrel, and with the sales tax added on to it, it was $2.05, and then perhaps 5 cents for moving it from one location to another.

Senator KERR. Is there a sales tax on your gas?

Mr. ABEL. No; we do not pay sales tax.

There is a franchise tax, however, which we have to pay to the cities and counties for the use of the streets.

Senator KERR. Is it based on volume?

Mr. ABEL. It is based on revenues, sir. It runs about 1.3 percent of our revenues, the franchise tax.

Senator KERR. Proceed.

Mr. ABEL. These nonregulated gas producers can build competing facilities to serve other large customers and under the current tax proposals they would be entitled to the full investment credit whereas our local gas utilities would not be entitled to the same benefit. I cite this instance as an example of an ever-present situation. We only ask that we not be made subject to the added competitive pressure of a discriminatory tax rate. In the long run, these competitive factors adversely affect the price of gas to our individual customers.

Regardless of the theoretical arguments which have been advanced supporting a tax discrimination against utilities, no new "growth" will be stimulated merely by transferring the construction of facilities from the regulated gas industry to an unregulated energy supplier.

The reasoning with respect to regulated industries passing the benefit on in lower rates to customers implies that this would not be true of nonregulated businesses. In our opinion, this same lowering of rates hypothesis would be equally applicable to nonregulated businesses and perhaps even sooner than for regulated industries.

For example, assume the following situation: A nonregulated corporation has been contemplating the construction of a new plant or pipeline. Without the investment credit they have not been confident that their product could be sold at a price sufficient to make an adequate return or profit on their investment, so this plant has not been built.

With the investment credit they can use the tax credit dollars to offset a portion of the plant cost with the result that they can actually cut their selling price and at the same time make a return sufficient to warrant the expansion.

The tax credit even though passed along to the customer in the form of lower prices under this situation would stimulate growth and would not be considered inequitable under the proposed Revenue Act of 1962.

In fact, nonregulated businesses will be able to immediately effect reductions in the price customers pay for their products while regulated utilities must wait until there has been a determination of their rates. These rate determinations are complex and time consuming. Irrespective of the ultimate outcome of such deliberations, funds provided the utilities by the investment credit would be available for expansion purposes during the interim.

Turning now to the second comment in the House committee report that—

> the size of the investment in regulated public utilities will in large part be determined by the growth of other industries, rather than their own.

We should not lose sight of the fact that the public need for regulated utility service will exist only so long as we can offer a product at a competitive price which the public is willing or can afford to pay. Plant facilities are not expanded from day to day but only after careful planning in the light of several factors.

Utilities, like many businesses, have marginal areas within their present service boundaries where it is not economical for them to render service. Customer requirements in these cases have not been enough for the companies to expand. The full investment credit could be the deciding factor which makes it feasible for utilities to expand into these new areas. Such expansion would have a stimulating effect on the economy as a whole by creating further expansion of utility plant and equipment with an increase in employment.

The regulated gas industry's contribution to the growth and prosperity of this country has been significant. The part played by our companies in the development of the southern California area has been especially noteworthy. We cannot agree that there is justification for treating the local gas distribution systems less favorably in the tax law than other energy sources with which we must compete. To do so is not only unfair and unjust but contrary to the President's expressed desire that our tax system contain provisions which will contribute to the broad goals of full employment, growth, and equity.

A week ago, the Honorable Douglas Dillon, Secretary of the Treasury, recommended that the entire public utilities be excluded from consideration in the investment credit. Any action in this direction would, of course, make our competitive position even more critical.

We earnestly and respectifully request that the investment credit provision, if enacted, be made equally applicable to all industry including regulated local gas distribution systems.

Senator KERR. Thank you very much, Mr. Abel.

I will ask you just one or two more questions.

Suppose it gets down in this committee and the Senate to the point where we must decide, if we have a bill, either to follow the recommendation of the Treasury, which is to pass the tax credit provision without any allowance for the regulated utilities, whether yours or electric utilities, or vote out and pass the bill as written by the House, 7 percent basically to industries generally, and 3 percent to regulated utilities generally, what would be your recommendation to the committee, to accept one of those alternatives, or entirely eliminate any tax credit provision in the bill?

Mr. ABEL. Well, of course actually the utilities would be better off with 3 percent than nothing.

Senator KERR. That would be especially true if 7 percent were going to be given to some of the industry generally?

Mr. ABEL. Yes; that would still be true.

We would be better off with 3 percent than with zero.

Senator KERR. Suppose we get down to where the choice is between 7 and 3 on the one hand, and nothing for either on the other.

Mr. ABEL. In that case, Senator, I personally—I would like to answer your question and then I would like to comment.

I would say that the answer should be to have no credit whatsoever.

In my opinion, this particular proposal—I do not like the use of the word "subsidy," but it is very close to that, in my opinion, and I think there are other ways that the objectives of the administration could be accomplished than by the investment credit which is currently being proposed.

I think it is unfair discrimination for our utilities, local gas distribution companies to receive 3 percent or nothing and business in general to receive 7 percent. I think it is unfair for certain elements of the business to receive nothing and other elements of the business to receive 7 percent. So I feel that there are other ways that would accomplish the objectives better than the investment credit.

Senator KERR. But if the committee decides to report out a bill with 7 percent and we are confronted with the alternative of following the Treasury and eliminate the provision of any tax credit to utilities or keep in what the House has, that would be your preference?

Mr. ABEL. I am sorry; I am not sure I understand you, sir.

Senator KERR. I say, suppose we decide, No. 1, that we are going to pass the bill out with 7-percent credit for industry generally; then we get down to the proposition, what are we going to do for the regulated utilities, and we have to decide whether we are going to follow the Treasury and give them nothing, or the House bill and keep the 3 percent.

Mr. ABEL. I would not be in favor of that kind of a proposal, sir.

Senator KERR. You mean you hope that alternative does not develop in just that form?

I am not saying it will, but you can understand that in view of the fact that that is the administration's position, that that will be one thing we will vote on in this committee when we get into executive session.

Mr. ABEL. Yes, sir.

Senator KERR. We will vote on whether we keep the 7 percent or not. Now, let's say that we have decided to keep it——

Mr. ABEL. Yes, sir.

Senator KERR (continuing). Then we are going to vote on whether we follow the administration and take the 3 percent for the utilities out or follow the House and leave the 3 percent for utilities in. We have already put in the 7 percent for industry generally, supposedly. What would be your recommendation?

Mr. ABEL. I personally would be in favor of no credit for the utilities, sir.

Senator KERR. You would rather they have none than 3, even though industry generally was receiving 7?

Mr. ABEL. I think that——

Senator KERR. I know that is a hard question, but it is one we are ging to have to answer on this committee.

We are going to be confronted with the necessity to make a decision on that question.

Mr. ABEL. Yes, sir; I appreciate it.

Senator KERR. You can take a little time, if you want to, to think about that—2 or 3 minutes.

That may be all the time I will have when I make up my mind.

Mr. ABEL. I think it is very unfair discrimination, sir.

Senator KERR. I understand. But what you have told me says that if you are going to be discriminated against, you want to be discriminated against 100 percent and not four-sevenths of a hundred percent.

Mr. ABEL. No, sir; Senator, I think that the equal treatment principle is very important.

Senator KERR. I understand you think that. You have made that very clear.

Mr. ABEL. Yes, sir; I did.

Senator KERR. But let's say that we have lost that battle.

Mr. ABEL. Then I think that I would rather not have any of the credit.

Senator KERR. You would rather not have any than have 3 percent?

Mr. ABEL. Yes, sir.

Senator KERR. All right.

Anything further?

Mr. ABEL. No, sir.

(Mr. Abel subsequently submitted the following for the record:)

SOUTHERN COUNTIES GAS CO. OF CALIFORNIA,
Los Angeles, Calif., April 10, 1962.

Hon ROBERT S. KERR,
U.S. Senate, Washington, D.C.

DEAR SENATOR KERR: In response to certain questions which you asked yesterday during my appearance before the Senate Finance Committee, I stated that, given the choice as between a 3-percent credit and no credit for utilities, I would vote for no credit. You kindly gave me 24 hours to think over my answer. I have done this and would like to clarify my position. In my prepared statement I emphasized the competitive situation which confronts our companies and the adverse impact on us resulting from the presently proposed 7-percent credit for our competitors as contrasted with the 3-percent credit for utilities. Obviously, and again as stated in my testimony, we would be more disadvantaged in this respect with no cerdit.

On the other hand, I am quite concerned about any willingness on the part of utilities to accept less than half as much as our competitors will get in this case as setting a precedent for our getting something less than our competitors when the depreciation reform promised by the Treasury or any other tax benefits are forthcoming in the future.

It was with this latter thought in mind that I responded as I did.

Consequently, I would like to supplement my answer by stating that for this particular investment credit and without prejudicing our position with respect to equal tax treatment for utilities in the future I would favor the 3-percent credit over no credit.

Very truly yours,

JERROLD Q. ABEL,
Controller and Treasurer.

Senator KERR. Mr. Theodore Wolfe.

STATEMENT OF J. THEODORE WOLFE, CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER, BALTIMORE GAS & ELECTRIC CO., APPEARING ON BEHALF OF EDISON ELECTRIC INSTITUTE; ACCOMPANIED BY JOHN THORNBORROW, DIRECTOR, ECONOMICS AND STATISTICS, EDISON ELECTRIC INSTITUTE; AND J. T. SMITH, COUNSEL, EDISON ELECTRIC INSTITUTE (REID & PRIEST)

Senator KERR. Since you are in somewhat the same position as this gentleman, you can answer that question before you present your statement, if you will.

Mr. WOLFE. May I identify myself and my reason for making it?

Senator KERR. I thought that had been done.

Mr. WOLFE. I want to be sure it is clear, Senator, that I am here to represent the Edison Electric Institute rather than any one utility company.

Senator KERR. But your name is Theodore Wolfe?

Mr. WOLFE. My name is J. Theodore Wolfe. I am chairman of the board and chief executive officer of Baltimore Gas & Electric Co., which happens to be the oldest gas company in the country, as well as an electric company.

But I am here to represent the Edison Electric Institute, a trade association for the investor-owned electric utility companies.

I have on my right Mr. John Thornborrow, who is a member of the staff of the Edison Electric Institute, and on left Mr. J. T. Smith, of the firm of Reid & Priest, counsel for the Edison Electric Institute.

Senator KERR. Are they lawyers or accountants?

Mr. WOLFE. Mr. Thornborrow is an economist on the staff of the Edison Electric Institute and Mr. Smith is a lawyer. I shall be glad to answer your question, sir.

Senator KERR. All right. And if there is any difference between the identities for whom you are speaking, say so. That is, if you, as J. Theodore Wolfe have one position and the Edison Electric Institute has one position, the Baltimore Gas & Electric Co. has a position—if they are all the same, you do not need to differentiate.

If there are different ones, do so.

Mr. WOLFE. I shall do that, sir, but I think the position is going to be the same.

Senator KERR. For all three of them?

Mr. WOLFE. For all three of them; right.

I personally, my company, and the Edison Electric Institute are all very strongly against discrimination in tax policy. We feel that the Congress should not adopt a tax policy which discriminates against a particular industry in favor of other industries.

But to deal with your question, we very strongly hope that when you get around to voting on the provisions of this bill, you will treat the regulated utility industries in exactly the same manner as you treat other industries, which is to say that if you decide that there shall be an investment credit provision in this revenue bill, you will put us all in on the same basis.

Senator KERR. Same rate?

Mr. WOLFE. Same rate; whatever that rate may be. We believe that is entirely proper, and it is the only thing that is proper.

Now, you asked what our position would be if you had voted first on the inclusion of the 7-percent credit as a general proposition.

Senator KERR. And approved it.

Mr. WOLFE. And approved it; and then you come to the next question, which is what shall we do about the regulated utility industries.

Senator KERR. You understand why I tell you we are going to be confronted with that position?

Mr. WOLFE. I think I do, sir; yes, sir.

Senator KERR. Because the Treasury favors 7 percent, or 8 percent, really, for industry generally.

It opposes any credit for the regulated utilities.

Mr. WOLFE. I understand that, sir. We would rather have four-sevenths discrimination than complete discrimination.

Senator KERR. Well, that makes sense to me.

Mr. WOLFE. In other words, if the committee in its wisdom——

Senator KERR. If the committee cannot get you as much as anybody else, we want to get you all we can.

Mr. WOLFE. We want to be treated as fairly as possible.

Senator KERR. Or as nearly fairly as possible.

Mr. WOLFE. Or as nearly fairly as possible; yes, sir.

Some of my comments will be repetitious. These were not prepared conjunctively.

Senator KERR. That is all right. Let me say this to you, that those who come after you will be even more so.

Mr. WOLFE. I listened to the three preceding witnesses, and I agree with most of what they said. Therefore——

Senator KERR. Where they agreed with each other, you agreed with them?

Mr. WOLFE. Yes; I think generally they did agree among themselves and I agree with them.

Senator KERR. I want to tell you, there was one point of major difference there. Mr. Abel said that if he could not get as much as the others had, he did not want any.

Mr. WOLFE. In that respect I cannot agree.

Senator KERR. All right.

I am going to give him until tomorrow to change his mind if he wants to.

Mr. WOLFE. I feel that it is only reasonable for me to ask your indulgence, even though I may repeat much of what has been said, because I am speaking as the representative of the entire investor-owned electric utility industry.

Senator KERR. You are speaking for a great outfit, and I am interested in what you are going to say.

Mr. WOLFE. The investor-owned electric utility industry is, of course, one of the largest industries in this country. In 1960, it had a gross plant investment of approximately $46 billion.

Its revenues in the year 1960 were approximately $11.6 billion, and it paid income taxes into the Federal Treasury of about $1,120 million.

It is for that industry that I speak here today.

The President, in his tax message of April 1961, stated that one of his objectives was to eliminate injustices and inequities from our taxing system to the end of providing a more uniform distribution of the tax burden.

We heartily agree with the President in this stated objective. We believe it is not only desirable but essential that taxation be imposed in an equitable and nondiscriminatory manner; and our sole reason for being here is to point out certain respects in which the revenue bill now pending before the committee is in conflict with that principle.

As you may know from our request for an appearance before your committee, we are very much concerned with the House bill provision, and even more so with the Treasury Department's proposal, relating to the investment credit. It is not the purpose of our appearance to discuss the merits of the investment credit. Neither do we seek preferential treatment. On the contrary, we seek your aid in obtaining equality of taxation for the electric utility industry in connection with the application of the investment credit should you ultimately decide to recommend to the Senate the inclusion of such a provision in any revenue bill.

Section 2 of H.R. 10650, 87th Congress, 2d session, discriminates against the electric and other regulated utility industries by providing for them an investment tax credit of only 3 percent as contrasted with the 7 percent tax credit provided for other industries.

This discrimination is illustrated on the chart wherein we make a comparison between the effective income tax rate applicable to corporate taxpayers other than regulated utilities as contrasted with the effective rate applicable to a regulate utility making capital investments which qualify for the credit. The black figures in the chart are those applicable to a corporate taxpayer other than a regulted utility. The red figures are those applicable to a regulated utility.

You will note that both the black and red figures in columns (1) and (2) are equal, indicating that under the present tax law a corporate taxpayer other than a regulated utility generally pays the same amount of Federal income tax as a regulated utility where the amount of taxable income is the same.

Column (3) represents the amount of investment qualifying for the credit which, for comparison purposes, is in the same amount in the case of a corporate taxpayer other than a regulated utility as it is in the case of the regulated utility.

Column (4) reveals the difference in the amount of the tax credit allowable to each taxpayer under section 2 of the House bill.

Column (5) sets forth the actual tax liability of each taxpayer.

Column (6) shows the effective tax rate under the House investment credit provision applicable to a corporate taxpayer other than a reg-percent in the case of a regulated utility.

You will note that where $100,000 of qualified investment is made by each taxpayer—top two lines of figures on the chart—the effective rate of tax in the case of a corporate taxpayer other than a regulated utility is 50.75 percent as contrasted with the effective rate of 51.15 percent in the case fo a regulated utility.

The difference is not great. However, as the amount of the qualified investment increases in relation to a given amount of net income, the degree of discrimination against the regulated utility taxpayer increases. Thus, you will note that, in the example, which is more nearly representative of the true situation, where $2 million of qualified investment is made by each taxpayer—bottom two lines of figures on the chart—the effective rate of tax in the case of a corporate taxpayer other than a regulated utility is 37.45 percent as contrasted with the effective rate of 45.45 percent in the case of a regulated utility. The discrimination is obvious.

Senator KERR. Just one moment, Mr. Wolfe. The reporter will copy that chart into the record at this point.

Mr. WOLFE. It is attached. Although it is not in black and red, it is otherwise here.

Senator KERR. I understand, but I wanted to be sure it is in the record of the hearings.

(The chart referred to is as follows:)

Comparison of effective rate of tax between corporate taxpayer other than regulated utility and regulated utility under sec. 2 of H.R. 10650

Taxable income (1)	Tax (2)	Qualified investment (3)	Credit allowable (4)	Tax less credit allowable [col.(2) – col.(4)] (5)	Effective rate of tax [col.(5) ÷ col.(1)] (6)
					Percent
$1,000,000	$514,500	$100,000	$7,000	$507,500	50.75
(1,000,000)	(514,500)	(100,000)	(3,000)	(511,500)	(51.15)
1,000,000	514,500	500,000	35,000	479,500	47.95
(1,000,000)	(514,500)	(500,000)	(15,000)	(499,500)	(49.95)
1,000,000	514,500	1,000,000	70,000	444,500	44.45
(1,000,000)	(514,500)	(1,000,000)	(30,000)	(484,500)	(48.45)
1,000,000	514,500	2,000,000	140,000	374,500	37.45
(1,000,000)	(514,500)	(2,000,000)	(60,000)	(454,500)	(45.45)

Parentheses indicates red figures.

Mr. WOLFE. Senator, I would like to explain why I say that the last example there is more nearly representative of the true situation than the first one shown.

This relationship of $2 million of qualified investment to $1 million of taxable income is fairly close to the situation we have in the regulated electric utility industry. In other words, our investments which would qualify under this provision run somewhere between 1½ and 2 times our taxable income.

So I want to direct your attention——

Senator KERR. I would like to ask you a question or two right there.

Did you hear Mr. Cook's testimony?

Mr. WOLFE. Yes; I did, sir.

Senator KERR. You heard him say that next year they expect to spend $160 million-some in investments?

Mr. WOLFE. $152 million, I believe it was, in 1962.

Senator KERR. Something around 55 percent, I believe, would be obtained from cash flow; the rest of it from credit?

Mr. WOLFE. Yes, sir.

Senator KERR. You heard him say that his company had a depreciated value on the books of about 1.35 billion and a tax and debt structure of something in the neighborhood of $300 million?

Mr. WOLFE. Yes.

Senator KERR. How do those figures generally compare with that of the industry, percentagewise, both with reference to the amount of this year's investment that is budgeted and being paid for out of available funds, the amount that will be paid for out of financing, the relationship between the present depreciated book value and the present debt structure?

Mr. WOLFE. Yes, sir; I have in my statement here a little later on, some of that. I point out that over the next 10 years, the entire regulated electric utility industry expects to generate approximately 50 percent of its capital requirements from internal sources. That is a little less, I believe, than the percentage which American Electric Power generates. I believe it is correct to say that the industry as a whole has a capital structure which shows about 50 percent in debt and the balance in preferred stock and common stock equity.

Senator KERR. Fine.

Thank you very much.

Mr. WOLFE. I would like to go back again to the——

Senator KERR. You heard the statement of the A.T. & T. representative?

Mr. WOLFE. I did not hear their statement.

Senator KERR. As I recall, their debt structure is about $2.7 billion and their overall book value is about 21, maybe.

Where there is about one-third or a little over, of their total depreciated book value in the form of outstanding indebtedness, what you are telling me is that the privately owned electric generating and distribution utilities in the country have a debt structure, say, of more nearly 50 percent of their present depreciated book net worth?

Mr. WOLFE. Possibly 50 percent, I would say.

Well, to be technically accurate, I would say it is 50 percent of their capitalization, which is the total of their bonds and stocks.

Senator KERR. I understand, but is that materially different——

Mr. WOLFE. And is approximately the same as the depreciated book value of their plant.

Senator KERR. In other words, what you said is technically correct and what I said is——

Mr. WOLFE. Means the same thing.

Senator KERR (continuing). Is generally correct?

Mr. WOLFE. Yes, sir.

Coming back to those figures in which I pointed out that the effective tax rate for a regulated utility under this House bill provision would be 45.45 percent, whereas the rate for other industries would be 37.45 percent, I should like to state now that if the Treasury Department's proposal were adopted and the regulated utility were deprived of any investment credit while other taxpayers are given a credit of 8 percent, the discrimination would be far worse. In the last example shown on the chart, the effective rate of tax in the case of a corporate taxpayer other than a regulated utility would be 35.45 percent instead of the 37.45 percent, whereas the regulated utility would pay 52 percent. In other words, the effective rate of tax borne by the regulated utility would be half again as great.

House Report 1447 accompanying H.R. 10650, 87th Congress, 2d session, seeks to justify the discrimination between regulated utilities and other taxpayers on the basis that much of the benefit that would be obtained under the investment credit provision is likely to be passed on in lower rates to consumers, thereby negating the stimulative effect on investments.

If this statement in the House report is to be viewed as a reason for denying the credit to a regulated utility, its inherent implication is a bit startling. The same reasoning could be applied to produce the absurd result that no deductions, even though allowed to all other taxpayers, should be accorded the utility in computing income subject to Federal income tax.

Mr. WOLFE. It is a fact, of course, that whatever the electric utility company pays in Federal taxes becomes a part of its cost of service to consumers and, generally speaking, its rates are regulated accordingly.

As a practical matter, however, whether a tax reduction in the form of an investment tax credit would be passed on to consumers would depend upon a number of factors. It should be noted in this regard that although a regulating commission determines the rate of return which will be allowed on investment, such determination by the commission in no way guarantees that this rate of return will be earned. Further, consumer rates are not automatically changed from year to year. A general shift in a utility's rate structure, on the contrary, is a rather rare occurrence.

Even assuming, however, that a reduction in tax burdens in all cases must be passed on to the consumer, the natural result is an effective reduction in rates or at least the prevention or retarding of an increase in rates which might otherwise occur as a result of other rising operating costs.

Senator KERR. Your position is that that affects your competitive position whether you pass it on or not?

Mr. WOLFE. Yes.

Senator KERR. I mean with other——

Mr. WOLFE. With other industries.

Senator KERR. Yes.

Mr. WOLFE. Despite the rather novel contention of the Treasury Department that the demand for electricity is inelastic, it is an historical fact that, as the cost of electric energy to consumers has decreased over the years, the per capita consumption has vastly increased. There is no question in the mind of any utility man that the continued growth of the regulated utility industry which has meant so much to the economy of our country is dependent upon the industry's ability to maintain costs of operations at a minimum. Certainly taxes, which consume 24 percent of the electric utility industry's revenue dollar, are a major element of those costs.

Senator KERR. Did you tell me a while ago the total annual investment contemplated in plant expansion by the electric utility industry? Did you give me that figure a while ago?

Mr. WOLFE. I am going to give you a figure which represents a 10-year projection.

Senator KERR. You told me you were going to give me a 10-year figure. You have not given me a figure for this year?

Mr. WOLFE. No, I have not.

Senator KERR. When you give me the 10-year figure, is it to be considered by the committee as being a total of which it invested approximately 10 percent per year?

Mr. WOLFE. No, sir; it does not, Senator, work quite that way.

Senator KERR. It increases as the decade——

Mr. WOLFE. We are increasing a certain rate percentagewise.

Senator KERR. Will you give it to me——

Mr. WOLFE. I will give you the 10-year figure. I can give it to you now if you want.

Senator KERR. As long as you give it to me.

Mr. WOLFE. Previously I referred to the annual revenues in 1960 as being $11.6 billion. That is the total revenues of all of these utility companies. But it includes some revenues other than electric, and in order to have it comparable with the income tax figure I gave you of $1,120 million, I would have to give you a different revenue figure. The correct figure would be $9,737 million.

Senator KERR. $9,737 million is the electric utilities' income, and $1.1 billion is the electric utilities' tax——

Mr. WOLFE. Income taxes paid to the Federal Government; that is right, sir.

Senator KERR. All right.

Mr. WOLFE. Application of the full investment tax credit to the regulated electric utility industry is just as much in keeping with the objective of the credit as its application to taxpayers other than regulated utilities.

Taxpayers generally are likely to utilize the tax savings from the investment credit to strengthen their competitive position by holding or reducing operating costs and prices. The resulting increase in demand for their products or services will be the motivation for additional capital investment.

Further, concerning the extension of the full credit to regulated electric utilities, it should be noted that where the tax savings resulting from the tax credit are passed on to the consumers through reductions in rates, such reductions will be of assistance to U.S. producers in competing favorably at home and abroad since electricity is one of the elements of their production costs.

At this point I should like to deal briefly with one of the common fallacies concerning the electric utility industry, namely, that the industry is a regulated monopoly free from competition. The fact is that in almost any given situation, from residential consumption through all the classifications of service rendered by the electric utility, to the industrial user who consumes power in huge blocks, electricity is in competition with other forms of energy as well as with other demands for the consumer's dollar.

By way of typical example, the residential or commercial consumer has a free choice as to whether he will use electricity, or gas, or coal, or oil, for space heating, water heating, and other purposes; and for many industrial heating and processing purposes, there is a similar freedom of choice. Furthermore, the large commercial or industrial user of electricity has a choice between purchasing his requirements from the utility company or installing his own generating equipment. Often the margin of costs upon which he bases his choice is very close and a differential in tax treatment could well be the determining factor.

Senator KERR. I would presume that you have more competition from other utilitities for the residential markets that you serve than you can give to these other competing energy-source industries for the industrial consumption markets available.

Mr. WOLFE. I am not sure that I understand you fully, Senator.

Senator KERR. All right. I will say it again.

I would presume that those who sell oil, gas, and coal as a fuel for house heating, can compete with you more effectively for the energy the house needs to heat it than you, an electrical energy producer, can compete with coal, oil, and gas supplier in the industrial market to supply the energy they need to run their businesses.

Mr. WOLFE. I am not sure that is right, Senator.

Senator KERR. You think that the electrical industry can compete with a brick plant——

Mr. WOLFE. Well, for operating the kilns in a brick plant, I must say I do not know of any case where the electricity is used to heat the kilns.

Senator KERR. Well, there is a great industrial demand in this country for energy fuel.

Mr. WOLFE. That is correct.

Senator KERR. There is a great demand in this country for energy to heat homes.

Mr. WOLFE. That is correct.

Senator KERR. From my own informed viewpoint, it is my opinion that you have the edge on the others when it comes to furnishing that home requirement to a greater extent than you have it on them when it comes to furnishing the heating required in the sum total of industrial heat users.

Mr. WOLFE. Senator, you just cannot generalize on that. The situation varies in different parts of the country. It is not the same in Baltimore as it is in Los Angeles or Chicago or Oklahoma, and you cannot generalize as to these industrial processes.

I think that there would be very little question that where you are simply making heat for industrial purposes, the electricity would not very often compete with gas or oil or coal, but there are many industrial heating processes which require a very finely controlled heat.

Senator KERR. I understand, like aluminum.

Mr. WOLFE. And electricity does compete there.

Senator KERR. They cannot compete with you there very well.

Mr. WOLFE. You just cannot generalize on this.

Senator KERR. I know this. But it seems to me that the electric utility is making very rapid strides in providing heat for homes.

Mr. WOLFE. That is correct.

Senator KERR. And to the extent that you are doing so, you are providing that element of competition with the fellow who sells the gas or the oil or the coal.

Mr. WOLFE. The part of that that I am trying to emphasize is that the electric utility and the gas utility are in competition with coal and oil, which would be given the full credit under the House bill proposal.

Senator KERR. I understand that. Actually, I am at this particular moment more in search of information than I am in determining attitudes about a provision in this bill, although it is not unrelated.

Mr. WOLFE. I think I should point out then, Senator, that there are certain places in the country where natural gas is sold at very low prices for residential heating purposes.

Senator KERR. Comparatively speaking.

Mr. WOLFE. Comparatively low.

Senator KERR. Yes.

Mr. WOLFE. And it is very difficult even for electricity to compete there. Electricity does not compete on a cost basis. It competes in terms of——

Senator KERR. Convenience.

Mr. WOLFE (continuing). Convenience and other advantages.

Senator KERR. But there are far more areas where that does not prevail than where it does.

Mr. WOLFE. That is correct. The competition for home heating in the last decade or two has been principally between natural gas and oil.

Now, in certain parts of the country natural gas is sold at a price advantage in competition with oil.

Senator KERR. Yes.

Mr. WOLFE. When you go up to Boston you find a totally different situation. They are trying to sell natural gas up there at a price quite a bit higher than the price of oil.

Senator KERR. For instance, in Hartford, Conn., or New York City, or Boston where natural gas sells at $1.50 a thousand or above, I would think that the electrical producer would be very effective in competition with them to furnish the heating energy for a house or a residence, while down in Oklahoma City where the householder can buy it for 45 to 48 cents a thousand cubic feet, the electrical producer is in a much less advantageous position.

Mr. WOLFE. I am not sure whether the president of the Oklahoma Gas & Electric Co. would want to agree with that or not, because I think he is doing a fairly good job at promoting electric heat.

Senator KERR. He is, but I do not think——

Mr. WOLFE. In Oklahoma.

Senator KERR. But I do not think he has as favorable an environment to do it in as you in Baltimore—well, maybe not Baltimore, but, for instance, here in Washington.

Mr. WOLFE. I really do not know, sir.

Senator KERR. All right.

Mr. WOLFE. I would like to give you one or two illustrations which are not in the prepared statement which, I believe, will help to show the importance of the competition we have in the industrial field between our own source of electric energy and the customer's own generating plant which he can put in if he so chooses.

We have a very large steel plant in our service area, the largest in the world.

Senator KERR. You are talking about the Maryland utility?

Mr. WOLFE. Yes.

Senator KERR. You are talking about the Fairless plant?

Mr. WOLFE. No, I am talking about the Bethlehem Steel plant.

Senater KERR. Is that bigger than Fairless over on the Delaware?

Mr. WOLFE. Much bigger.

Senator KERR. You are helping my general fund of information no end. Go right ahead.

Mr. WOLFE. Probably eight times, possibly six times; it is the biggest in the world.

That steel plant has an electric requirement we express in terms of demand of about 300,000 kilowatts. They have their own generating plant which is capable of generating about 60 percent of that total requirement. The other 40 percent they buy from us.

Now, as they grow they are constantly making studies to determine the comparative economy between expanding their own electric generating plant or buying more electricity from the utility companies, and these calculations, as you may assume, are made on a very careful basis with a very sharp pencil.

We expect their total electric requirement over the next 5 years to increase by about 75,000 kilowatts. We want to sell that to them. They really want to buy it from us.

But if this discriminatory investment tax provision comes into the picture it may very well upset the calculation.

Senator KERR. It would be the difference. In other words, if they do it they get 7 percent, if you do it under this bill you get 3.

Mr. WOLFE. We get 3.

Another example, we have a large copper refinery which was built in our territory just a couple of years ago. It is a good-sized customer, and it uses about 21,000 kilowats. We really had to negotiate hard to get them to use our service rather than put in their own generating capacity.

They expect to increase by about 50 percent within the next few years, and they have already told us that they are going to restudy this question of a private powerplant versus purchased electric power when they expand their plant.

It will be very close figuring, and we just do not feel that it is fair for us to be taxed out of the picture by a discriminatory investment tax credit.

Senator KERR. They told you that in light of the proposed bill or before this proposed bill?

Mr. WOLFE. Before this proposed bill we were on notice from them that they were going to figure very closely again when they were——

Senator KERR. Then they will notify you again if we pass this bill, won't they?

Mr. WOLFE. Yes, sir.

Now, speaking again for the whole industry, it will obviously be unfair to put the regulated electric utility at a competitive disadvantage by discriminating against it in applying the investment tax credit.

There is another important reason for extending the full investment credit to the electric utility industry. Our industry is in continual need of additional investment capital. Capital is required not only to meet increasing demands for electric power, but also to maintain and improve its operating efficiency.

Any industry which can make its capital purchases at a 7- or 8-percent discount as compared with an industry which can make capital purchases at only a 3-percent discount, or no discount at all, is in a position to offer a more attractive risk to suppliers of capital. Any factor which affects adversely the flow of new capital could have serious consequences to the electric utility industry and, in turn, to the economy of the entire Nation. The investor-owned electric utility industry accounts for approximately 10 percent of the capital investment made annually in this country. Our present estimate is that in the next decade our industry will spend approximately $48.5 billion for capital additions and improvements, and the figure for the year 1962 is about $3.5 billion.

Senator KERR. Is that 10 percent of the capital investment this year?

Mr. WOLFE. It averages about 10 percent year after year, sir.

Senator KERR. I thought the estimates we were looking at were in excess of $35 billion for this year.

Mr. WOLFE. It is $36 billion.

Under the existing tax structure, it is estimated that approximately 50 percent of the new capital required for these additions and improvements over the next 10 years will have to be obtained through the sale of securities in the open market. Any tax discrimination between industries that would reflect in the relative attractiveness of our securities in the open market would be both unfair and unwise.

In conclusion, I would like to emphasize that the growth of the electric utility industry is a most important factor in the strength of our economy. That growth is by no means automatic, but depends upon the ability of the industry to meet competition from other sources of energy.

In the expansion and modernization of its facilities by the investment of new capital, our industry is certainly entitled to any form of encouragement extended to other industries and should not be discriminated against. Discrimination against the electric utility industry in the formulation of tax policy is, in our judgment at least, contrary to the public interest.

Senator KERR. Thank you very much, Mr. Wolfe, for a very informative statement.

I had one other question.

Mr. WOLFE. Yes, sir.

Senator KERR. A witness last week argued that the allowance of an investment credit would so increase stated income after taxes for 1962 as compared with 1961, per share of common stock, as to cause in many cases a pronounced increase in the value of the common stock, and that that would be especially true for other companies who have large outstanding preferred stock issued, since the benefit would go primarily to the equity stockholder or common stockholder.

Now many of our private utilities, electric and otherwise, have a substantial amount of outstanding preferred stock.

Do you have any comment on this?

Mr. WOLFE. Was that statement with reference to the utility industry, sir?

Senator KERR. I believe it was made with reference to—a member of the staff who also heard the testimony reminds me that the accountant who gave that testimony was referring to 45 or 50 companies, all of whom would get the 7-percent tax credit, and making the point that those whose capital structure included a lot of preferred stock and relatively smaller amounts of common stock would produce greater benefit to the common stockholders; that is, the common stockholders would share or would have a greater benefit in proportion to the relationship between common stock and preferred stock.

Now what I would like to have you comment on is with reference to the electric or other regulated utility industries, even with reference to the 3 percent, in view of the fact that there are so many electric or other regulated utilities with varying amounts of preferred stock.

Maybe you would rather take a little time.

Mr. WOLFE. No; I think I can comment on that, sir.

Senator KERR. All right.

Mr. WOLFE. I would like to make a comment about his statement, in general, first because I refer specifically to the regulated utility industry.

Senator KERR. All right.

Mr. WOLFE. He is apparently assuming that these companies which would get the investment tax credit would hold on to all of that credit in the form of increasing earnings.

Now I think that is open to question. We have a competitive economy and if costs go down I cannot help thinking that selling prices would go down. You would not necessarily hang on to the tax credit in the form of additional earnings. You may pass it on in the form of price reductions and make yourself more competitive and increasing the demand for your products, and I say that with reference to industry generally.

Now insofar as the regulated utility industry is concerned, I think it can be said even more emphatically the strong probability is that the tax reduction which a regulated utility would get through the application of this investment credit would have an effect upon the rates they charge their customers, which serve either to permit a reduction in those rates or to forestall an increase which otherwise would be required because of rising wages rates and local tax rates, and so forth.

I think you may assume that the regulatory commissions around the country are going to watch the effects of any investment credit applicable to the utilities, and certainly the benefit of it would go to the customers one way or the other.

Now, as Mr. Cook very well pointed out this morning, anything that helps you lower your rates or reduces the income tax element of your fixed charges of supporting investment tends to make you more competitive, and to make economic some types of investment which otherwise would not be economic.

This is the sort of a two-step affair in the case of the electric utilities, and I believe it would really be the same there as it would be in other industries.

The effect of this would be to reduce the taxes that these companies pay, and if they can reduce their taxes they will undoubtedly be able to sell their products at lower costs, become more competitive, increase the demand for their products or services, and thereby be called upon to make additional investments to meet the increased demand.

Senator KERR. Your position is then that the tax credit should be enacted but that it should be made the same figure as between the regulated industries, on the one hand, and other industries, on the other.

Mr. WOLFE. Senator, we are not taking any position on whether the investment credit should be enacted or not.

Senator KERR. The statements you have made seem to me to support it.

Mr. WOLFE. Well, there are various ways of providing tax relief, and we are not really taking a position which of those, if any, the Congress should adopt at this time.

Senator KERR. The others are not before us. This is the measure that is now before us, and while I cannot speak for anybody but myself, my judgment is that this would be the only tax relief there would be considered seriously by the Congress this year or next year as far as industry is concerned.

Mr. WOLFE. Our whole position really is if you decide to give this tax relief it ought to be done on a nondiscriminatory basis.

Senator KERR. But you take no position as to whether it should or should not?

Mr. WOLFE. We do not, sir.

Senator KERR. What do you personally think about it? Let us forget about the Edison Institute.

Mr. WOLFE. Well, I think that the investment credit would have a tendency to make American industry more competitive and to stimulate investment. I think that can be done in other ways, also.

Senator KERR. Let us take them one at a time. You think it will make American industry more competitive in the world market?

Mr. WOLFE. I think it would have that effect to some extent; yes, sir.

Senator KERR. Well, that is a desirable effect, is it not?

Mr. WOLFE. Yes.

Senator KERR. Do you think it would stimulate investment in those industries within our economy who supply only a demand for their product in the domestic market?

Mr. WOLFE. I think it would stimulate investment and thereby——

Senator KERR. And accelerate the rate of growth.

Mr. WOLFE. That is right.

Senator KERR. Do you think that is wholesome?

Mr. WOLFE. I think that is wholesome. Now where I get into trouble, of course——

Senator KERR. You do not need to go any further. Nobody wants you to get into trouble.

Mr. WOLFE (continuing). Is to choose between that and some other way of doing the same thing. We do not want to take a position on what is the best way of doing it.

Senator KERR. Thank you very much, Mr. Wolfe, for a fine statement.

Mr. WOLFE. Thank you, sir.

Senator KERR. Mr. Lucht, American Retail Federation. Proceed.

STATEMENT OF ALLAN P. LUCHT, TREASURER, FEDERATED DEPARTMENT STORES, INC.

Mr. LUCHT. Senator Kerr, my name is Allan P. Lucht. I am treasurer of Federated Department Stores, Inc. with offices in Cincinnati, Ohio. I appear here on behalf of the members of the American Retail Federation with offices at 1616 H Street, NW., Washington, D.C.

The American Retail Federation is a federation of 31 national retail associations and 42 statewide associations of retailers. Through its member associations the federation represents more than 800,000 retail establishments, of all kinds and sizes, which employ about 5 million persons and account for approximately 70 percent of the retail sales in the United States.

SCOPE OF THIS PRESENTATION

Members of the retail trade field are vitally interested in many of the provisions of the current tax bill, H.R. 10650, which is now before you for consideration. My presentation today will be confined to one feature—the investment credit provision. I should like permission to file a supplementary statement at a later date before the close of the hearings, which would cover other subjects of interest to retailing, as well as to amplify my necessarily brief remarks today.

Senator KERR. Very well, Mr. Lucht, you may do that.

Mr. LUCHT. Thank you.

(The document referred to follows:)

SUPPLEMENTAL STATEMENT OF THE AMERICAN RETAIL FEDERATION, APRIL 19, 1962

This statement is submitted in order to amplify and expand the necessarily brief statement presented on behalf of the American Retail Federation to the committee on April 9. That statement dealt solely with the investment tax credit provision and only in general terms. It did not deal with other provisions of the bill before you on which the federation wishes to make its views known.

CREDIT FOR INVESTMENT IN CERTAIN DEPRECIABLE PROPERTY

Retailers are particularly concerned as to whether or not they can take advantage of the provisions of this section because of the vagueness and indefiniteness of the definitions of the two kinds of property which qualify for the credit; viz (*a*) tangible personal property, and (*b*) certain other tangible property.

It may be the intent of Congress that retailers can qualify for this credit, but in reading the bill and the report of the Committee on Ways and Means, retailers are left with a great feeling of uncertainty. If the bill as it now stands becomes law, retailers are fearful that those who will administer its provisions will give a narrow interpretation to the kinds of property which Congress intended should qualify for the investment credit.

Tangible personal property.—The House committee report on H.R. 10650 states:

"* * * all tangible personal property qualifies as section 38 property * * * Tangible personal property is not intended to be defined narrowly here, nor to necessarily follow the rules of State law. It is intended that assets accessory to a business such as grocery store counters, printing presses, individual air-conditioning units, etc., even though fixtures under local law, are to qualify for the credit. Similarly, assets of a mechanical nature, even though located outside a building, such as gasoline pumps, are to qualify for the credit * * *"

The language in the above quotation indicates a rather narrow concept of a modern retail establishment and the property it uses. It would be unreasonable to expect the committee report to enumerate in great detail all of the retail assets that are considered personal tangible property. But, it is suggested, that the Senate committee report include some additional examples of retail personal tangible property, but without limitation, that qualify for the investment credit. This would help clarify the intent of Congress. We suggest the following: Display racks and shelves, display boards, special panel dividers between selling areas, merchandise handling equipment, cash registers, and compressors for refrigeration. All of these items are "accessory to" the retailing process.

Other tangible property.—The language of the present bill in its definition of "other tangible property" which qualifies for the investment credit appears to exclude retailing. The definition follows:

(B) Other tangible property (not including a building and its structural components) but only if such property—

(i) is used as an integral part of manufacturing, production, or extraction, or of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services, or

(ii) constitutes a research or storage facility used in connection with any of the activities referred to in clause (i).

This represents a serious omission. We respectfully suggest, therefore, that H.R. 10650 be amended by adding the word "retailing" to follow the word "production" in subsection (B) (i) of section 48(a) (1).

In addition to the amendment suggested, the status of retailers in regard to qualified "other tangible property" could be clarified even further if the report of this committee would spell out its intent in this regard.

The House committee report states that real property (other than buildings and structural components) which qualifies as integral parts of categories referred to above includes such assets as blast furnaces, oil and gas pipelines, railroad track and signals, and fences used in connection with raising cattle. Retailers purchase and utilize certain items of built-in tangible property, other than personal, which are most definitely an integral part of the retailing process which should share the same eligibility as the specific items mentioned in the House committee report and which should be specifically mentioned in the Senate committee report.

Such items include show windows—both the actual glass window front and the wall at the rear—store front signs, and refrigerated and low temperature installations used to keep meat and other perishables. The latter does not refer to refrigerated display cases, on view to the customer, but to installations constructed and placed in space at the rear of a store, or in the basement. Without this type of equipment, the great outpouring of perishable products from producers could not be stored in quantity and reach the buying public in a condition that would meet the required standard of health and sanitation.

Retailers believe that escalators and facilities used in parking lots, such as fences and outdoor lighting are integral parts of, and accessory to, the retailing process and, therefore, should be considered as property qualifying for the investment credit. Retailers must have adequate, up-to-date facilities to move not only goods in mass quantities, but also to accommodate and move people en masse. Escalators and parking lots are involved in the latter process.

The Ways and Means Committee report mentions specifically that the parking lot of a factory is not used as an integral part of manufacturing. It is for the benefit of the employees of the factory. However, the retailer's parking lot is in an entirely different category. Present day consumer habits have made the customer parking lot a vital necessity. The retailer who does not have one soon falls behind in our highly competitive system. The customer's requirements cannot be overlooked and investment is needed to accommodate that requirement.

Outdoor shopping areas are becoming more prevalent. Many retailers have outside lots from which they sell outdoor furniture, garden supplies, and the like. These lots must be equipped and lighted, and retailers believe that investment in these facilities for the benefit and convenience of the customer should be eligible for the credit.

RETAILERS' PROBLEMS CONCERNING USEFUL LIFE OF DEPRECIABLE ASSETS

Retailers would like some clarification of the bill's proposed section 47 of the code dealing with certain dispositions of section 38 property. As we read this section, it appears that a retailer would be required to keep his records in such manner as to identify each item of section 38 property. If that is so, then every counter, display case, table, etc. would have to be separately identified. There are indeed few retailers, if any, that maintain property records identifying each item of furniture and fixtures used in their business. The usual retail practice is to average the life of various properties acquired.

If the above interpretation is correct, and we hope it is not, the retailer will encounter considerable difficulty in complying with the provisions of the bill. He will find himself in a continual state of audit and there will be no end to his problems. Many retailers may even be deterred from taking advantage of the investment credit provisions of the bill as intended by Congress.

It is felt that the report of this committee should recognize this situation that is peculiar to retailing and clearly and specifically state that the retail practice of averaging the useful lives of the component parts of store modernizations will be acceptable for the purpose of qualifying for the investment. The committee report might also clarify the application of section 47 to dispositions of section 38 property by retailers who have taken advantage of the credit on an average-life basis.

DISPOSITION OF SECTION 38 PROPERTY BECAUSE OF UNCONTROLLABLE CONDITIONS OR CIRCUMSTANCES

Section 47 of the code proposed by the bill governs disposition of property on which the credit has been taken before its useful life has been completed. To prevent abuses of the credit, it provides for recomputation of taxes which had been decreased through operation of the credit.

It is not clear to retailers, and perhaps to many others, how this section is to apply to cases of involuntary conversions resulting from uncontrollable conditions or circumstances. Our purpose is to raise some questions which we hope this committee will answer or clarify in its report. More specifically, how will this provision apply in the case of property destroyed by fire and in which case the owner is a coinsurer?

Many retailers operate in leased property on which they make their own improvements. These improvements are depreciated on the basis of the lease and options for renewal. Take the case of a tenant with a 20-year lease, and a 15-year renewal, for example. He undertakes a program of substantial improvements, but loses his lease prior to its expiration because the property is condemned for a highway or for area rehabilitation purposes. We believe it is the intent of Congress to provide some protection to investors in situations of this kind. However, the bill is not clear on this point.

RETAILERS PLAY VITAL ROLE IN NATIONAL ECONOMIC GROWTH

We believe the basic reason for the adoption by Congress of the investment credit is to assist business in programs of expansion and modernization, thus contributing to an expanding economy and more jobs for our people. We wish to emphasize, as strongly as we can, that the retail industry is the final, vital link in the process of getting the products of farms and factories expanded production into the hands of the buying public. It is useless to talk about expansion and modernization of productive facilities unless there is an expanded and modernized retail industry ready to transmit the increased volume of goods produced.

For these reasons we earnestly hope that the Congress will make it clear that the retail industry will be afforded the full benefits of the investment credit proposal—benefits which we are sure were intended to be available to it in the same degree as were intended for manufacturing and production. Unless retailing is permitted to play its part in this modernization and expansion role and take advantage of the investment credit provided by H.R. 10650, the ultimate national goals of full employment, growth, and equity in the tax structure will not be attained.

APPEARANCES WITH RESPECT TO LEGISLATION

The American Retail Federation endorses section 3 of the bill which would permit deduction of ordinary and necessary expenses incurred by taxpayers in connection with appearances before legislative bodies and communications with such bodies and the members thereof.

Expenses incurred in appearances before executive or administrative agencies and tribunals, and appearances before the courts are now deductible when they otherwise qualify as ordinary and necessary business expenses. The enactment of section 3 of the bill will simply place all such expenses of the taxpayer on an equal basis.

In the present extremely complex state of the economy it is vitally important that all legislative bodies obtain as complete information as may be available as to the potential effects of any law or ordinances which they may be considering, particularly when this effect may be vital to the very existence of business. No artificial barrier, in the form of unfair tax treatment, should be raised to prevent a legislative body from obtaining the views of individuals who are interested in or will be affected by pending legislation.

DISALLOWANCE OF CERTAIN ENTERTAINMENT, ETC. EXPENSES

The American Retail Federation strongly believes that expenses deductible as normal and necessary business expenses should not be subect to arbitrary limitations whether expressed in dollars or otherwise. It clearly recognizes the difficulties involved in formulating specific and precise guidelines as to what constitutes "ordinary and necessary" expenses related to the conduct of a trade or business. It is a subjective decision which responsible businessmen are qualified to make and should be allowed to make in the light of their own business circumstances and the tax regulations which now exist.

Despite some abuses which have occurred in this area, it is felt that too restrictive legislation may hamper legitimate business operations and that such abuses can best be dealt with through sound and realistic enforcement policies under the law and regulations as they now exist.

TAX TREATMENT OF COOPERATIVES AND PATRONS

The federation endorses the principles contained in section 17 of the bill dealing with the tax treatment of cooperatives.

These provisions, in effect, do no more than reestablish the intent of Congress in enacting the Revenue Act of 1951. The purpose was to insure that earnings of cooperatives would be currently taxable (to the extent that they reflected business activity) either to the cooperative or to the patron. Court decisions have vitiated this provision of the law, holding that noncash allocations of patronage dividends generally were not taxable to the patron, although deductible by the cooperative.

The force of the provisions of the 1951 law should be renewed. At one time there may have been some reason for special tax treatment of cooperatives. There is none today. Cooperatives should not be treated differently from businesses with which they compete.

WITHHOLDING ON INTEREST AND DIVIDENDS

The federation is opposed to withholding of income tax on interest and dividends, as proposed in section 19 of the bill. It is felt that the use of taxpayer account numbers and automatic data processing (ADP) should prove to be adequate administrative tools to eliminate tax evasion and tax avoidance on payment of dividends and interest.

The proposed system of withholding is not necessary to prevent such evasion and avoidance. Its imposition will place added administrative burdens on payers of interest and dividends, and could prove to be a real hardship to the recipients of such payments, particularly those taxpayers whose tax liability will be substantially less than the amounts withheld.

REPEAL OF THE DIVIDEND EXCLUSION AND DIVIDEND CREDIT

Although the present bill does not include any provisions calling for the repeal of the dividend exclusion and dividend credit, there have been suggestions that such provisions should be added. As a matter of policy, the American Retail Federation strongly opposes the repeal of the dividend exclusion and dividend credit.

The dividend exclusion and dividend credit represent a token acknowledgment, by the Congress, that the double taxation of corporate income is unsound. Until such time as the whole corporate tax structure can be revised, and an equitable method devised to eliminate double taxation of corporate income, the exclusion and credit should remain in the tax law, if only as a reminder that an inequity exists in the tax structure.

RETAIL EXCISE TAXES

This is another subject not now dealt with in this bill, but because it is one of real concern to the retail segment of the economy, the federation wishes to state its position as to Federal retail excise taxes on jewelry, furs, toilet preparations, and luggage.

The retail industry is strongly opposed to these excise taxes and earnestly seeks their repeal at the first possible opportunity. These discriminatory selective taxes were imposed as wartime measures 20 years ago. The amount of revenue they raise is not important. However, they do serve to impede the sale of goods at retail, and at a time when the economy should be encouraged to expand in every possible way.

Mr. LUCHT. The American Retail Federation agrees that changes should be made in the tax law to stimulate investment in capacity expansion and modernization. We agree that suitable tax law changes would contribute to the growth of our productivity and output. We believe that these worthy objectives can be better attained by changes in the tax law other than those proposed in H.R. 10650.

Investment credit provision of H.R. 10650: However, assuming the bill will include an investment credit provision, we should like to point out certain deficiencies in the proposed language implementing the investment credit. We request that the language be broadened so as to provide an environment for more thoroughly achieving our national goal of economic growth.

I refer specifically to section 48, "Definitions; Special Rules" (a) "Section 38 Property" which among other things defines the kind of property for which the proposed investment credit will be applicable.

There are two kinds of property which qualify for the investment credit, to wit:

(a) Tangible personal property, and
(b) Certain other tangible property.

We raise no issue concerning the inclusion of tangible personal property, for we strongly believe that all expenditures on this kind of property should qualify for the investment credit. It is to the definition of "other tangible property" that I should like to draw your attention this afternoon.

Definition of "other tangible property" should be broadened:

"Other tanglible property" is defined in H.R. 10650 as not including a building and its structural components. Furthermore, the benefit of the investment credit on new investments in this kind of property is restricted to certain industries. These industries consist mainly of manufacturing, extractions, production, transportation, and communications. As presently worded, therefore, the bill does not make the investment credit on "other tangible property" available to the distribution industry.

We are in complete agreement with the concept that, to achieve our national goal of increasing capacity and of improving the efficiency of existing capacity, it is highly desirable to stimulate investment in manufacturing, extraction, production, transportation, and communications, as well as in certain public utilities specified in the bill.

However, we feel that by omitting distribution, and specifically merchandising, the bill represents an incomplete proposal. We disagree strongly that it is possible to achieve our national goals of rising employment and rising standards of living without encouraging a balanced growth throughout our country's industries.

To enlarge capacity for making things without enlarging the capacity to distribute them can only lead to an unbalanced economy with a consequent decline in capacity, decline in employment, and decline in standards of living throughout the country.

It is difficult to comprehend on what basis it was concluded by the draftsmen of this bill that the distribution industries should not be mentioned specifically. Certainly we should encourage greater capacity, let us say, for the extraction of coal and iron from our mines, for the transportatiton of these materials to steel plants, for their conversion to steel, for their transportation to factories for the manufacture, of, let us say, refrigerators, and for their transportation to the point of sale to the consumer.

However, what good are all these preceding steps if we do not have a healthy and efficient distribution system employing the most up-to-date concepts of design, layout, and construction? All the extraction, transportation, and production facilities in the country are of limited use unless there is a matching distribution system which can take the output of our industrial plant to the consumer at the lowest possible cost.

Aside from the significance of distribution as one of the basic essentials of our overall economy, we should like to emphasize to you that on absolute basis distribution is a large and important industry. It should receive the same encouragement to enlarge its facilities as other industries.

It is difficult to give you a simple picture of the magnitude of retailing. There are so many individual proprietorships and partnerships—about 1.6 million—that precise statistics are not as complete as they might be. One way of indicating the size of the industry is to tell you or remind you that it employs over 8 million people, or 15 percent of the total number of individuals currently employed outside agriculture. Another measure is that 2 million or 43 percent of the 4.7 million business firms in the United States are engaged in retailing.

I am hopeful that these few figures are persuasive on the point that retailing is a big, important, and highly essential business activity, and one that should not be omitted in any overall program for enlarging capacity and improving existing capacity.

Specific language change in H.R. 10650 is proposed:

We respectfully suggest, therefore, that H.R. 10650 be amended to include retailing as one of the industries entitled to the investment credit related to "other tangible property" which benefit as the bill is now worded is restricted to:

manufacturing, production, or extraction or of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services.

We urge you to give the vitally important retail distribution industry the same status afforded these others.

This amendment could be effected simply by adding the word "retailing" to the proposed new section 48(a)(1)(B)(i) of the Internal Revenue Code of 1954.

Senator KERR. What do you contemplate as being the amount of investment involved by the industry you speak for?

Mr. LUCHT. Unfortunately, Senator Kerr, our industry is so broadly dispersed throughout the country and involves so many small units that good figures of the kind you seek are simply not available.

Senator KERR. Well, you say you are representing 800,000 retail establishments.

Mr. LUCHT. That is true.

Senator KERR. And they account for 70 percent of the retail sales; that they employ 15 percent of the total number of people employed outside of agriculture.

Mr. LUCHT. Those are the easy figures, Senator Kerr.

Senator KERR. 8 million people.

Mr. LUCHT. Those are the easy figures to get together. But the dollar figures are the difficult ones to assemble.

Senator KERR. To what do you figure it would apply, the retail store, the improvements in the supermarket; in the wholesale house. the transportation facility to deliver it to you, the gadgets that enable you to handle the bundles and get it to the point where employees open packages and put articles out on the shelf? What are you talking about apply this investment credit to?

Mr. LUCHT. Well, let me distinguish, first, that this is a technical point, and let me distinguish between the two kinds of property which the bill discusses.

As I read the bill at present, tangible personal property, as invested in by retailers, would qualify for the investment credit, and some of the things that you enumerated—for instance, let us say, a pushcart in a supermarket would qualify.

Senator KERR. That is what I thought.

Mr. LUCHT. Right. However, the next section of the bill——

Senator KERR. That is the reason why I am asking you to identify the things to which you would like to have it apply and which it will not apply in the present act.

Mr. LUCHT. Those things would be items which would come under the second section of the definition in the bill; "certain other tangible property" are the words used. It is an effort——

Senator KERR. Let us not take the time to do it now. You are going to submit an additional statement.

Mr. LUCHT. Yes, sir.

Senator KERR. Outline them.

Mr. LUCHT. Well, for example——

Senator KERR. Identify them.

Mr. LUCHT. For example, suppose we have a refrigerated case which is built into a store so that it constitutes real property as bolted to the concrete floor, and it is an integral part of the partitions, and so forth.

From a legal point of view and from any other points of view, it would be considered real property.

The way the bill is now drafted, certain industries are enumerated who could make investments in real property of this kind, they would get the credit, the investment credit, under that kind of investment.

However, retailing is not one of those, and we were simply requesting that retailing be mentioned as one of the specific list of industries eligible to receive that consideration.

If it is not done we fear that on administration this point may be overlooked, and we may have trouble with our tax returns.

Senator KERR. Fine. Thank you very much.

Mr. LUCHT. You are welcome.

Senator KERR. Mr. Norton, Associated Industries of Georgia. Go ahead, sir.

STATEMENT OF WILLIAM L. NORTON, JR., TAX COUNSEL, ASSOCIATED INDUSTRIES OF GEORGIA

Mr. NORTON. My name is William L. Norton, Jr. I am a tax attorney with offices in Gainesville and Atlanta, Ga. I come here today as tax counsel for the Associated Industries of Georgia which has represented the manufacturing interests of Georgia since 1915 and which has around 1,400 member firms having an average of around 50 employees per firm, although the largest member employer in our State employs some 14,000 people.

It is a real privalege to appear before this committee. I must say, though, that I don't envy you your jobs as Senators. In attempting to prepare myself for this appearance, I have endeavored to come to intellectual grips with H.R. 10650, and the report of the House Ways and Means Committee which explains it. I confess that I have not made much progress; I am a bit confused. I can't help but get the feeling that those who wrote this legislation and prepared the report also are perhaps confused. What possibly could be the overall purpose of this kind of discordant legislation?

The administration has, as one of its basic policies, a program to decrease employment by increasing the rate of industrial growth in this country. The Economic Report of the President, dated January 1962, states that—

> We have not, in recent years, maintained the 4- to 4½-percent growth rate which characterized the postwar period. We should not settle for less than the achievement of a long-term growth rate matching the early postwar record. Increasing our growth rate to 4½ percent a year lies with the range of our capabilities during the 1960's.

Obviously, the administration recognizes that it will require additional capital which can be utilized to build the new plants and enlarge or improve existing plants to produce this additional employment and additional productivity required to maintain a sustained and increased economic growth consistent with these goals of 4½ percent annual increase in gross national product.

The desire for a substantial percentage increase in gross national product coincides with the desires of the members of the Associated Industries of Georgia and the approximately 4 million citizens of our State. Due to mechanization of the farms and lack of job opportunities in the industrial areas of Georgia to other regions of the country several thousands of high school and college graduates migrate annually each year. Specifically, there are around 70,000 persons annually coming on the job market—that is, needing jobs—in Georgia (this includes approximately 28,000 high school graduates; 4,500 college and university graduates; 26,000 high school students that drop out each year after the 10th grade but prior to graduation; and about 15,000 displaced workers, such as farmers and other rural people moving to the cities), while the State's economic activity is only offering approximately 12,000 new jobs each year.

Consistent with these figures, one leading Atlanta banker recently reported in a speech that 65 percent of Georgia's high school graduates leave the State because of unfulfilled job opportunities within Georgia. It is a regrettable fact that Georgia Tech provides several hundred graduates each year trained in the technological sciences that must leave the State because of insufficient and inadequate job opportunities within Georgia.

This is a tremendous drain on the taxpayers of the State of Georgia who finance the educational system which furnishes the education and training of these valuable youths, the cream of the human resources produced each year in the State of Georgia.

Therefore, it is little wonder that a primary goal of the people of Georgia and, in particular, the Associated Industries of Georgia is to find a means whereby increased industrial activity can be generated in Georgia to furnish sufficient job opportunities for our own citizens and to serve the markets of the South.

It is obvious to us that if we are to have economic progress and increased industrial development we must have additional sources of equity investment to supply the capital needed for new industrial installations. We do not desire the relocation in Georgia of existing plants from other areas; we want and need newly established plants, new industrial firms utilizing new technological processes and developments which research has shown is possible and feasible in our area. To accomplish this we need capital, capital from within our own State, and capital attracted from other sources from other areas through investments. To obtain this needed capital, our citizens must be able to accumulate more savings; existing plants must be able to accumulate additional earnings for expansion.

Yet it is our conclusion that under existing tax laws, both corporate and individual tax rates siphon off earnings which otherwise would furnish the capital needed to provide the industrial and economic expansion required to satisfy the needs of our State and region.

Associated Industries of Georgia, therefore, agrees with the administration that an increase in the rate of growth of productive capacity and our gross national product is greatly needed, and we would endorse any long-range program of tax revision designed to fulfill these needs. However, we feel that H.R. 10650 falls short of fulfillment of these goals.

Personally speaking, as a practicing attorney, I naturally am sensitive to the nature and internal structure of existing tax law, and before H.R. 10650 came along, I did have some definite impressions as to some things I felt were wrong with the law.

In the first place, I felt that the law was too complicated and complex. Most taxpayers and tax practitioners agree. It is a historic fact that most changes in tax or any other law add to rather than subtract from the problem of interpretation, enforcement, and compliance. We know that there were many problems of interpretation hanging over from the 1939 code revision, when we entered into the 1954 revision. As a trial attorney and special assistant to the Attorney General in the Tax Division, Department of Justice, down the road apiece on Pennsylvania Avenue, during the years 1951–54, I witnessed and was intimate with some sections of the 1954 revision and felt then that we were perhaps moving too fast for perfection in such an historic task as total revision of the code. Now 8 years later, there inevitably are a host of unresolved problems from the 1954 code; Treasury Regulations are still being written.

Even without any more serious tinkering with the internal structure of the code, it would be years or even decades ahead before any tax attorney could say that the tax law, as revised and codified in 1954, is now plain to all practitioners as regards intent and interpretation.

Moreover, the seriousness of tinkering with our tax laws and periodic piecemeal changes is appreciated by those tax practioners who attempt to serve taxpayers within a State which likewise has a personal and corporate income tax law. By that I mean that taxpayers become concerned and openly hostile when the State law concerning deductions, credits, and depreciation, differ from the Federal law on the same transaction. Most States attempt to accommodate their own taxpayers by conforming in most respects with the Federal statutes. However, it takes time for the various legislatures to consider such changes and often time results in much confusion whether the conforming change is made or not. Therefore, this committee should be cognizant of the fact, as I am sure it is, that each substantive change of the Federal income tax law creates a chain reaction among the States due to its effect on State income tax statutes.

My second attitude in regard to the tax law, before H.R. 10650 came along, was that there probably were some rather flagrant loopholes lying around. But, on studying this bill, I do not get the feeling that most of the problems it deals with are in any sense "loopholes," but instead they are matters on which thinking might differ according to philosophy regarding the relative roles of government and free institutions. It is puzzling that where unquestionable "loopholes" exist, as regards taxation of competing businesses in which the only difference is form of organization, the bill stops far short of full solution.

My third belief in regard to the Federal tax law was that it was heavily biased against capital formation and economic growth, whether by design, or as a result of a sort of drift toward always levying the most tax against the numerically smallest segments of our population. Again, my study of H.R. 10650 does not give me any comfort as regards any significant relief of this situation.

I realize that others may see different problems in the tax structure, but it does seem to me that a legislative approach which is so misdirected or inadequate in regard to these three major problem areas should be subject to the greatest suspicion. If there were not other compelling reasons for enactment, then—in my opinion—it would be much better to abandon the whole project. My view in this respect is stronger because of statements by administration spokesmen to the effect that, when H.R. 10650 becomes law, they will then send up another legislative package of the same general nature. Hence we can expect more technical changes; resulting in more taxpayer confusion.

In regard to complicating an already too complex tax law, I imagine it would take a paper of many, many pages simply to list the new facets of law, and the points on which interpretation and regulation will be required, if H.R. 10650 is enacted. Of course, only time will tell as to the number of these areas which will result in controversy between the tax administrators and the taxpayers, but it could well be that the list in this area also would run to many pages. As a practicing attorney, perhaps I should welcome the prospects in this respect; certainly, the more legislation of this kind that is enacted, the more business there will be for the members of my profession. But this hardly seems a legitimate objective of public policy.

I am here to testify especially in regard to the proposed tax credit on investment, but it would seem useless for me to dwell too long on this point. The credit by its nature reflects the objective of arbitrary use of the tax law, making some effective rate reduction available to many business operations in varying relation to their tax liability, but none at all to others. I suppose that even the proponents of the credit must admit that it is discriminatory in nature, that it is complicated, and that it will require a maze of involved administrative interpretation and regulation. Aside from its discriminatory allocation of tax relief, the credit after all is just as much tax reduction for businesses which do what the Government decides is good for the economy at a particular time. An equivalent amount of relief through rate reduction also would be good for the economy, in our opinion just as good as an investment tax credit, and of course rate reduction would involve no further complication of the code. The rate reduction would not be discriminatory or complex—but would tend to increase the accumulation of capital generally and thereby stimulate the economy which, as stated, is so important to our goals in the South.

The provisions in regard to entertainment and business expense accounts equally will add complexity to the tax law, opening up various new lines of departure as regards what is deductible in this area. This complexity will not be a burden just to those who seek to evade taxes by passing off personal expenses as business tax deductions, but to the great host of businesses and businessmen who would not deem to run their businesses or attempt to take advantage of the tax law in this manner. When you throw out of the window an anchor post of policy for coordinating law and business practice, such as the "ordinary and necessary" concept as regards business expenses, there really is no way to forecast in advance the potential of ramifications which may result.

Even the most avid proponents of withholding on dividend and interest income would not, I am sure, contend that the process would be a simple and uncomplicated one. It would be my guess that the book could never be closed upon a legislative venture in this area; that year after year the tax administrators would be coming back to you requesting this or that change in a fruitless effort to fit a square peg into a round hole.

I am not an authority on the taxation of business income earned abroad, but as a lawyer and in reading the House report, I sense that there are many already troublesome areas which will be compounded if H.R. 10650 is enacted.

In regard to my second broad frame of reference, the assumptions that a program of this kind would be confined to real loopholes in the tax law, I seem to have also been off track. I don't know whether it would be a loophole, but certainly the investment tax credit is a device to give tax reduction not in relation to present liability, but in relation to a sliding scale yardstick involving variance both in regard to coverage and as to rates. It would hardly be even-handed tax treatment.

In regard to entertainment and business expense accounts, there certainly is no loophole in the tax law, unless it is maintained that a business should not be allowed to deduct those expenses which are "ordinary and necessary" to its operation. The problem in this area (which I believe has been overstated and overpropagandized) is one of compliance and enforcement. It can be solved with tax administration; the dishonest can be caught; so why enact new and ingenious methods for tormenting the honest businessman in his desire to spend some time in running his business instead of being run by government.

Again, the fact that some do not report and pay taxes on interest and dividend income does not make a loophole. The problem here too is that of tax enforcement and compliance. Having a law office in Atlanta, I am perhaps more aware than others that we are the seat of one of the initial installations of the automatic data processing system. After a great deal of promotion in regard to the potential of this system, I understand that more recently Government spokesmen are claiming it is not an efficient means for catching the small evaders of tax on interest and dividend income. Why not? This system will automatically match up information and tax returns, and in fact can be used to ferret out citizens who have an obligation to file returns but do not. Then, the machines can automatically produce letters addressed to the offenders. It seems to me that the notion that any great number of offenders would ignore the omniscience of this mechanical Hawkshaw lacks plausibility. It is one thing to evade taxes when the Government has no means of tagging you. It is quite another thing to believe that many people would thumb their noses at the cold print of a letter stating the precise amount of unpaid tax and listing the penalities for failure of remittance. If we could get by from 1913 until 1963 without withholding on interest and dividends, then I should think we could be patient just a little longer until 1966 when ADP will be fully in operation. In the meantime, if the picture is not confused by withholding on interest and dividends, it would be my guess that a great number of taxpayers would have decided that they would be better off by voluntarily reporting their delinquencies than by waiting for the machines to catch them.

Again, in the foreign tax area, I do not get a feeling of loopholes so much as one of change in judgment as to when the tax extractions on foreign business earnings should take place and what they should be in amount.

I believe that similar comments would be in order in regard to various other sections of the bill.

But when I come to the taxation of cooperatives, I find a quite different situation. In this area, there can be no question of the existence of a loophole, in the sense that public policy to the present has been to provide relief from payment of tax when a business is organized on what might be called a nonprofit association basis. Such cooperatives in my area have registered phenomenal growth and are absorbing and inundating many competent private enterprise firms. With the Government so dependent upon business earnings for its revenue, this to me does seem a strange paradox. But, at any event, it is equally clear that the bill does not even pretend to place cooperatives on an equal tax basis with their competitors organized in regular corporate form. It seems to me that when a cooperative operates like a regular corporation, it should be taxed as such. In other words, when cash earnings (regardless of fictional paper-passing ownership) are actually retained in a cooperative, such earnings should be taxed at full corporate rates; and there should be no deductions in regard to earnings which are paid out to stockholders on the basis of relative ownership interest. I would be much less concerned about the liability for tax on actual cash remitted to patron-members on the basis of their use of a cooperative's facilities, but even in this area, the distinction between a cooperative and a regular corporation seems more fictional than real.

As the situation is at present, a patron-member of a cooperative can reap the ownership benefit of reinvested earnings in a co-op, while paying no tax on the scrip which is passed out to him each year. The important thing to me is that the cash, the growth capital, that stays in a co-op, or which underlies equity ownership in a co-op, should be taxed the same as the income of the co-ops' competitors. Measured by these yardsticks, H.R. 10650 would, as I understand it, at the best, through withholding, impose a top tax of 20 percent on cash earnings retained for growth. To me this is a totally inadequate resolution of this problem. It appears to me that Government spokesmen, while claiming diverse and numerous loopholes in the tax law, have nevertheless moved only half-heartedly toward closing the most glaring and unjustified loophole of all.

When it comes to the relation between tax policy, capital formation, and economic progress, my third concern in regard to tax law, it seems to me that H.R. 10650, or any legislation conceived on the same basis, is or would be a total bust. It appears that the very purpose of this kind of legislation is to increase taxes in one area in order to reduce them in others. I don't believe that anyone could seriously claim that any exercise of this character could ever make a material contribution to the capital available for starting and expanding businesses, and for increasing the number of jobs. I should make it clear that any substitution for the investment tax credit, no matter how desirable the form of tax relief provided, would not materially change the legislation in this respect.

The tax credit idea doesn't, we feel, create capital growth, certainly not along the lines we feel needed. It is merely the process of shifting tax dollars from one cash register to another that seems to me to be completely futile in terms of improving the prospects for the strong growth of our economy.

Now rather than appear completely negative—though to this H.R. 10650 we must be—may I give a brief word on what kind of new tax policy would appear to us to best serve the human and economic needs of our country. I am sure I do not need to tell you that it would be a policy which afforded substantial and repetitive tax reduction until a reasonable and moderate system of tax rates was achieved. In this connection, it seems to me that there are two aspects of the relation of tax policy and human well-being which are generally misunderstood.

The first is that tax policy adversely affects human well-being as it adversely effects what might be called "investing power." By investing power, I mean the power to save, retain, and multiply the capital which underlies all human progress. By use of these words, I intend them as a contrast against the notion that "consuming power" is the lead factor in human progress. As a practical matter, consuming power which does not come from the fact of investment can be no more than a temporary mirage. Whenever the Government attempts by arbitrary means to increase consuming power, or when other factors combine to push money incomes faster than the flow of production measured in constant dollars, the result is inflation—not increase in human well-being. Comparing the history of our Nation with the history of the world, our greater progress of the past was accomplished because more of our people and more of our businesses saved and invested a greater proportion of current income in facilities for increasing production than in any other country.

More recently, other economies have surged ahead of us in this respect, and their economic growth rates are in excess of ours. This obviously has happened because of a national preoccupation for many years with the concept of consuming power, instead of recognition in national policy that real and sustained increases in consumption can only come from real and sustained increases in investment. When the existing tax law is viewed in these lights, it is shown to be a most effective instrument for thwarting and restraining the economic advance and strength of our Nation in this critical area. Our tax laws, we feel, should not have such a deterrent effect on our economic growth.

The second area of misunderstanding has peculiar relation to the Southland, including my State of Georgia. It seems to have been generally believed that because most Southern States get back in Federal funds more than their citizens and businesses pay in Federal taxes, that it is a net gain to them in consuming power. In a sense, this belief is on a par with the belief that shifting of tax dollars between cash registers will mean more dollars for economic progress. The same tax laws which may be said to have been used to transfer income from other sections of the country to the South have also been used to dry up the wellsprings of capital formation. And, yet, it is the South which is most in need of new capital if the average income and well-being of its people is to move up to a level of that in other sections.

It is true, of course, that these present tax laws convert capital into Government spending which otherwise might be used in other sections of the country, but it also drains away capital which would have been accumulated elsewhere and which might be invested in the Southland as well as capital which our businesses and citizens in the South could otherwise have retained and used in a home-based building of our economy. To summarize on this point, it is the weaker sectors of the economy—the people who most need new and better jobs, the businesses which don't get started or can't grow because of lack of adequate capital, the sections of the country where incomes and standards of living are relatively lower, the States which cannot offer sufficient and satisfactory employment for their high school and college trained young men and women—that are most adversely affected by our present tax laws.

It is the growing realization of these facts that has induced such widespread interest in Georgia and other Southern States in the legislation for reform of tax rates and methods initially sponsored by

Representatives Herlong and Baker, members of the House Ways and Means Committee. It was a great disappointment to those of us who have followed this legislation when that committee, on February 19, adopted a motion to table the Herlong-Baker bill, by a vote of 14 to 11. It seems to me, however, that there is sound reason why this committee might seriously consider the substitution of the Herlong-Baker bill for the body of H.R. 10650.

I understand that Senator Carlson has, for the purposes of discussion, introduced the legislation into the record of these proceedings. While the substance of the Herlong-Baker legislation is quite different from that of H.R. 10650, the latter has been promoted as serving the purposes of economic growth, but in our judgment only a program such as the Herlong-Baker bill would serve such an objective. If the Herlong-Baker program were enacted, it would mean a limitation on the growing amount of money which would come back into Georgia and to the Southern States through Federal spending programs. In my opinion, however, we would get our full share of new capital as a trade; first, because of the attractions which our section of the country offers to outside investors, second, because our own citizens would receive the benefit of the same tax reductions and reforms, and third, would, by stimulating our economy on a permanent basis, provide the additional revenues needed by our State and local governments.

I can assure this committee that the organization which I represent would do everything in its power to inform the citizens of Georgia on the benefits to them of such a course of action, if you, this committee, will lead the way.

Thank you for permitting us to come before you and outline our views on this legislation.

Senator KERR. Thank you, Mr. Norton, very much.

Mr. NORTON. Thank you, sir.

Senator KERR. Mr. James P. Wesberry, Jr., Georgia Junior Chamber of Commerce.

All right, Mr. Wesberry.

STATEMENT OF JAMES P. WESBERRY, JR., GEORGIA JUNIOR CHAMBER OF COMMERCE

Mr. WESBERRY. It is a genuine pleasure to be able to appear before this distinguished and key committee of the Senate; my name is James Pickett Wesberry, Jr., and I appear as spokesman for approximately 7,000 Jaycees in the State of Georgia. It is appropriate to add that this is the first time that any State Jaycee organization has ever presented its views before a congressional committee.

I do not think I need to point out to you, Senator Kerr, any facts about the junior chamber of commerce, since you come from the home State of our national Jaycee organization.

Senator KERR. Yes, sir. We are very proud of that great organization in Oklahoma.

Mr. WESBERRY. I should point out that the junior chamber of commerce differs radically from practically all the organizations which have and will present their views to you during these hearings. It is composed of young men between the ages of 21 and 36 and is the only such organization in the world. You are no doubt familiar with the charitable, civic, and educational activities of Jaycees throughout the country. Most organizations presenting testimony to you do not engage primarily in this combination of activities.

In addition to my work with the Georgia Jaycees, I serve as national governmental affairs chairman of the U.S. Jaycees. I make my livelihood as a practicing certified public accountant and partner in the accounting firm of Waite & Wesberry.

On May 3, 1961, the Ways and Means Committee received a detailed explanation of the tax program outlined by the President in his tax message. However, it was not until March 12, 1962, with the introduction of H.R. 10650, that this program was in legislative form. The Ways and Means Committee report was available 1 week later. The House passed the bill on March 29. Because of this timing and the lack of opportunity for further hearings in the House, the role of this committee in fully reviewing and deliberating at length on this tax package is of critical importance.

The Georgia Jaycees have authorized me to present testimony on the investment tax credit portion of the bill, since it has been labeled as the "central element" of the bill. Nevertheless, we are against the entire set of tax proposals before this committee, for the very fundamental reason that the use of governmental revenues to support any proposal which further increases the power of Government to manipulate and control the private economy is bad in principle and even most injurious in practice.

The junior chamber of commerce is a "peculiar type of selfish-interest group." They represent but one interest—an interest in America and its future—its prosperity and its continued growth—its strength and its world leadership and most of all its freedom—the freedom to work, to live, to speak, to write, to exercise individual rights.

But the freedom we are concerned with here, is the freedom of citizens to manage their own affairs—to make their own decisions—to expand their businesses or not to expand them—to modernize them, or not to modernize them. These freedoms are inherent to our way of life.

But it is such a small freedom—that freedom to decide whether or not to invest more capital—certainly everyone wants to expand his business. It is such a small freedom to lose—no one will really miss it—after all, it is in the interest of the national economy and what is a small freedom compared to the national economy? Yet, the small freedoms are the foundation stones for the great freedoms and their destruction, one by one, can and will undermine our great heritage, destroy our country and leave us nothing but the vast mindless machinery of the welfare state—where individual freedoms do not exist—where individuals do not exist.

It is our opinion that the investment credit is one of the most far-reaching proposals, in its implications, ever to be considered by Congress. Nearly 4 years ago, Gen. Douglas MacArthur said:

> * * * when taxation is used as a social regulator, it becomes a menace to freedom * * *.

The proposed investment tax credit extends taxation even beyond social regulation—to business regulation—to dictation by the Federal Government that it is in the best interest of our economy for business to make certain decisions. Such decisions are relatively small, dealing only with whether to purchase new equipment or modernize, but what other decisions might the Federal Government find in the interest of the economy and act to influence in the future based upon this precedent.

I beg your indulgence while I make some observations which you may think are peculiar: According to the administration's thinking and emphasis on purchasing power economics, it would assist the national economy if every citizen were to buy a new car. Will we have a new car investment credit? A new home investment credit? A new clothing investment credit?

We would certainly solve many of our farm problems if people would eat twice as much—shall we consider a food consumption investment credit? Georgia poultry farmers would appreciate a chicken-eating tax credit, and it would be helpful economically. Yes, we could have innumerable tax credits—and all of them for good purposes and with good intentions—and it would help the national economy—particularly the economy of we CPA's, who undoubtedly would become rich from preparing such complicated tax returns. Certainly, I am in favor of increasing my own personal income, but not if I would be forced to reinvest my material gains in new adding machines, new typewriters, and all sorts of other equipment against my wishes.

I can foresee in our CPA offices of the future, two adding machines to each accountant, three typewriters to each typist, and all because it is good tax planning. Please pardon my speculations into the ridiculous. They are intended only to point out the direction this legislation takes, and I believe it would be a revolutionary direction.

It has been stated that the investment tax credit represents a bold new innovation designed to spur the economy onto a higher level of economic growth through an incentive device. In our opinion this tax mechanism should better be labeled as a disincentive tax credit. Such criticism is not intended to be facetious but to correctly identify the error or the approach being advocated.

The handicap on business and the American public in recent years has not been the lack of tax incentives to encourage modernization in industry, but the basic inability to overcome the disincentives in our existing tax structure.

The proposal before you recognizes the debilitating effect of current tax policies on investment capital, but can only offer tax manipulation as a cure. This is like force feeding an ineffective medicine to a patient on the presumption that if a small amount doesn't work, increased doses will. Unrelenting efforts in such a direction certainly constitute malpractice.

The disincentive aspects of the credit are further demonstrated by its justification on the basis of European experience with this concept. If our competitors have been successful with such a device then it must logically follow that we will be successful with it. Not only is this fallacious reasoning, but it disregards the difference between the conditions abroad with those found in the United States.

Through continual diversification of the economy, rapid development of new products and entry into new markets, we are in a vastly superior position to that of our foreign competitors. It is this condition which requires capital, not only for modernization, but for new risk enterprises and a wide range of other capital needs. Thus, the disincentive of the credit stems from a lack of free movement of capital as well as from the fact that it provides no net addition to total capital supply. Why should we hamper American ingenuity and progress by channeling capital into only one area of capital need? What is really needed is the ability to make large, continuing additions to capital in order that it will be available to any and all sectors of the economy.

It seems that the existing tax policy has already limited our ability and desire to compete. If we wish to compete, it should not be done by following the lead of others, but rather by achieving an approach which our competitors cannot match. The investment credit in no way recognizes this basic fact of how to secure a competitive advantage. This country has always been a leader, not a follower, and it hurts us throughout the world when efforts are made to change this longstanding and most envied reputation.

In addition to the broad considerations which I have stated, there are several other aspects of this provision which only further serve to substantiate that this approach is neither correct nor proper.

The investment credit proposal is objectionable to us because—

1. It involves governmental intervention into private business decisionmaking.
2. It is applicable only to specific businesses, and certain specific types of investments.
3. It does nothing for the individual taxpayer.
4. It has no precedent in accepted principles of accounting or taxation (being vastly different from the types of credits now available under the 1954 code).
5. It will require of small businesses the maintenance of even more detailed records and even more expense for professional tax advice.
6. It will not even apply to a vast number of small businesses.
7. Specific businesses to which it would apply do not need it and many of them have testified that the do not want it.

It is inconceivable to us that legislation of this type and with such far-reaching implications should be submitted to the Congress of the United States along with the statement by the Secretary of the Treasury that revised depreciation guidelines will be announced in the spring of this year. What are these guidelines? How will they, combined with the provisions of H.R. 10650, affect Federal revenues?

We believe that this committee and the full Congress should be fully advised of all planned administrative revisions before enacting tax legislation.

In addition the President has upon several occasions spoken of a broad proposal for tax reform which he intends to submit to Congress. What will this proposal embody? How would it affect your decisions upon the aspects of H.R. 10650 if you knew what it would include in its provisions?

Will it include additional incentive tax credits? Will it conflict with portions of this bill? Are you as a member of the Senate Finance Committee prepared to assume the responsibility for acting upon this piece of legislation without full knowledge of further intended legislation?

We raise these questions because we believe them to be particularly vital to the measure under consideration. We do not believe this bill, or any other of similar intent, is so important that it should be pushed through Congress with such great haste, without consideration of overall tax reform. It seems to us that this proposal is intentionally being taken out of context as a trial balloon.

We would therefore urge that action on any and all tax measures be taken at one time collectively, so that the full impact on our economy and on our revenue can be made known. This is why we particularly speak in opposition to this bill.

The most alarming and disconcerting point in this matter was brought out very well by Secretary Dillon when he stated:

> There is often a very thin line between a "yes" and a "no" decision in the investment area. With the credit, we will have affirmative actions where there would otherwise be none.

We would ask the Secretary what right the Federal Government has to attempt to influence that thin line of decision? What precedent has been set in the entire history of the United States which would allow Federal intervention by taxation or otherwise into the business decisions of individual citizens? In this proposal for an incentive tax credit could lie the ultimate destruction of privately managed business, for this could be the first step toward further incentive credits to influence that "thin line" of decision, heretofore solely the property of management.

I am sure you gentlemen are asking why we as Jaycees from Georgia express such strong sentiments against the credit. The young leadership which is present in our organization is well aware that it is the decisions of today which we will have to live with in the years ahead, perhaps sitting where you now sit and wondering how to best undo that which never should have been done in the first place. As a CPA with a future working career of 40 or more years, I do not relish having to deal with the complexities of this or any other such proposal. We certainly hope that your action will lift our burden rather than add to it.

As young men we are finding that opportunities to move ahead in the future are becoming more and more elusive and that those which do exist are becoming increasingly more conditional upon a concept of partnership between the individual and the Government rather than just upon individual initiative. We find it is more difficult to acquire capital out of current earnings for additional business investment or to acquire capital to place with others who can expand or create new businesses, new job opportunities, new products, and new services in the cities and towns of our State.

We agree with the President and the Secretary of the Treasury that efforts must be made to increase the growth of the American economy. The table submitted by Secretary Dillon showing comparative average annual increase in gross national product (exhibit 1–B, table 2) is indeed alarming. It indicates that our country's rate of economic growth is far below its historic average. We believe it is significant to note that the decline in our country's rate of economic growth has varied inversely with the emphasis during this century upon a higher and higher progressive rate of income taxation.

It is our opinion that the same objectives sought by the President and the Secretary can be attained by comprehensive reform of tax rates and methods.

These are the principles which have been endorsed by the Georgia Junior Chamber of Commerce, and the Jaycee organization in each of

Georgia's 10 congressional districts. We particularly oppose the specific methods proposed by the President because they conflict with our view that overall tax rate revision is essential to overall economic growth. This approach is embodied in the Herlong-Baker bills which I understand Senator Carlson has filed for the record of this committee for purposes of discussion. It is an approach which has so much to commend it that we are at a loss to understand why the Congress has failed to enact this measure.

This legislation establishes no prejudices against those who do what the Government wants and those who don't as in the case of the investment tax credit. It would reject a shift in tax burdens from one segment of the economy to another by providing tax reduction and reform of tax methods to all segments of the economy from the smallest income tax payer to the biggest. By the release of capital over a 5-year period through scheduled rate reductions, the private economy would be endowed with the increments from greater economic growth presently preempted by the Government.

As Jaycees, most of us are not confronted with the near confiscatory rates which presently restrict the capital accumulation and usage faced by upper bracket taxpayers, yet we fully recognize that it is the capital which is presently taxed away from these people which has such a direct impact on the jobs we presently hold and the better jobs we aspire to in the future. It seems to us that the current tax philosophy which is based on the idea of taxing those in the middle and upper tax brackets at an unduly heavy rate has placed a severe penalty upon those at the lower income levels by reducing the opportunity for new and better jobs which would result if additional capital were available for expansion of existing businesses and the creation of new enterprises. We can and must do better if we are to maintain our leadership role domestically and internationally.

It is only natural that we should attempt to document the effect of this comprehensive tax rate reform legislation in relation to the total economy and to individual well-being. Representative Herlong in a statement on February 6 of this year, which I would like to submit for the record, indicated that if this legislation were enacted in 1962 and the results projected through 1970 the following would occur: Gross national product would increase from $570 to $851 billion, personal income would jump from $448 to $669 billion, per capita income would be up from $2,402 to $3,163 (accounting for increased population) and the individual income tax base would grow from $211 to $382 billion.

On the basis of this projected growth, I was requested to prepare an analysis of these figures for the Jaycees. In evaluating these figures, it seemed appropriate to determine what the results of this legislation, using the same economic assumptions as Representative Herlong, would have been if enacted in 1956, since Mr. Stanley Surrey of the Treasury had already indicated publicly that if the Herlong-Baker legislation had been enacted, 5 years ago, we would now be running a deficit of $27 billion. It is my estimates of the impact of this legislation from 1956 to 1962 which I would like to call to the attention of this committee. The estimates of economic activity are based on calendar year 1955, with increases in annual growth calculated at 4 percent in 1956, 4.5 percent in 1957, 5 percent in 1958, and 5.5 percent in 1959 and thereafter—or the same sequence of increase in rate of growth projected by Mr. Herlong from 1963 on.

Based on constant 1961 prices, GNP would have grown from $473 billion in 1956 to $643 billion in 1962, or $83 billion more than the $560 billion now being pessimistically forecast. The individual income tax base over the same period would have increased from $157 to $248 billion, or $41 billion above current estimates. However, the most revealing data is contained in the revenue estimates.

With enactment in 1956, the Herlong-Baker legislation would have yielded accumulative additional revenues by 1962 of $6.5 billion beyond that which has been available under our existing system of taxation. A complete analysis is attached for the record.

The idea that this legislation would be detrimental to our Federal budget situation, as claimed by the Treasury, is misdirected. Indeed, the detriment to fiscal balance and integrity stems from too much spending and too little revenue which in turn has resulted from too little growth. For example, actual budget receipts (in constant prices) from 1956 to 1962 increased only $6.6 billion. Had the opportunity been available through the enactment of Herlong-Baker to build the private economy at the expense of the Government sector rather than the reverse, we would not be far ahead in terms of individual, national, and international well-being.

Gentlemen, the decision as to which way we will go can only be made by the Congress and more specifically by the members of this committee. Through this vital legislation, which provides for the release of the impediments to capital through comprehensive reform of tax rates and methods, there is no longer a need to be pessimistic about placing Government spending in proper relationship to national growth and individual betterment. By giving the private economy a chance to demonstrate its potential, there is assurance that we can meet our governmental obligations while bestowing the blessings of economic progress and prosperity on all our citizens.

We believe that American industry is able to modernize without special incentives.

We believe that the American economy will progress without specialized subsidies to industry or to anyone else.

We believe it is unnecessary to induce American business to do something they have the ability to do anyway.

We believe the competitive free enterprise system of the United States of America is the most progressive economic system anywhere in the world—and that it need not stoop to imitate anyone anywhere.

We have faith that there is but one "incentive" needed to improve the economy—the same incentive both for business and for individual citizens—that is the incentive of reduced tax rates—the incentive of abandonment of a system which penalizes success—the incentive of a tax structure which fails to discourage individual initiative and utilization of individual abilities.

Mr. Chairman, the young men of 1962 ask but one incentive—the incentive to freely conduct our own businesses—the incentive to make a dollar—or to make a million (and to be able to keep half of it)—the incentive to maintain the status quo—or to rise to the utmost heights of success. The incentive we ask is the same incentive you had when you stood in our shoes only a few years ago. Give us that incentive and our generation will give our country its most dynamic, energetic economy—as yours has done before us.

(The attachments to Mr. Wesberry's statement follow:)

Estimates, H.R. 2030 versus present taxes, 1956–70, constant 1961 prices

GROSS NATIONAL PRODUCT (CALENDAR YEARS)

[Billions of dollars]

	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
If H.R. 2030	455	473	495	519	548	578	610	643	679	716	755	797	841	887	936	987
Present taxes	455	465	474	466	497	511	521	560	[1] 574	588	603	618	633	649	665	682
Additional	0	8	21	53	51	67	89	83	105	128	152	179	208	238	271	305
Cumulative additional	0	8	29	82	133	200	289	372	477	605	757	936	1,144	1,382	1,653	1,958

INDIVIDUAL INCOME TAX BASE (CALENDAR YEARS)

	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970
If H.R. 2030	148	157	168	181	196	212	229	248	268	290	314	340	368	398	431	467
Present taxes	148	158	161	158	173	183	192	207	215	223	231	240	249	258	268	278
Additional	0	−1	7	23	23	29	37	41	53	67	83	100	119	140	163	189
Cumulative additional	0	−1	6	29	52	81	118	159	212	279	362	462	581	721	884	1,073

BUDGET RECEIPTS (FISCAL YEARS)

	1957	1958	1959	1960	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970	1971
If H.R. 2030	73.6	74.1	75.3	77.2	78.6	83.6	89.1	94.9	101.2	108.3	115.7	123.5	132.0	141.0	150.8
Present taxes	75.5	71.9	69.9	78.8	77.7	82.1	92.3	95.1	98.3	101.5	104.7	108.1	111.5	115.1	118.8
Additional	−1.9	2.2	5.4	−1.6	.9	1.5	−3.2	−.2	2.9	6.8	11.0	15.4	20.5	25.9	32.0
Cumulative additional	−1.9	.3	5.7	4.1	5.0	6.5	3.3	3.1	6.0	12.8	23.8	39.2	59.7	85.6	117.6

[1] 2½ percent growth starting with 1963.

Countdown on Economic Progress

Remarks by Representative A. S. Herlong, Jr., Democrat, of Florida, in the House of Representatives, February 6, 1962

Mr. Herlong. Mr. Speaker, it is time for some blunt talk. In the cold light of history, men and governments must be judged by the consequences of their acts, not on their good intentions. It is the economic consequences of the collective acts of the Federal Government which too often are lost sight of in the planning rooms of the executive branch and in the legislative chambers of the Congress.

I do not question the patriotism or motivation of any man or woman in any branch of Government when I state that, in the total of its spending and taxing policies, the Federal Government is shortchanging the American people. This is simply to state the economic consequences of what we have wrought. What harms our Nation economically is not just a matter of lost jobs, of lower living standards, and of less human well-being. It is a matter of less national strength, of lowered military security, and of diminished prestige and capacity for leadership in the world. What harms us economically aids our enemies.

For a number of years, many Members of both branches of the Congress, and of our two major political parties, have been warning of the pitfalls of too much spending. I believe it is accurate to say that a great majority of the Members of both branches are deeply concerned about this trend. I further believe that the time is here when the Congress as a whole is willing and ready to take a new look, to face squarely the issue of which legislation will best serve the public welfare and national interest.

One thing which is certain is that concern about inflation does not stop the spending. I suppose the reason is that any group favoring a particular spending program is willing to take the chance of inflation, leaving it up to other groups to control their appetites for public money. I doubt if we can expect the separate groups interested in spending on particular programs to act much differently, except by a stronger demonstration of their combined interest than is provided by the inflationary threat.

Regardless of separate group interests in spending, all Americans do have the same interest in our national strength and prestige and, hence, in the rate of economic growth. Even as members of separate groups, they know that high-rate economic growth is the key to the improvement of their individual positions; that a buoyant, dynamic, fast-moving economy not only would insure the best progress to them individually, but will in fact eliminate or moderate conditions on which so much of the spending is based.

Thus, every citizen of whatever group must be concerned with the fact that growth in the total of Federal spending is at the expense of growth in the private economy.

For several years, my colleague on the Ways and Means Committee, Representative Howard H. Baker, of Tennessee, and I have been pointing out that continuation of the spending trend prevents the reform of tax rates and methods which impede capital formation and hence limit economic growth. Our bills, H.R. 2030 and H.R. 2031, with which I am sure every Member of this body is familiar, are designed to reflect the general public interest in permitting greater growth in the private economy as against more growth in Federal spending.

We have not proposed a rollback in the total of Federal spending. Instead, our bills would preempt the revenue gain from economic growth to remove the tax brakes on greater growth. After the necessary tax reductions were effected, and the economy had responded in a continuing trend of greater growth, Federal revenues would soon move ahead of those which can be expected under the present tax structure. The price of achieving these ends, so necessary to the public welfare at home and our national strength and prestige looking abroad, is a moratorium on further spending increases.

Only by controlling its spending can the Government achieve the results which so often, but inaccurately, are said to come from increased spending. The greatest hoax of our time is the notion that greater spending in the so-called public sector is a means for increasing economic growth. The Government lives off of the private economy, and not vice versa.

In statements in support of our legislation, we have noted that while our recent growth rate has been only about 2 to 3 percent annually, the economies of other nations have been bounding ahead. In Western Europe, the rates of growth have been double to triple our rate, and Japan has been doing even better. According to CIA estimates, the Soviet economy achieved an average growth rate of 7 percent in the 1950's.

Growth comes from capital formation. The greater the capital supply, the greater will be the growth of any economy. In the less advanced economies, most new capital will go into the creation of entirely new productive capacity, thus resulting in net increase in economic output. In an economy like ours, a great deal of capital formation only replaces wornout or obsolete productive facilities. Keeping these facts in mind, it is evident that a rate of new capital formation in our country will not produce as rapid a climb in total production as will comparable rates in other countries. Nevertheless, we have one of the lowest rates of gross capital formation in the world today, or approximately 15 percent of gross national product. In Western Europe, comparable rates in 1959 were: Belgium, 17 percent; France, 18 percent; Italy, 21 percent; Austria, 23 percent; and Germany, 23 percent. According to the CIA, 30 percent of Russia's gross national product goes into capital formation.

Whatever excuses there may have been for our not heeding these facts before now, we can have none hereafter. A new and authoritative study is now available which documents in quantitative data the fact that Government, in the total of its spending and taxing policies, is the culprit insofar as our inadequate capital formation and economic growth is concerned. Dr. Simon Kuznets, of the National Bureau of Economic Research, is the author of this study.

The data provided by Dr. Kuznets show that, over the past century, the total of capital formation in this country has been relatively stable though tending slightly downward as a percentage of gross national product. However, the part of this capital formation required for replacement has been rising so steeply that net capital formation has been a consistently declining percentage of gross national product. From the period 1869–88, to the period 1946–55, the decline was from 14.6 to 7 percent of gross national product, measured in constant prices. Since economic growth was on a generally adequate level between 1946 and 1955, before the poor record of recent years, we may take for granted that the percentage of net growth capital is even smaller today.

Dr. Kuznets' study leaves no room for mistake about the source of our problem. It is clear from his analysis that the principal cause of too little capital formation is the combine of public spending and tax policies which takes so much capital away from the private economy.

There obviously is no escaping the conclusion that the Federal Government, in its capital destroying tax policies, is responsible for the inadequate rate of economic growth; that the failure to control spending so as to admit of fundamental reform of the tax structure is at the expense of our domestic well-being and national security; and that contemporary spending proposals designed to relieve problems caused by inadequate growth simply compound the total of such problems.

Herein is the truth of my statement that the Federal Government is shortchanging the American people out of the natural bounty and security of their free economic system.

If the Congress should this year, now, enact the legislation which Representative Baker and I have sponsored, what would this mean in terms of increasing well-being for the American people, and our position of economic leadership in the world?

In answering such a question, we have to decide on a timespan first, and make certain assumptions.

Because of the great emphasis on the critical decade of the 1960's, the timespan which we have used would carry us through the year 1970.

The assumptions which we have made are as follows:

First, that unions and management will have the wisdom and courage to confine wage decisions to overall productivity, so that all citizens may enjoy the maximum fruits of progress without further creeping inflation.

Second, that upon enactment of this legislation, at this time:

(a) The current recovery will not be quickly dissipated in a new recession, as has happened on four occasions in the past dozen years, but will be transformed into the beginning of a new era of high-rate, long-term growth.

(b) The economy will achieve a growth rate of 4 percent in 1963, 4½ percent in 1964, 5 percent in 1965, and 5½ percent annually thereafter.

Third, that, however, without enactment of this legislation at this time, the economy will achieve a gross national product of no more than $560 billion in 1962, as compared with the $570 billion projected by the administration's budget message and Economic Report.

From these assumptions, we find that from 1962 to 1970, gross national product will grow from $570 to $851 billion; that personal income will grow from $448 to $669 billion; that income per capita, taking account of increasing population, will grow from $2,402 to $3,163; and that the base for the individual income tax will grow from $211 to $382 billion.

By contrast, if through these years the economy should grow at only a 2½-percent rate annually, starting from the base of $560 billion in 1962, gross national product would grow only from $560 to $682 billion; personal income would grow from $440 to $536 billion; income per capita would grow from $2,359 to only $2,534; and the base of the individual income tax would grow only from $207 to $278 billion.

Now let's contrast these figures, on a total cumulative basis:

Upon enactment of our bills, these projections would indicate by 1970, additions—above what would result from 2½ percent average annual growth—of $699 billion of gross national product; of $547 billion of personal income; of $2,681 of per capita income and $402 billion in the tax base.

The following tables show these data years from 1962 through 1970.

Gross national product

[Billion dollars]

	Calendar years								
	1962	1963	1964	1965	1966	1967	1968	1969	1970
Upon enactment of H.R. 2030 and H.R. 2031	570	593	620	651	689	725	765	807	851
Without fundamental reform of tax rates and methods	560	574	588	603	618	633	649	665	682
Additional gross national product	10	19	32	48	71	92	116	142	169
Cumulative additional gross national product	10	29	61	109	180	272	388	530	699

Personal income

[Billions of dollars]

	Calendar years								
	1962	1963	1964	1965	1966	1967	1968	1969	1970
Upon enactment of H.R. 2030 and H.R. 2031	448	466	487	512	540	570	601	634	669
Without fundamental reform of tax rates and methods	440	451	462	474	486	498	510	523	536
Additional personal income	8	15	25	38	54	72	91	111	133
Cumulative additional personal income	8	23	48	86	140	212	303	414	547

Personal income per capita

[Dollars]

	Calendar years								
	1962	1963	1964	1965	1966	1967	1968	1969	1970
Upon enactment of H.R. 2030 and H.R. 2031	2,402	2,459	2,530	2,619	2,719	2,825	2,932	3,044	3,163
Without fundamental reform of tax rates and methods	2,359	2,380	2,400	2,425	2,447	2,468	2,488	2,511	2,534
Additional personal income per capita	43	79	130	194	272	357	444	533	629
Cumulative additional personal income per capita	43	122	252	446	718	1,075	1,519	2,052	2,681

Individual income tax base

[Billions of dollars]

	Calendar years								
	1962	1963	1964	1965	1966	1967	1968	1969	1970
Upon enactment of H.R. 2030 and H.R. 2031	211	224	239	257	278	301	326	353	382
Without fundamental reform of tax rates and methods	207	215	223	231	240	249	258	268	278
Additional individual income tax base	4	9	16	26	38	52	68	85	104
Cumulative additional individual income tax base	4	13	29	55	93	145	213	298	402

Suppose our estimates of growth upon enactment of our bills are too high; suppose despite the record of recent years, our estimate of growth with nothing more than reshuffling of the present tax structure is too low; suppose the difference would be, say, no more than one-half of that which we have projected?

Over recent years, and currently, the Federal Government has been exposed to a barrage of demand for Federal aid to education, and to the argument that training and education themselves are means to economic progress. Dr. Kuznets notes that the development of scientific knowledge and technological skill inevitably contributes to improvement of our economic productivity. However, he adds that "One persistent bottleneck in the use of knowledge in economic production has been the scarcity of the resources for the production of capital goods needed for the application of new knowledge."

It seems to me that Dr. Kuznets is saying that we may have been getting the cart before the horse. Training and education do not displace the need for capital; instead, they increase the need for it. We are rendering a dubious service to our youth when we use Federal moneys to increase education when the total of Federal spending and taxing in themselves deprive trained people, and in fact all members of the working force, of the best and most productive job opportunities. It may be noted that greater capital formation and economic growth would greatly improve the base for State and local, and private support, of our educational institutions. If our economy had not been bound in the past by uneconomic tax rates, we could be certain that education would be in better position today without any direct Federal aid than is now the case. Looking ahead to 1970, no reasonable man could doubt that education would be a major beneficiary of the economic growth possible under a Federal tax structure which does not unduly penalize capital accumulation and use.

We have heard a good bit about sacrifice in the last couple of years. The question posed by the facts and figures which I have cited is where the sacrifice should be made.

Should we continue with an accumulation of public policies which deprive the people of our Nation of the jobs and advance in living standards, and of the pride and independence, which would come from the kind of growth permitted by fundamental reform of the Federal tax rates and methods?

Should we sacrifice the security and strength and prestige that would accrue to our Nation in this troubled world which would come from such growth?

Should we sacrifice the inherent power of our free economic system, letting the Soviet Union move up to our heels in its bid for world economic domination?

Or, should the Government itself make the sacrifice?

Mr. Speaker, and members of this body, we are not laying before you a soft or easy program. No family, no business, no nation has for long prospered and endured unless it demonstrated the capacity for discipline, for prudence today in order to multiply the well-being of tomorrow.

Is the Federal Government willing to make the sacrifice, or is this administration and the Congress to continue on the path of consuming the seed corn of tomorrow's strength?

Put in this light, there is not really as much sacrifice as we have indicated. Upon enactment of H.R. 2030 and H.R. 2031, we estimate that Federal revenues would total $88.4 billion in fiscal year 1963, slowly trending out from this figure reaching nearly $92 billion in 1967; then moving rapidly to $98 billion in 1968; $105 billion in 1969; $112 billion in 1970; and $119 billion in 1971.

In the intervening years, it is true we would get more revenue under existing tax rates, admitting whatever reshuffling of tax liabilities might take place. But in fiscal year 1971, the revenues which I projected would exceed those which would come from continuation of the existing spending and taxing policies, and thereafter would race ahead.

There is the question, Mr. Speaker, will the Federal Government sacrifice today, in order to enable the private economy to save and invest, to serve the public welfare at home and to confound the enemy which has stalked us with a capital formation rate twice our own.

We believe we know your answer—that this great representative body of the people, that the Senate, and that the President of the United States, understanding these facts, will make the right decision for America.

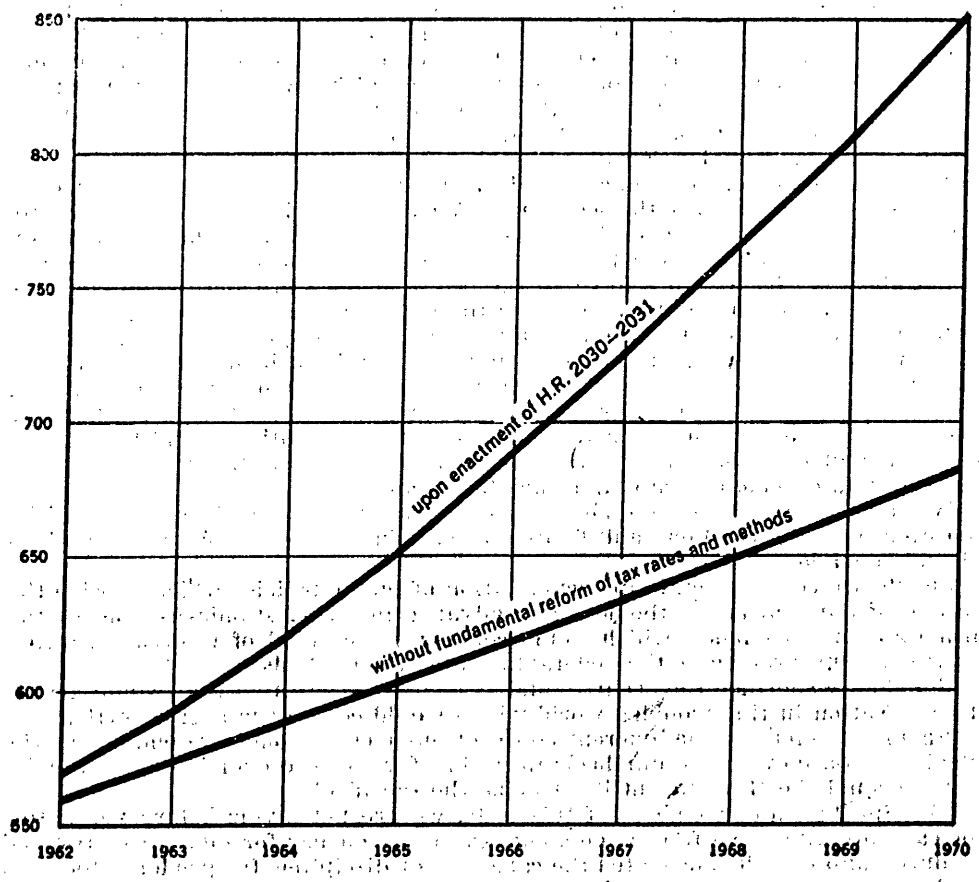
Our legislation was introduced 3 years ago this January. It has received the support of scholars, of commentators on the public scene, of representative bodies of American citizens.

No one, no group, has contested the validity of its basic assumptions and procedures. It is, in our opinion, Mr. Speaker, time that this legislation be exposed to the full deliberative process of the Congress.

Projected Economic Growth

GROSS NATIONAL PRODUCT

(Billion $)



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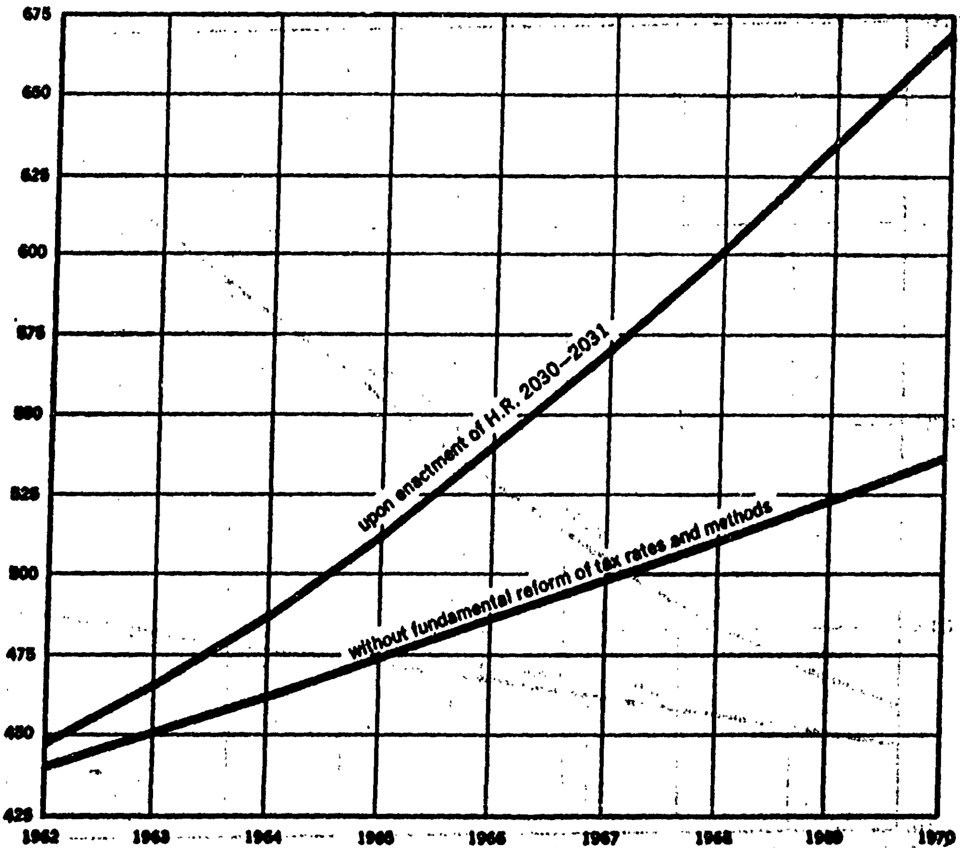
Projected Economic Growth

PERSONAL INCOME

(Billion $)



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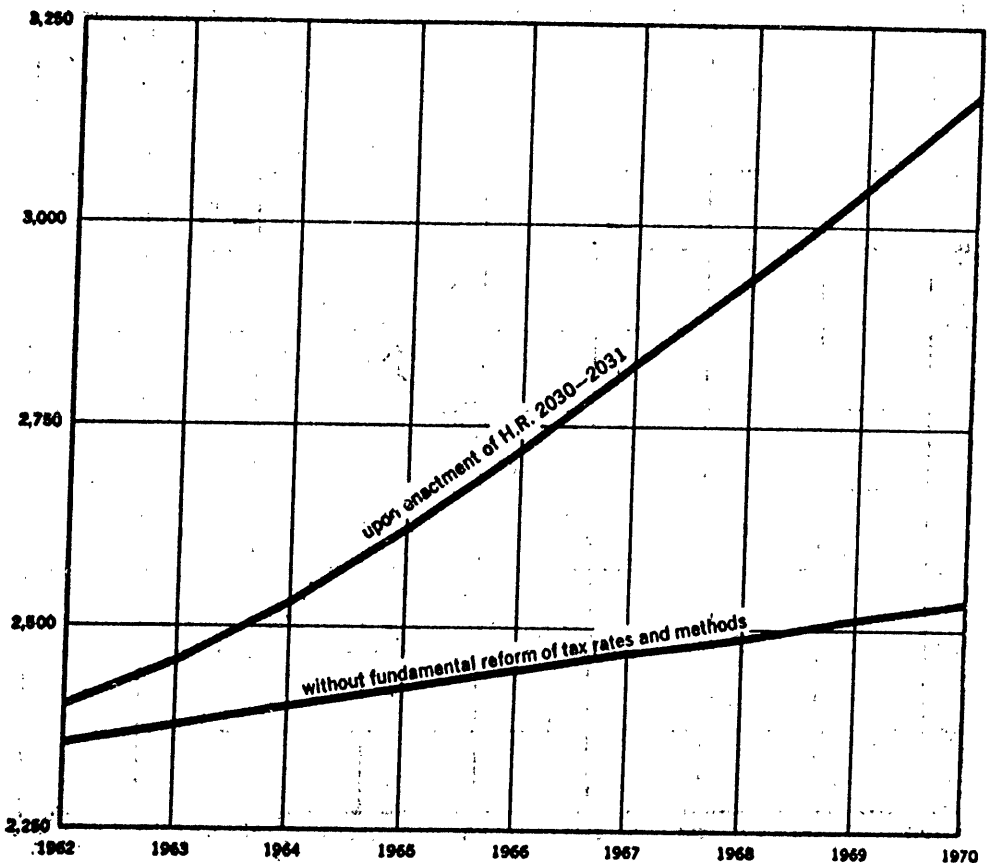
Projected Economic Growth

PERSONAL INCOME PER CAPITA
(Dollars)



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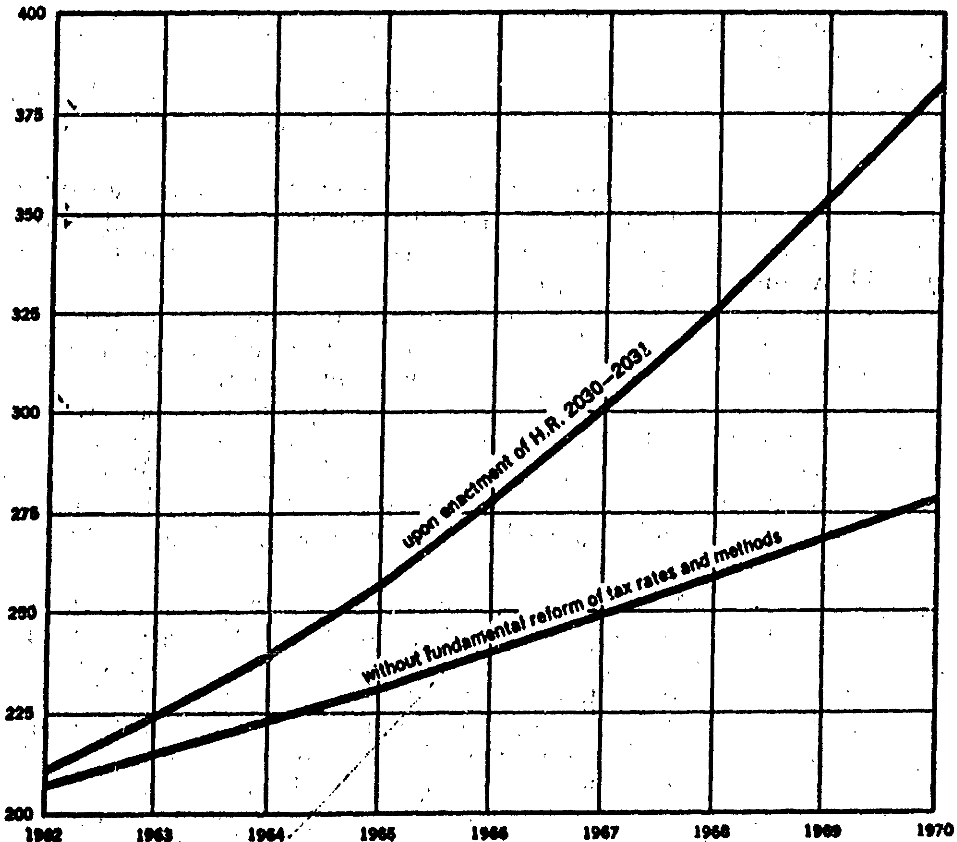
Projected Economic Growth

INDIVIDUAL INCOME TAX BASE

(Billion $)



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Additional Individual Income Tax Base	4	9	16	26	38	52	68	85	104
Cumulative Additional Individual Income Tax Base	4	13	29	55	93	145	213	298	402

Senator KERR. Thank you very much, Mr. Wesberry, for a very interesting and informative statement.

Mr. WESBERRY. Thank you.

Senator KERR. Mr. Max Dodson, Lone Star Steel Co.

STATEMENT OF MAX DODSON, EXECUTIVE VICE PRESIDENT, LONE STAR STEEL CO.

Mr. DODSON. Mr. Chairman, my name is Max Dodson. I am executive vice president of Lone Star Steel Co. of Dallas, Tex. It is a pleasure to appear before this distinguished committee in regard to the pending tax legislation.

Federal spending and taxing total is really big, some $93 billion annually. And, so is our current rate of capital development at about $70 billion a year.

We know that all we produce and consume comes from the saving and use of capital. Our standard of living, and our strength and prestige in the world, are dependent on the process of capital formation and how judiciously it is used.

The amount of capital we save annually, determines the progress we make. Increased capital saving means increased production and productivity, improvement in old and creation of new jobs, resulting in an advancement of the well-being and strength of our society.

The Government itself is just as dependent on the saving and use of capital in the private economy, as is the private sector itself. To carry the point further, what the Government takes from the private economy is a subtraction from what otherwise would be available for use as private investment.

As the demands of Government increase, we need to step up our capital input, or the private sector must suffer. In the past when we developed much more rapidly than the rest of the world, we were putting back into our economy more capital than the total burden of taxes. In recent years, when the economies of other nations have been moving ahead much more rapidly than ours, we find that the total of our taxes—at the Federal level alone—is substantially in excess of the amount of capital we have been able to put back into the economy. When State and local taxes of about $40 billion are added to the Federal tax burden (without consideration of social security and related imposts) we find that the total "take" of Government from our economy today is nearly twice our current rate of capital formation. It is little short of miraculous that we have been able to do so well as we have under such a burden.

Compounding the difficulty, our Federal tax system is transferring a huge section of our production from the private to the public sector in a way designed not just to raise revenue, but to limit in large measure the capital creating potential of higher incomes, and of businesses, and convert to Government spending, a great deal of capital which already has been accumulated. If the burden of Government were met by taxes which did not impose an excessive drain on the capital creation and use side of the economy, our total of production would be correspondingly greater, and the burden of Government itself would be a relatively smaller proportion of our total output. If we had used this formula the last 10 years, we would not now be up against the fact that other major economies of the world, including the Russian economy, are showing us their heels as regards economic growth.

My purpose in appearing before you is to strongly advocate just two very important and far-reaching points. If they seem revolutionary and extreme it may be because we have come such a long way along this line of the indulgent father who cannot bear to deny his children, even though he has to borrow to satisfy them. We have drifted a long way from our forebears' creed of "work and save." There simply must be a day of reckoning, and I fear that we are closer to it than many of us wish to admit.

In House Report No. 1447 covering the report of the Committee on Ways and Means the objectives of the bill H.R. 10650 are—

> to provide a stimulant to the economic growth of this country—

which—

> is needed to improve our competitive position abroad and in the long run to raise our standard of living at home—

and—

> to improve the equity of our tax structure.

No thinking citizen of the United States could conscientiously disagree with these stated objectives. But each of us, and I think the majority, disagrees with the means, as set forth in H.R. 10650 of attaining these objectives.

H.R. 10650 does not accurately prescribe the ways and means of accomplishing these objectives because this bill does not get at the heart of the problem. To truly accomplish our stated objectives will take more than a few technical, surface, and short-term-effect changes in our tax laws.

What is sorely and vitally needed is to make it possible for individuals and businesses to create capital in the operation of their businesses and to put this capital to work in our economy.

Each dollar of earnings which is permitted to be reinvested in our economy, as opposed to being immediately drained off as a tax payment, will create economic growth. This principle is recognized by the authors of H.R. 10650, for in House Report No. 1447 in section 2 covering investment credit, it is stated that—

> the investment credit will also encourage investment because it increases the funds available for investment—

and in the same section 2 it is stated—

> the President also points out that the tax credit for investments is in part self-financing. He indicates that the stimulus it provides to new investments will have favorable effects on the level of economic activity during the year and this will in turn add to Federal revenues.

Apparently, then, everyone is in agreement with the principle that dollars which were permitted to work rather than immediately being paid as taxes will—

> provide a stimulant to the economic growth of this country—

which—

> is needed to improve our competitive position abroad and in the long run to raise our standard of living at home.

Therefore, why wouldn't it be wise to really put this principle to work by taking a longer range view of our country's fiscal problems and at this time while we have the opportunity, revise section 3 of H.R. 10650 to provide for—

1. A reduction of tax rates for all individuals and businesses and not just a selective reduction limited to a small group which qualified because of investments made in technically defined properties; and

2. The taxpayer to have the full right, and responsibility, for selecting the depreciable life he will use for all depreciable properties put in use after December 31, 1961.

All equitable, across-the-board tax rate reduction will accomplish more to stimulate our economy than scores of technical, hybrid amendments to our already complex tax laws.

The taxpayer already has the right, by law, to deduct as depreciation the full cost of depreciable property in the calculation of his taxable income. Presently, however, these reductions are arbitrarily scheduled over diverse lengths of time which have become a constant source of bickering and disagreement.

I propose that the taxpayer be given the right, by law, to determine the depreciable life of his own properties at the time such properties are placed in use. The taxpayer is well aware that he can deduct the cost of properties only once, and therefore he will use his best judgment in selecting the depreciable life. If he elects to take all his depreciation in 1, 2, or 5 years, he is well aware that his taxable income will be without benefit of deductions for depreciation for all the years following. Accordingly, he will carefully apply business judgment in executing the responsibility of deciding the depreciable life of new property investments.

To protect against the promiscuous use of this right it is recommended that there be a provision which requires that depreciation taken in excess of actual decline in value, measured at time of disposition, shall be taxed as ordinary income rather than as capital gains.

If the taxpayer has this right he can, and will, proceed confidently with plant expansion and modernization using depreciation deductions as an integral part of his financing arrangements. This principle has also already been proven right here in this country with the "accelerated amortization program" granted under certificates of necessity during the emergency conditions of World War II and the Korean conflict. The country's fiscal condition at this time presents as much of an emergency as any we have faced in the past.

I think my company, Lone Star Steel, is a good example of what happens to the economy and to Federal tax revenues when a business is given the right to integrate a short depreciable life for tax purposes with the financing of a large plant expansion.

For the years 1948 to 1950, Lone Star Steel Co. was a merchant pig iron producer with a property investment of $11 million, 1,500 employees with a payroll of about $4 million per year, and we paid Federal income taxes of about $1 million per year.

In 1951 we obtained a loan for some $80 million to expand into a fully integrated steelmill. We were fortunate in obtaining the right to amortize 85 percent of the cost over a 5-year period for tax purposes. The loan agreement provided, in effect, that the tax reduction resulting from the accelerated writeoff was to be paid on the loan in addition to the fixed annual principal payments.

As a result of this financing, of which accelerated depreciation was an integral part, we expanded our fixed assets to $90 million; increased our average payroll to over $25 million annually since construction, and paid an annual average Federal income tax 3½ times what we paid before expansion.

Income taxes paid on the increased payroll, using a 10-percent rate, amounts to six times as much each year as was applicable to the annual income taxes paid on salaries and wages before construction.

As a matter of fact, at no time did taxpayments by Lone Star Steel Co. and its employees total less than they would, had this capital expansion not been undertaken.

These are only the direct income-tax payments made by the company and its employees and does not reflect the taxable income:

(*a*) Generated by the company's purchase of materials and services from hundreds of suppliers; or

(*b*) Generated by the expenditure of our employees' salaries and wages to hundreds of taxpaying consumer industries in our area.

In addition, Lone Star Steel Co., by taking its tax deduction for depreciation over a short period, is committed to pay higher taxes over the future years because it will have no further depreciation deductions on those particular properties.

This is an actual example of the increases in Federal tax revenues and the increases in our economy when a business is permitted to reinvest dollars, rather than to immediately pay out these dollars as taxpayments.

Now, not next year, is the time when genuine corrective action is needed in our tax structure in order, first, to preserve the present position of our economy, and second, to stimulate its growth.

Gentlemen, I urge serious consideration be given to revising section 2 of H.R. 10650 so as to provide—

(1) A reduction in tax rates for all individuals and businesses; and

(2) To give the taxpayer the full right, and responsibility, of selecting the depreciable life of all properties placed in use after December 31, 1961.

These two steps alone will serve the stated objectives of the Revenue Act of 1962 but will accomplish much more. It is true that possibly tax revenues will be decreased for a short period after enactment.

After that period the growth in our economy will provide an increasing scale of tax revenues.

Therefore, knowing we will have reduced revenues temporarily, it would be necessary to reduce our spending accordingly.

All of us are personally familiar with this principle and know that it is not impossible.

I think it is well worth the try.

Another point which I would like to emphasize for your consideration. Never in any of the estimates of increased costs or revenues of any tax bill do the authors take into consideration the administrative burden placed upon taxpayers by the proposed legislation. Businesses spend millions of dollars each year in their role as tax collectors for the Federal Government.

This bill, H.R. 10650, has several provisions which will add to this already costly burden. As an example the withholding of taxes on dividends and interest will cost millions of dollars to administer but absolutely no recognition is made of this added cost.

These requirements placed on taxpayers cost the same kind of dollars as those we pay in taxes. A reduction here in the cost incurred by industry to service the Federal Government will free dollars for reinvestment the same as will formal tax reform.

The provisions on entertainment and expense accounts have been promoted as a program to stop evasion in this respect. The truth is that most businesses would not evade taxes through these or any other means. Further, waste on entertainment and expense accounts is no different than waste on other production and distribution costs. Waste is the way for a business to make less rather than more profits. The idea that business as a whole would engage in wasteful practices is no credit to the economic judgment of the American businessman as well as his integrity. Insofar as the average business is concerned, the "ordinary and necessary" rule as applied to entertainment and expense accounts simply fits tax law to the realities of good management. The profit objective of business operations is the Government's guarantee that there is no tax escape through this route among well-managed American business. Nevertheless, both the spirit and design of the provisions of H.R. 10650 in this area would put honest, well-managed business in the same position as the "tax evading" group.

We would have new problems of compliance, and the Government would have new problems of surveillance and audit in an area in which there is only one possibility for gain in revenue. That possibility is when the letter and intent of the law, or regulations thereunder, supplant business judgment with Government judgment. In such cases, and I believe they would be manifold under any change in basic law in this area, the businessman who followed his judgment would be adding to the Federal revenue but would be forced to subtract an equal amount from legitimate profits. In other words, to put it bluntly, the Government would be applying an income tax not on the economic profits but on expenditures which makes the profit possible.

I am not questioning that there are some businesses, including people in business for themselves, who do attempt to take advantage of the law by charging off personal expenses as business expenses. This, to me, however, poses a problem of enforcement, and certainly does not justify developing new law and regulations which would be onerous and unproductive of revenue as regards the vast majority of businesses concerned. As a matter of public policy, and accordance with American traditions, I have no hesitancy in saying that the fact that enforcement can never be made letter perfect as regards this or any other area of Government jurisdiction provides no justification for harassing and penalizing the innocent.

To me, the proposal for withholding on dividend and interest payments also seems to be a sharp departure from American traditions. It was difficult enough for many of us to tolerate the introduction of withholding on wages and salaries, but in this area it is at least possible (because of allowance for deductions and personal exemptions) to achieve a reasonable relation between the amount withheld and taxes due. Such a relation would be impossible to achieve in regard to dividend and interest income. This means that withholding in this area is a device for extracting money from a segment of the public rather than a means for facilitating the collection of taxes legally due. The procedures provided in the bill would not in any way contribute to the identification of tax evaders, but instead would provide them with a sense of security that their failure of honest tax reporting will go undetected.

Other provisions of the bill, which seem to me to depart from American principles and traditions are those dealing with the taxation of business income earned abroad. While my company does not have foreign investments, we believe there is a great issue of principle in this area. When a corporation is formed in America, partly or wholly with foreign capital, it nevertheless is subject to the full jurisdiction and sovereignty of American laws. We have full jurisdiction over the income of such a corporation, except to the extent and until it is returned as dividends to foreign shareholders.

Equally, foreign countries have jurisdiction over corporations organized within their borders, regardless of where the capital comes from. I just can't understand on what principle we should disregard that sovereignty and attempt to tax the income of such corporations to American shareholders before it is brought back here as dividends. If such a procedure were sound and fair as regards a corporate shareholder in a foreign corporation, then some day it might be claimed that an individual American owning shares in a foreign business could equally be taxed on the earnings of that corporation which had not been declared in dividends. I realize that there is an area here of personal holding companies in regard to which present law does reach behind the corporate entity when that entity is used as a means for avoiding the payment of individual income taxes. Of course, we would not have the problem in this area except for the excessive rates of corporate and individual tax, and the absence of full relief from double taxation of dividend income. Regardless, a precedent used to prevent avoidance of payment of individual income taxes should not be extended to the disregarding of national sovereignty over income of legitimate business enterprises.

On the broad matter of taxation of income earned abroad, I feel that there is some confusion as to what really serves our national interest. At this time, I understand that our accumulation of foreign investment is providing nearly a billion dollars more in return income flow each year than the new capital which we are now sending out of the country.

This seems like mighty good business to me, not just for those who are engaged in foreign production, but for the country as a whole. It might be that some changes in tax laws would, temporarily, step up the current amount of return income flow, and reduce the amount of current outflow. But in the long run, such a temporary process would have proven to be extremely shortsighted. It looks like we are going to have to send a lot of tax money out of the country for years ahead, to maintain our military establishments and otherwise further our interests around the world. To help finance this outflow, we obviously will have need for all of the income that is economically feasible to provide for capital invested abroad.

May I add one more thought. With this handicap to American business abroad, will it not be able to remain competitive in the highly competitive foreign market where its foreign competitors carry a far lighter taxload? I do not think so. My thinking is that it would tend to handicap American business growth abroad with the end result of a much lesser tax rate for the United States.

Senator KERR. Thank you very much, Mr. Dodson. We are very proud of your company down in the southwestern part of our country.

Mr. DODSON. Thank you, Senator.

Senator KERR. Mr. Kamp, Bristol-Myers Co.

STATEMENT OF WALTER H. KAMP, FINANCIAL VICE PRESIDENT, BRISTOL-MYERS CO.

Mr. KAMP. My name is Walter Kamp, and I am financial vice president of Bristol-Myers Co., located at 630 Fifth Avenue, New York. Bristol-Myers and its subsidiaries manufacture prescription and proprietary drug preparations and cosmetic products, and sell them throughout the United States and many foreign countries.

It has been classified by Fortune magazine as one of the 300 largest companies in this country, and was classified in last week's issue of Life magazine as one of the 20 leading growth companies in this country.

I mention this latter fact because growth companies are one of the types of companies which would benefit most from the investment credit provisions of section 2 of the Revenue Act of 1962. Despite this, I am down here today to register my company's protest against the provisions of this section.

1. INEFFECTIVENESS

As I understand it, the basic purpose of this credit is to stimulate industrial expansion and modernization and thereby promote economic growth and fuller employment. Certainly, all of us are in full accord with these objectives. However, good intentions notwithstanding, the investment credit proposal will be almost completely ineffective in achieving these objectives. If it were not for the fact that any reduction in taxes releases additional funds for expansion or other corporate purposes, it could be stated with assurance that this proposal would be wholly ineffective in stimulating industrial expansion and modernization.

However, I do not believe that the investment credit is a good method of reducing Federal income taxes since the proposed investment credit will be of the least help to those it is primarily designed to help; i.e., industries lagging in the modernization of plant and equipment.

You will note that I have purposely omitted from this category expansion in the productive capacity of our industrial enterprises. As one who has seen his own company's sales grow from $6 million in 1929 (the year in which I joined Bristol-Myers Co.) to over $164 million in 1961, I can state without hesitation that if the economic factors are right—i.e., growing consumer demand for a company's product, a reasonable price to the consumer, and an adequate return on the investment required—industry will provide its own expansion of industrial facilities and productive capacity without any need for an investment credit provision. Certainly, this has been the experience of our company throughout the entire period of my 33 years' association with it.

To return then to those industries lagging in the modernization of plant and equipment, this is due generally to either a lack of cash or unfavorable economic factors.

If the problem is lack of cash, the investment credit provision will be of no help whatsoever, because in order to obtain a tax credit of $100,000 a company would first have to pay out $1,400,000 for the purchase of new equipment. Obviously, if the company were short of cash to begin with, it certainly wouldn't have $1,300,000 net to lay out for new equipment. On the other hand, accelerated depreciation could apply to equipment already purchased and would thus involve no additional cash outlay, but the savings in taxes accomplished thereby would be immediately available for either additional new equipment or the replacement of obsolete equipment.

If, however, the lag in modernization of plant and equipment is due to unfavorable economic factors, no 7-percent discount in the purchase price is going to answer or substitute for the solution of the basic underlying problems.

To summarize, then, the investment credit provision will help those people who do not need help and will be completely ineffective in helping those people who need help.

I suppose if I were a defeatist, I might say that the chances of ever obtaining any reduction in corporation taxation are infinitesimal, and therefore we ought to grab any opportunity for tax reduction that is offered us. Fortunately, our company was never built upon defeatism, and therefore my colleagues and I feel that we must oppose this investment tax provision even though—short range—it might be of immediate benefit to us. I hope you will bear with me if some of the points I make in succeeding paragraphs have already been covered by others in these hearings.

2. REVENUE LOSS

At a time when we are already faced with a substantial deficit for the current fiscal year, and the probability of an even greater deficit for the 1963 fiscal year, it would appear most unwise to increase these deficits by a costly give-away program of highly doubtful effectiveness which business in general does not want and which, in my opinion, would be unsound at any time.

3. DISCRIMINATORY EFFECTS

As I tried to point out in section 1, the application of this provision would be highly discriminatory in its effect upon varying industries, and taxpayers who cannot qualify for the favored treatment—i.e., those who most need it—will, in effect, have to bear the load for the benefits granted to the favored few.

4. GOVERNMENT INTERFERENCE AND CONTROL

The enactment of a provision of this nature would create an extremely dangerous precedent leading to the encouragement or discouragement of any particular segment of private enterprise, depending upon the whim or mood of the moment. Today it is an investment credit for new machinery and equipment. Tomorrow it could be an investment credit for industrial development in Africa, Latin America, Oshkosh, or Timbuktu. The scope of such favored and discriminatory treatment is limited only by the imagination of those proposing it.

In conclusion, may I say that the investment credit concept is moving far afield from the basic purpose of tax legislation; i.e., to raise the necessary governmental revenue with the least possible disruption of normal business practices.

May I thank you for granting me this opportunity of appearing before you on behalf of my company.

Senator KERR. Thank you very much, Mr. Kamp.

Mr. KAMP. Thank you.

Senator KERR. Thank you for your statement.

The committee will recess until 10 o'clock in the morning.

(By direction of the chairman, the following is made a part of the record:)

LYBRAND, ROSS BROS. & MONTGOMERY,
New York, March 5, 1962.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: We would like to bring to your attention certain accounting problems which appear likely to arise upon enactment of the proposed legislation for allowance of an investment credit for investment in certain depreciable property. Ordinarily, an accounting matter, even though it may relate to a legislative enactment, is not of direct concern or interest to the legislative body. The present legislation, however, in the absence of some clarification in the legislative record, may give rise to the adoption of a manner of accounting for its effects which, in our opinion, could seriously impair effective achievement of what appears to be the legislative purpose. Primary because of this possible consequence we are suggesting that serious consideration be given to the accounting implications of the proposed investment incentive legislation; apart from this, our firm, as practicing certified public accountants, is keenly interested in the adoption of appropriate and useful accounting practices.

The proposed legislation takes the form of a tax credit. However, its primary purpose appears to be related only secondarily to the function of determination of taxable income or tax rates within the framework of tax policy considerations. Its intent appears to be not to grant a tax reduction per se, but to provide an impetus for private investment in productive capital facilities. This diversity between form and purpose may give rise to diverse accounting treatment of its financial effects:

First, it may be viewed, in conformity with its form, as a reduction of income tax expense of the year in which it is granted. The effect of accounting for the credit in accordance with this view would be to give rise to an equivalent increase in reported net income in the years in which capital investments are made, as the result of reporting lower tax expense in those years.

Secondly, the credit may be considered as a form of Government financial assistance to private capital investment. If this view is adopted, it would follow, in our opinion, that the financial benefit accorded by the credits should be accounted for over the period of use of the capital facilities to the financing of which they contributed.

For reasons discussed later, we believe the objectives of the proposed legislation will be better served by adoption of the second method.

Although it is not within the province of accountants to pass upon the merits of legislative proposals, we believe that the proposed legislation, viewed only as tax legislation, would be difficult to envision as fitting within any reasonable or equitable scheme of tax policy, since it applies only to selective groups of taxpayers and, except within broad limits, is related not to taxable income but to capital expenditures. To account for the credit as a tax reduction would have the effect of generating earnings coincident with investment in capital assets rather than through their use, and we believe that an accounting practice which has this effect is highly undesirable: capital assets generate income only from use, not by expenditures for them. Since most businesses incur major capital investments only infrequently, this accounting would also give rise to wide fluctuations in reported business earnings, and would tend to accentuate cyclical swings in the economy. Such accounting would also, in our opinion, seriously impair the usefulness of reported earnings as a measure of profitability from operations since, to a large extent, they would be influenced by capital expenditures. The results of this accounting may also have undesirable economic effects on labor negotiations, stock prices, etc. For these reasons, we believe that accounting for the proposed credit as a reduction of income tax is undesirable, and is, in fact, inconsistent with the apparent intent of the proposed legislation.

The second method of accounting referred to above appears to conform with that intent. Under this viewpoint, the creditors would be reflected in income over the productive lives of the capital facilities with respect to which the credits were granted. This accords with the purpose of the legislation when we consider that its objectives can be attained over a period of years only to the extent that the incentive enables U.S. industry to become more competitive in the world economy through more efficient and more profitable operations.

For the reasons stated, we believe that accounting for the tax credit as being in substance a reduction of tax expense is undesirable and thwarts, or at least detracts from, the purposes and objectives of the legislation; on the other hand, it is our opinion that accounting for it as a form of financial assistance toward capital investment, the benefits of which should be reflected throughout the period of use of such investments, is consistent with and aids in achieving the objective of the legislation.

Nevertheless, the very fact that the legislation is being framed to provide for the incentive in the form of a tax credit is likely to lead many companies to treat it as in fact a reduction of tax expense and thereby to account for it in their financial statements as a "windfall" increasing current profits merely by the making of capital expenditures. In order to avoid this interpretation, we urge insertion in the official committee proceedings of a statement to the effect that, while the legislation is taking the form of a tax credit, its purpose is not to provide a tax "windfall" in any one year, but rather to provide incentive to eligible capital investments by granting financial assistance which will reduce the net private financial cost of such investment and thus improve profits over the productive life of the facilities. We believe insertion of some such statement in the record would have considerable influence in the final determination of the accounting to be followed.

We are sending similar letters to Congressman Wilbur Mills and to Mr. Colin Stam so that they will be familiar with our views.

Very truly yours,

LYBRAND, ROSS BROS. & MONTGOMERY.

MOREHEAD CITY, N.C., *March 8, 1962.*

Senator H. F. BYRD,
Senate Office Building,
Washington, D.C.

DEAR SENATOR BYRD: Your committee will commence consideration of proposed income tax modifications in the near future.

As a practicing income tax return preparer, I wish to signify my opposition to the concept of a special credit for investment in plant and to the application of withholding tax provisions to dividends and interest. Neither of these provisions are necessary.

With respect to the tax credit:

(1) I agree with the view that has been expressed already by others that businessmen do not invest on the basis of available tax inducements but rather on the basis of anticipated profits. (No profit, no tax—credit or no credit.)

(2) There seems little equitable justification for limiting such credit to investment in "plant" only; many other classes of investment also tend to "stimulate" business, employ labor, etc. Once this credit is granted, pressure for similar credits in respect of these other classes of investment may be forecast with certainty. The result is merely another step in the restriction of the tax base and further distortion of our economy.

With respect to the dividend and interest withholding provisions:

(1) Form 1099, now required, provides the IRS with all of the necessary information for enforcement. This is particularly so in the prospect of the heralded employment of electronic data processing techniques.

(2) Much of the money withheld will have to be refunded because the payers cannot modify the tax withheld for each payee in accordance with the individual tax situation of such payee. (This suggests something of the "forced loans" required by ancient monarchs.)

(3) Complications relating to the taxable, nontaxable, and partially taxable (long-term capital gains) characteristics of certain dividends—mutual funds, for example—will involve administrative problems for payers, payees and the IRS which are difficult to foresee in detail but certain to burden everyone concerned (perhaps this is justified as employing people).

Enclosed is a recent Lincoln Day talk which voices what seems to be a growing realization in eastern North Carolina.[1] It also relates generally to the subject of this letter, and I hope you will find it of some interest.

With much respect,

JOSIAH W. BAILEY.

SPRAGUE ELECTRIC CO.,
North Adams, Mass., March 12, 1962.

Hon. HARRY F. BYRD,
Senate Office Building,
Washington, D.C.

DEAR SENATOR BYRD: You will be called upon shortly to act on the President's proposed tax program. This program will include two features which are of great importance and concern to the Sprague Electric Co., and which may affect the jobs which our company provides in your State.

I refer specifically to the 8-percent tax incentive credit for investment in machinery and equipment, which our company vigorously supports, and the so-called tax-haven provision for taxing foreign-source income, which our company strongly opposes. Both of these legislative provisions can have serious implications for our company, American business, and the foreign competitive situation which will be created under the President's reciprocal trade program.

Mass production methods have been a major factor in our country's economic progress, jobs for our people, and our high standard of living. Our ability to mass produce is dependent upon a continuing and increasing investment in machines and equipment. In our company, creation of a new manufacturing job requires, on the average, an investment of at least $10,000.

Tax laws vitally affect the ability to make such investment. The 8-percent tax incentive credit will encourage increased investment in machinery and equipment.

The tax incentive credit is a necessary and primary step in the overall revision of depreciation rates, which revision is vital to the maintenance of our competitive position with our oversea counterparts operating in highly modern and efficient plants and in countries whose depreciation policies are far more favorable than ours.

The co-called tax-haven provision is an attempt to solve a tax-enforcement problem which may seem to be presently troublesome. But, in doing so, it places unnecessary stumbling blocks in the path of all U.S. businessmen who extend their operations abroad. The proposed cure may well be worse than the alleged disease. The tax-haven provisions are tremendously complicated. The admin-

[1] Copy of speech referred to made a part of committee files.

istrative effort which would be imposed upon taxpayers and the Government may well be out of all proportion to the anticipated revenue to be obtained.

In any case, the tax-haven provisions are certainly premature. They attempt to deal with a situation which can be entirely changed by the President's reciprocal trade program. Most surely it will place American business in a less favorable position to compete in foreign countries.

Our company earnestly solicits your favorable action in respect to the tax incentive credit provision, and your rejection of the tax-haven provision at least until it can be realistically reviewed under the conditions which will be created by the President's reciprocal trade program.

Sincerely,

ROBERT C. SPRAGUE.

STATEMENT ON TAX CREDIT FOR INVESTMENT IN DEPRECIABLE PROPERTY BY AMERICAN GAS ASSOCIATION, NEW YORK, N.Y.

The American Gas Association is a trade association representing utility, pipeline, and manufacturing company members in all the States of the Union. The utility company members have over 30,500,000 customers, which was 92.3 percent of all the customers in the country served by piped gas in 1960.

The utility members of the association are deeply concerned by the discriminatory treatment of gas utilities in the income tax credit provisions applicable to investment in depreciable property, as proposed in section 2 of the Revenue Act of 1962 (H.R. 10650). No segment of American industry should be singled out for less equitable treatment than another, in the absence of justifiable bases of distinction.

Secretary Dillon's testimony in connection with the hearings of the House Ways and Means Committee on May 3, 1961, includes the statement:

"* * * Investments by these regulated monopoly industries are largely governed by determined public requirements and are subject to regulated consumer service charges designed to provide a prescribed after-tax rate of return on investment."

This contention has presumably resulted in the bill's unfair treatment of the utilities. Although gas utilities are required to provide service to all who apply, when economically feasible, any reduction of the tax burden upon them would make it possible for them to enlarge their measures of economic feasibility and to extend service to individuals and communities not now served.

In fact, because of the extremely large capital requirements of the gas utility industry in relationship to revenues, the cost of capital is more of a consideration than in nonregulated industries. Any reduction in income tax, such as would be produced by the incentive credit, tends to make economically possible gas utility investments in projects which otherwise would not be justified. The effect of tax credit in stimulating gas utility investment would inevitably be compounded by the expansion of utility plant, equipment and service, and the employment of more people.

In a further explanation of the credit to regulated companies other than "electric, gas, water, telephone, and similar public utilities" (specifically, transportation utilities), Secretary Dillon said:

"The proposal would, however apply to enterprises in the transportation field (other than the subsidized merchant marine) which, although subject to various forms of regulation of their charges, are in fact highly competitive businesses with varying rates of return on investment. This group would include railroads, airlines, truck and bus operators, and other types of public carriers. Many of these enterprises are not only competitive among themselves at given regulated prices, but also must compete with private truck fleets, private airplanes, and other transportation facilities operated by industrial corporations which would be eligible for the credit."

Gas utilities must also compete for the energy business with industries which would be eligible for the full credit. Gas utilities are in direct competition with nonregulated and regulated businesses in many ways. In the energy market we compete directly with nonregulated coal, oil, and other petroleum products, bottled gas, and others, all furnishing competitive energy products, and with the advantage of the tax credit.

Further, all segments of the gas industry should be treated equally and without discrimination. The gas utilities segment, which handles the final distribution of gas through their systems, is as important in this dynamic industry as are other segments, and must be accorded the full credit for investment incentive in order to keep competitively healthy and strong through modernization and expansion of plant and facilities as proposed by President Kennedy.

Also, if the nonregulated suppliers of energy in the form of coal, oil, or bottled gas are benefited by a tax credit and the gas utility industry is not treated equally, the suppliers of those products are placed in a most advantageous competitive position as against the gas utility industry. Such discrimination would hamstring the service and expansion of the gas utility industry, especially in those major population areas which are far from the gas fields.

Gas utilities are also in competition with nonregulated and regulated industries in other ways. For example, we compete with other regulated industries—electricity for cooking, space and house heating, air conditioning, water heating, waste disposal, refrigeration, clothes drying, and many commercial and industrial uses. Again, in the consumer market, we compete directly with other goods and services for customer dollars.

Another field of economic activity in which gas utilities clearly must compete with all industry is the capital market. It is well known that, because of their huge requirements for capital, the regulated gas utilities cannot finance more than 40 percent of their necessary expansion from retained earnings and depreciation allowances. They must repeatedly and frequently seek most of their funds in the money market in open competition with nonregulated industries. Since a tax reduction such as the proposed incentive credit would lend strength to the financial position of any company to which it applies, it would bear unfavorably on companies which are less favorably treated.

Gas utilities have been part of the national economy for just short of 150 years. As such, they pay, and have paid, their share of the tax levied upon the Nation's business. There is no justification for not according them treatment at least as favorable as that accorded elements of the economy with which they compete. As the President said in his "Message on Taxation" of April 20, 1961, "Whenever one taxpayer is permitted to pay less, someone else must be asked to pay more." The proposed discrimination demands "less" from the bulk of tax-paying industries and "more" from tax-paying gas utilities.

The American Gas Association submits that the exclusion of these utilities from the benefits of the full incentive credit is not only unfair and unjust, but runs directly counter to the purposes envisioned by the President when he said in his message, "I am now proposing additional incentives for the modernization and expansion of private plant and equipment." The President's message also pointed out that these incentives would, among other things, "stimulate employment."

In the gas industry especially, the stimulation of employment has a unique characteristic. Labor costs of construction in the gas industry equal or exceed the material costs. The minimum personal income tax withholding from wages is 20 percent. Consequently, insofar as this industry is concerned, there will be no revenue loss to the Government from allowing the full incentive credit; on the contrary, there will be a revenue gain.

The association earnestly and respectfully requests that the provision of the incentive credit, if enacted, be made fully applicable to the regulated gas utility industry.

WEST FLORIDA NATURAL GAS,
April 9, 1962.

Senator HARRY F. BYRD,
Chairman, Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: We write with reference to a memorandum which will be filed with your office by Mr. Curtis Morris of the American Gas Association. We would like to say that our position in this matter is essentially the same as that outlined in the memorandum and we would appreciate your giving this matter your favorable consideration.

Yours very truly,

A. M. LEWIS, Jr., *Vice President.*

CASCADE MANUFACTURING CO.,
Portland, Oreg., March 20, 1962.

DEAR MEMBER OF CONGRESS: I am sending this letter to every Member of Congress in the hope that you will give thoughtful consideration to the reasons for our opposition to certain features of the tax bill H.R. 10650, which is now being deliberated in the House of Representatives.

Our first point of concern is in the investment tax credit feature. This would, in effect, penalize those companies that have regularly and continuously reinvested their earnings in new machinery and equipment, and whose plants are thereby modern, by rewarding the less progressive companies who would then enjoy a tax advantage in "catching up." A tax system that, in effect, penalizes the efficient companies through the artificial stimulation of the inefficient will certainly thwart our country's efforts to become competitive in world markets.

The logical alternative would be the adoption of more realistic schedules of depreciation. This would promote actual savings within industry for future reinvestment, whereas the proposed investment tax credit would only encourage borrowing, which in itself is inflationary.

We are also opposed to the contemplated taxation of dividend income accruing to foreign subsidiaries. As a small company (300 employees) we have a wholly owned subsidiary in the Netherlands and, through this, a 50-percent equity interest in a Dutch manufacturing company. We also contemplate purchasing, through this subsidiary, a minority interest in companies in both England and Australia. All of these companies are manufacturing products identical to those we build here in the United States, and dividend income to our subsidiary from these investments is desperately needed to provide the financing for the future growth of our business. The tax bill under consideration would "deem" or assume that this dividend income was repatriated to the parent company here in the United States, and we would be taxed accordingly, even though the dividends were not paid to us in fact, but were held in the foreign subsidiary for reinvestment in new plant and machinery.

Nothing could be more shortsighted. This could mean that we would have to divest ourselves of our foreign holdings and, should this occur on a widespread basis, it would completely nullify the administration's goal of increasing U.S. foreign trade. Prior to our oversea investments, we were unable to sell any of our products abroad simply because we could not compete. Today, after only 2 years of foreign investment, we are exporting approximately 6 percent of our total domestic production in the form of parts, subassemblies and other components to our subsidiary, and this percentage is continuing to grow. We have also created a substantial market for U.S.-produced steel tubing that did not exist before.

We are not concerned over a tightening of the tax regulations to curtail lavish entertainment or other expenses that are not essential to the legitimate conduct of business, but we are totally opposed to any regulation that attempts to set a "reasonable allowance" on meals and lodging while traveling, instead of the "entire amount" as under the present law. It is difficult enough for companies to hire the type of personnel who are willing to spend a large percentage of their time away from their families and homes and undertake the arduous amount of travel required by today's competitive business conditions, without imposing arbitrary restrictions in the form of tax limitations on the deductiblity of their traveling expenses.

I sincerely hope that you will give credence to these arguments and vote against these particular provisions of the tax bill.

Sincerely,

R. C. WARREN, *President.*

WARREN, OHIO, *March 21, 1962.*

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SIR: I understand that the Senate Finance Committee is planning to hold public hearings on the administration's tax revision bill, H.R. 10650. There are certain parts of this bill which I believe to be neither realistic nor in the best interests of the public.

The first of these provisions is the 8-percent investment credit. The objectives of this provision are obscure to me, but I understand that the primary objective is to encourage industry to modernize their existing facilities and to provide additional facilities, thereby stimulating the economy. I respectfully submit that the only time industry will invest in new facilities is where such investments are required and where it appears likely that the return to be gained from the investment in those facilities would be adequate to justify the expenditure. This proposed 8-percent credit has the effect of reducing the total cost of investment by 8 percent. In very few cases will this be sufficient to change the decision with regard to a proposed investment. If an 8-percent difference in cost would influence the decision, the return to be obtained from this investment is probably so marginal that the investment should not be made anyway. Projecting this 8-percent credit on a most conservative basis, it could influence the selling price of the product to be made by only 1 percent projected over the life of the facility or if the selling price were to remain the same could result in a 1 percentage point increase in the before-tax profit of the sales made as a result of this facility.

There would seem to be no question but what some change is in order in the depreciation allowed for tax purposes. This cannot be considered a substitute for realistic depreciation allowances and, at best, appears to be only a means of giving the industrial segment of our economy some part of that which we seem to be trying to give to everyone.

The second provision to which I would like to invite your attention is the proposal with regard to entertainment and other business expenses. I am sure that you realize that every dollar spent by one company or an individual on travel and entertainment expenses becomes income to some other company and/or individuals. The only way that the Government suffers a loss of revenue is where the tax rate of the spender is higher than the tax rate of the ultimate recipient. The tax loss, therefore, through so-called unwarranted travel and entertainment deductions is minimal.

There is no question but what there are abuses in this area. To prove that abuses are abuses could be difficult and time-consuming proposition.

To curb abuses, I would like to suggest that the amount and purpose of travel and entertainment expenses be left solely to the discretion of the corporation or individual paying the bill. To encourage close control of these expenses, which action appears to be advisable, it would seem that a good way of doing this might be to limit the deduction of these expenses for tax purposes to 50 percent of the amount paid out. The implication of something like this is apparent, and I am sure that no individual or no company could permit abuses in this area.

The third provision is the withholding on dividends and interest. I would have to agree that there have been unreported dividends and interest. The Treasury Department has taken steps through installation of data processing systems and reporting requirements that should eventually resolve this problem. A withholding requirement would probably cost more in the aggregate than could be recovered through increased taxes. It would not necessarily cost the Federal Government this much, but the cost to the unofficial tax collectors would be staggering. To the extent that there would be additional cost to the payers of dividends and interest the revenue to the Government would suffer. It would seem that this is the most expensive way to enforce tax laws, and elimination of this from the House bill should be given consideration.

Very truly yours,

D. O. TOWNSEND.

DI GIORGIO FRUIT CORP.,
San Francisco, Calif., March 22, 1962.

SENATE FINANCE COMMITTEE,
Senate Office Building,
Washington, D.C.
(Attention: Mrs. Elizabeth B. Springer.)

GENTLEMEN: We have read with interest of the proposed tax credit which will be given to taxpayers as a result of their investment in new assets and equipment. In this connection we have reviewed H.R. 10650 containing this proposal which has been recommended for passage to the House of Representatives by its Ways and Means Committee.

This bill provides for an overall limitation on the amount of such credit and in adding section 46(a)(5) to the Internal Revenue Code it further provides that there should be only one such credit for each affiliated group of corporations.

The common method of growth in industry is the acquisition of corporations in related businesses. This generally makes greater financial resources available to the individual corporations for investment in new assets and machinery as compared to their individual resources prior to such affiliation. However, if the investment credits available are reduced from one for each separate corporation to one for the entire group, then this result will tend to negate the beneficial effect of affiliation on their investment in new equipment.

The above limitation will tend to defeat the purpose of such investment credit.

An analogous situation is the lower rate of taxation on the first $25,000 of corporation income. Each corporation is still entitled to this tax treatement even though a member of an affiliated group and only loses this right if the group files a consolidated return. Similar tax treatment should be applied to the proposed investment credit.

We are bringing this to your attention in view of the fact that the Senate Finance Committee still has to review the proposal and the Senate to act thereon. Therefore, we respectfully recommend that the Senate eliminate the provision in the proposed investment tax credit legislation which will only give one such tax credit to each group of affiliated corporations rather than one credit to each corporate member of such group.

Sincerely,

D. B. SHIPPEY, *Controller.*

ARTHUR YOUNG & CO.,
New York, March 23, 1962.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: We are writing you regarding H.R. 10650, the short title of which is "Revenuue Act of 1962." The specific section of the bill on which we would like to comment relates to the provision of a tax credit for investment in certain depreciable property.

The impact of the investment credit on Federal income tax payments has most recently been estimated to be a reduction of $1.2 billion a year. The importance of a tax reduction of this magnitude has prompted us to give advance consideration to the financial reporting treatment to be accorded this tax reduction by corporate taxpayers if the bill becomes law. Our consideration has led us directly to the conclusion that attainment of the primary congressional objective—stimulation of the economy through an increased rate of investment in productive facilities—may be substantially influenced by the financial reporting treatment to be given the investment credit by corporate taxpayers.

We believe there are two principal and completely different financial reporting procedures which may be used by corporate taxpayers in accounting for the the proposed tax reduction. These two procedures are:

(1) Handle the credit as a reduction in current Federal income tax expense: Under this concept, the benefit of the credit is considered to be realized immediately and the net income of the corporate taxpayer would be increased in the year in which the related capital expenditures are made and the credit realized.

(2) Handle the credit as a reduction in the cost of the acquired property: Under this concept, there would be no substantial immediate effect on reported net income of the corporate taxpayer; instead the reduction would be spread over the estimated life of the asset in the form of a reduced depreciation charge against income.

While the availability of an investment credit would probably be sufficient to stimulate some acceleration in capital expenditures by some, but by no means all, corporate taxpayers, in the final analysis corporate management must be satisfied that the acquisition of the new facilities will reduce costs or expand output, and thereby increase future profits. It is our view that the second financial reporting procedure—handling of the tax credit as a reduction in the cost of the acquired property—is likely to be of greater effectiveness in accomplishing the primary congressional objective. We also believe this reporting procedure will place emphasis on the true nature of the credit—a sharing of the cost of the acquired machinery and equipment by the Government.

There are other important reasons of a more technical nature why we believe it is appropriate and desirable to encourage usage of the second financial reporting procedure. As an example, it is generally recognized that corporate net income is generated by the profitable use of capital assets. The purchase of such assets should not directly give rise to an immediate increase in net income.

Emphasis on use also is helpful in achieving the commonly accepted financial reporting objective of matching costs with revenue.

We believe it would be inappropriate to stipulate any financial reporting procedure in the legislation itself. However, in order to provide appropriate guidance as to congressional intent, we believe it is highly desirable that legislative committee proceedings emphasize the objective of Congress to stimulate the economy over the useful productive life of the capital assets to which the proposed tax credit is applicable.

Yours very truly,

ARTHUR YOUNG & CO.

THE EQUITABLE LIFE ASSURANCE SOCIETY OF THE UNITED STATES,
New York, N.Y., April 4, 1962.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: I am a vice president of the Equitable Life Assurance Society of the United States and am in charge of the society's investment of nearly $800 million in the American railroad industry. I have followed with great interest the development of those provisions of H.R. 10650 that would provide a 7-percent tax credit for certain types of capital investment.

The purpose of my writing to you is not to support or oppose these provisions. Rather, it is to point out my strong belief that although the enactment of the proposed investment credit would help somewhat in meeting the railroads' critical need to modernize equipment, the relief would be entirely inadequate. The railroads would still need and deserve more favorable depreciation treatment.

The American railroads have long suffered from outmoded and unrealistic depreciation standards, particularly in regard to the useful life of their equipment. A change in these standards, consistent with modern technological and economic thinking, is urgently needed to help reverse the economic deterioration of the railroads.

In support of my view that such a change in depreciation practices should be permitted whether or not the proposed tax credit is approved, I respectfully submit to your committee the attached statement on the subject and request that the statement and this letter be included in the record of your committee's hearings on H.R. 10650.

Additional copies of the enclosed statement are being delivered to the chief clerk of the Senate Finance Committee, Friday morning, April 6.

Sincerely yours,

HUNTER HOLDING.

STATEMENT OF HUNTER HOLDING, VICE PRESIDENT OF THE EQUITABLE LIFE ASSURANCE SOCIETY OF THE UNITED STATES

My name is Hunter Holding. I am a vice president of the Equitable Life Assurance Society of the United States at its main office at 1285 Avenue of the Americas, New York City. I have been engaged in finance and securities work for over 35 years, the last 25 of them with the society, and have been in charge of Equitable's railroad portfolio for over 17 years. Since coming to the society, I have been involved in continuous study of the status and future of the transportation industry as a whole, its component industries and individual companies. Equitable's investment in railroads now totals about $786 million, including approximately $116 million in railroad equipment.

I. GENERAL

We believe a strong transportation system based primarily on common carriers of all types including railroads, trucks, water carriers, pipelines, and airlines is essential to the very livelihood of the country. This system must be prosperous so it can earn enough to keep modernized for good service, and the best way to meet these aims is to keep transportation a private enterprise. There are many changes needed in current transportation policy to accomplish this, but we believe an area of primary importance where a slight change of policy can bring outstanding improvement quickly is in protection from income tax funds for property investment, particularly in the financing of modernization of properties—primarily railroad rolling stock.

As in other business if the machinery is modern and efficient, it will make for better service and lower cost of operation. On the other hand, if it is antiquated and inefficient, it will result in a high-cost operation and poor service. So much has been said in recent years about dieselization of the railroads that it may have left the impression with the public that there is little more that can be done to modernize equipment—at least locomotives and freight cars. The public's concern and complaint has been about old passenger equipment for which it has been extremely critical of management.

There is a tremendous shortage of modern freight cars, and much still to be done to get better locomotives. For the most part this technological lag is not the fault of management but lack of funds, and a great deal can be done to correct it. The 7 percent investment tax credit as provided in H.R. 10650 will contribute somewhat to the greatly needed additional raidroad income after tax required to settle the equipment problem. However, it would be entirely inadequate as a substitute for the reform of depreciation policy itself and should be considered in addition to depreciation reform. Both the tax credit and realistic depreciation will be discussed after first considering the condition of railroad equipment.

II. CONDITION OF RAILROAD EQUIPMENT

The December 31, 1961, balance sheet figures showing class I railroad investment in rolling stock are not available, but for our purpose we can use the December 31, 1960, figures:

Class I equipment

[In millions of dollars]

	Dec. 31, 1960		
	Investment in equipment	Accrued depreciation	Investment less depreciation
Freight cars	7,236	2,656	4,580
Locomotives (all)	4,268	1,655	2,613
All other equipment	1,717	895	822
Total	13,221	5,206	8,015

These figures show clearly that freight cars and locomotives represent nearly 90 percent of total equipment. Therefore, our discussion will for the most part be confined to these two items.

A. Freight cars

About 12 years ago the Equitable in one of its studies of railroad problems concluded that class I roads needed extraordinary amounts of new locomotives and freight cars. At that time (based on figures of January 1, 1949) there were over 1,762,000 railroad-owned freight cars, 611,000, or nearly 35 percent, of which were over 25 years old. Repair costs per car were running at the rate of nearly $241 annually and loss and damage claims of nearly $104 million annually represented 1.47 percent of freight revenues.

Total cars except cabooses, Jan. 1, 1949	1,762,239
Cars over 25 years old	611,070
Percent over 25 years old	34.7
Repair cost per car owned	$240.94
Loss and damage, freight:	
Amount	$103,537,000
Percent of freight revenue	1.47

As of January 1, 1961, the number of freight cars had receded to a little over 1,653,000 of which about 416,000, or 25 percent were over 25 years old. The repair cost per car (1960) had risen to nearly $292 and the loss and damage claims were $110 million or 1.37 percent of freight revenues (schedule I).

The decline of about 109,000 freight cars between the two dates was not because of a decline of freight volume; there was slightly more class I volume in 1961 than in 1949 (566 billion ton-miles (estimate), 1961, versus 527 billion in 1949). There were just fewer cars for the traffic because the roads have scrapped more very old cars than they could replace with new. Car shortages in this country in boom periods have become a national problem of major importance, and in case of a national defense emergency, might be disastrous.

Yet numerical shortage of total cars is a minor problem compared with the very serious major shortage in the proportion of new or modernized cars. The 416,000 cars over 25 years old January 1, 1961 included 78,800 over 40 years old. The industry agrees it could use at least 100,000 new freight cars a year (about $1 billion worth), yet there were only 16,000 cars on order February 1, 1962. This is so because the industry knows it has to wait better earning periods to afford new cars.

If the roads could get 100,000 cars a year, we estimate it would take about 7½ years to modernize the present fleet only to the point where no cars would be over 25 years old, and another 1½ years to get it back to the number owned in 1949, with none over 25 years. Seven to nine years of $1 billion annual expenditure on freight cars would give a substantial boost to car manufacturers, steel companies and other suppliers and would put the railroads in a position to get more rapidly the technological improvements in new cars. Such improvements would include roller bearings, shockproof cars, mechanically refrigerated cars, larger capacity cars, lighter weight cars, automobile parts cars, and wide door or even full length side-loading boxcars.

It would also reduce currently large repair bills, damage claims, cost of hotboxes and wrecks they cause, and it would give much better service to shippers and greater ability to meet competition. The result would be higher railroad revenues and lower costs.

B. Locomotives

While the locomotives have been almost entirely dieselized, this move started well over 15 years ago, and there are now about 9,900 locomotives over 12 years old. The technological improvement in diesel locomotives has been so great in the interim that some roads are turning in their 12- to 15-year-old diesel locomotives for new or upgraded units. The newer locomotives have about one-third more power and considerably more efficient operation than those of 12 to 15 years ago.

Concerning the 7-percent investment tax credit provided in H.R. 10650, while we can make only an estimate based on preliminary figures of additions and betterments of class I railroads for 1961, on that basis it is calculated such an investment tax credit would not have provided more than about $45 million if in effect all of 1962.

The details of the railroads' need for funds will be discussed later, but they include $1 billion worth of freight cars and $240 million worth of new locomotives annually. Based on 20 percent equity payment and 15-year financing, these two items alone would cost $248 million annually for down payments and would add $66 million each year to equipment obligations maturing annually. Thus the $45 million additional available income is too small to help materially in meeting equipment requirements.

III. THE EFFECT OF DEPRECIATION CHARGES ON FINANCING

Had the roads been able to earn sufficient income after Federal income tax their rolling stock would not have been in such an outmoded condition or, even with the low rate of earnings which has prevailed since World War II, had their cash flow been protected by a realistic rate of depreciation charges, they would have had substantially higher untaxed income with which to replenish their equipment over the years.

Considering for a moment some elementary principles—the very heart of the railroad operation is the rolling stock but it is a wasting or depreciating asset. The purpose of a depreciation charge to operating expenses each year is to allow a cash flow to be set aside annually before income tax, to be used to replenish old equipment and keep the fleet continuously modernized. To accomplish this the rate of depreciation depends upon the economic life of the equipment.

If a piece of equipment were worn out or obsolete at the end of 1 year that would be its economic life, and 100 percent of the cost would be charged to operating expenses as depreciation. These funds would not be subject to income tax and the whole amount would be used to buy a new piece of equipment for the next year. If the equipment had a 2-year life the depreciation charge would be 50 percent of cost, etc.

Based on the experience of the railroads (discussed later), we believe the economic life of freight cars and locomotives is not over 15 years (and may be less in some instances). The Internal Revenue Service, and in the past the Interstate Commerce Commission, have held the economic life of cars and locomotives to be anywhere from 25[1] years to over 30 years. In more recent years (ICC Annual Report—1961) the Commission has recommended (shorter) more realistic economic life for depreciable properties as has the U.S. Chamber of Commerce. The Association of American Railroads and the Transportation Association of America have recommended 15 years as the economic life of all rolling stock. Nevertheless in practically no case does the IRS allow 15-year depreciation on this equipment.[2]

The extremely damaging result of the roads' inability to use a 15-year life for depreciation purposes has been the sharp curtailment of the railroads ability to acquire new equipment.

For many years the usual pattern for equipment financing has been under an equipment trust with 20 percent of cost paid in cash and the 80 percent balance financed so as to be repaid to the lender over a 15-year period,[3] usually in equal annual amounts. The result has been that full cost of equipment had to be paid during a 15-year period, but only 60 percent (4 percent a year based on 25-year life[4]) of it could be from earnings before taxes, on a straight-line depreciation basis.

The other 40 percent would be from earnings after taxes—or at a 52-percent tax rate—payable in $2.08 dollars. Thus excluding any consideration for interest and other charges, a $10,000 car would require earnings before taxes of $14,320 in 15 years—i.e., $6,000 from funds earned before tax deduction (60 percent straight-line depreciation in 15 years) and $8,320, from funds after tax, when $2.08 would have to be earned for every dollar available after a 52-percent tax. Had there been a depreciation charge based on a 15-year life—or 6⅔ percent of cost a year—the amount available before taxes would have been $10,000 to pay the $10,000 cost of the new car.

NOTE.—For the sake of simplification, discussion of depreciation charges do not take into account depreciating to a scrap or salvage value.

IV. AMOUNT OF DEPRECIATION AVAILABLE COMPARED TO THE AMOUNT NEEDED

The amount of depreciation charged on all equipment in 1960 was $471 million of which a little over $200 million was on freight cars and a little under $200 million applied to locomotives.[5] By comparison the estimated amount of equipment maturities due within 1 year (due in 1961) was a little over $340 million. It is generally considered that equipment maturities will be paid off from the amount of cash flow protected from income tax by depreciation charge. Thus over $340 million of the $480 million depreciation charge for 1961 would be taken by the equipment maturities of that year. This would leave only a balance of $140 million available for all downpayments on new equipment and for additional equipment maturities contracted for by any new equipment purchases and financing.

A. *Freight cars*

It has already been pointed out that the roads could use a billion dollars worth of new freight cars a year. Even a 20-percent downpayment for these cars would cost $200 million each year and based on 15-year financing the additional annual equipment maturities would be $53 million a year. Thus, the downpayment requirements for financing an adequate amount of additional freight cars would alone exceed by $60 million the income protected from taxes by depreciation on all equipment.

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[1] A 28-year average for all types of freight cars.
[2] Exceptions include a 15-year life on some locomotives of two railroads if they're scrapped by that time.
[3] Based on reports and evidence of questionable economy of equipment thereafter.
[4] The IRS has allowed 25-year life in equipment of some roads. It is not universal.
[5] The breakdown of the 1961 figure of $481 million (almost the same total as the 1960 figure) is not available.

B. Locomotives

It has been stated by industry representatives that an additional 1,200 locomotives units are needed annually. At an average price of about $200,000 per unit this would cost $240 million annually and 20-percent downpayment on this amount would be over $48 million, while annual 15-year payments of the balance would cost about another $13 million each year.

Thus just to obtain adequate new freight cars and locomotives over the next 7 years would require $248 million each year in downpayments and by the end of the 7 years, $462 million in additional annual equipment maturities would accrue.

The total annual equipment maturities should then become about $625 million adjusted for scale off of maturities on presently outstanding equipment obligations (after providing for modernization of freight cars and locomotives only). By that time the program could probably slow down but whatever downpayments of cash were made, would have to be added to the $625 million under the tax umbrella provided by depreciation charges. If such equity payments dropped to $150 million annually, the tax protection required from depreciation charges would become $775 million (still excluding all equipment needs, other than freight cars and locomotives).

The depreciation base for class I freight cars and locomotives (November 30, 1960, latest available) was $10,670 million. If it is to be assumed that about this amount would be retired in 15 years from now (as indicated in S. 1370), the annual straight-line depreciation charge would be about $710 million. This amount would be immediately free from income tax deductions, more than enough cash flow to pay all current equipment maturities and make a $248 million downpayment annually on 100,000 freight cars and 1,200 locomotives (but only assuming, contrary to fact, that all railroads now pay income tax). Subject to the same assumption, increased equipment maturities caused by large new acquisitions would be fully covered by tax-free cash flow through the 15-year depreciation scale.

V. CLAIM THAT 15-YEAR LIFE WOULD HELP ONLY PROFITABLE ROADS

It has been pointed out that in recent years many class I roads have not reported a net income, and are therefore not subjected to income taxes. It has been argued that, therefore, 15-year life for depreciation purposes would not be helpful to these roads. This argument doesn't hold up when it is considered that because of free interchange of cars between roads, railroad cars are a part of a vast national fleet and any contributions of modern cars that can be made by the "profitable roads" will contribute to the improved operation of the whole fleet. In addition most class I roads show earnings in some years and adequate depreciation not only would protect earnings available for equipment in those years, it would provide tax loss carryovers from loss years, more nearly adequate for long-term equipment improvement. The net result of proper depreciation charges available to the whole industry should strengthen all parts of the industry materially as it gradually increased available modern and efficient equipment, which in turn would contribute to lower operating costs and better service to shippers.

VI. LITTLE LOSS OF TAX REVENUE TO THE FEDERAL GOVERNMENT ON A 15-YEAR LIFE

Contrary to widely held opinions on the subject it is probable that loss of tax revenue to the Federal Government would be small. The reason would be that at the present time the railroads charge to operating expenses the very high heavy repair bills, maintenance costs, and rebuilding costs (within limits). With proper depreciation charges, the fleet would be upgraded to such an extent that maintenance costs, heavy repair charges, and rebuilding would be reduced so drastically as to be a major, or possibly eventually a complete, offset to the higher depreciation charge. In other words maintenance and depreciation to equipment which for 1961 totaled $1,683 million (consisting of $1,202 million maintenance and $481 million depreciation) would probably remain about the same with a large reduction in the maintenance cost to offset a sizable increase in the depreciation charges.

In support of this, it must be pointed out that at the present time a heavy major repair job costing anywhere from about $1,200 to $1,800 is done when the car is about 7 or 8 years old and a second overhaul or heavy repair job would normally be done at about the 15th year. In lieu of these two heavy repairs a "rebuild" job costing anywhere from $3,000 up to $4,000 or more (depending upon the type of car) would be done at around the 15th year. Thus in effect obsolete cars (at the 15th year) are being given a new lease of life, as would be a beautifully maintained 1925 Packard car. It is because of extended life of obsolete equipment based on this procedure, that up to this time the IRS has argued that the economic life of a car is more than 15 years.

Financially, the result of this procedure is about as great a charge per car to operating expenses as would be 15-year depreciation. Assuming an annual depreciation rate of 4 percent for tax purposes (excluding consideration for scrap), by the end of 15 years, 60 percent of the cost of the car would have been charged off to operating expenses. In addition, some time roughly within 15 years, at the option of the company, two heavy major repair jobs would have been done on the car and charged to operating expenses. At an average cost of $1,500 for each of these repair jobs, $3,000 would have been charged to expenses plus 60 percent of the original cost all within 15 years. Had the car originally cost $6,000, $6,600 would thus have been charged to expenses, during the 15-year period. Had the car originally cost $8,000, $7,800 would have been charged to operating expenses, and had the original cost of the car been $10,000, $9,000 would have been charged to expenses.

It was not until recent years that the average freight car cost got up to around the $10,000 level—from about $5,000 12 years ago—another major factor which has made current depreciation charges completely inadequate.

Acquisition of large amounts of modern railroad equipment in the next few years would be a long stride toward creating higher profits based on sound earning power, which in turn should increase Federal income tax revenues in future years.

While a 7-percent investment tax credit would help move in that direction to some degree, it does not correct the basic problem of inadequate depreciation. However, railroads are exceptional among transportation companies in that depreciation rates on equipment are based on an unrealistic "economic life" far in excess of the length of maturities of obligations which finance the equipment. This problem does not face trucking and airline companies. Bringing depreciation rates into line with shorter and more realistic economic life, and with the financing obligations, would be an outstanding contribution to the industry, the general economy, and probably in the long run to Federal Government revenues.

Freight cars—Class I railroads

	Total cars (excluding cabooses)	Over 25 years old	Percent over 25 years old	Year	Repair cost per car owned	Loss and damage freight	
						Amount (thousands)	Cents per dollar of freight revenue
As of—							
Jan. 1, 1929	2,282,277	(1)	(1)	1929	$146.56	$35,564	0.74
Jan. 1, 1930	2,262,909	(1)	(1)	1930	114.01	31,215	.77
Jan. 1, 1931	2,265,047	(1)	(1)	1931	84.14	23,882	.74
Jan. 1, 1932	2,195,569	(1)	(1)	1932	55.49	17,303	.71
Jan. 1, 1933	2,127,593	(1)	(1)	1933	57.96	14,308	.57
Jan. 1, 1934	2,019,925	(1)	(1)	1934	66.90	16,214	.62
Jan. 1, 1935	1,907,089	(1)	(1)	1935	77.78	18,285	.66
Jan. 1, 1936	1,815,377	386,549	21.3	1936	102.74	21,260	.64
Jan. 1, 1937	1,744,317	357,732	20.5	1937	111.67	22,958	.68
Jan. 1, 1938	1,729,361	385,758	22.3	1938	77.75	20,411	.72
Jan. 1, 1939	1,680,623	424,024	25.2	1939	101.35	20,683	.64
Jan. 1, 1940	1,636,191	400,317	24.5	1940	115.96	21,764	.62
Jan. 1, 1941	1,646,799	415,061	25.2	1941	149.46	24,505	.55
Jan. 1, 1942	1,691,351	494,922	29.3	1942	171.49	36,365	.61
Jan. 1, 1943	1,742,322	536,802	30.8	1943	186.08	45,492	.67
Jan. 1, 1944	1,756,634	539,329	30.7	1944	205.77	63,790	.91
Jan. 1, 1945	1,771,394	578,092	32.6	1945	204.89	82,989	1.27
Jan. 1, 1946	1,770,852	574,190	32.4	1946	211.62	90,727	1.57
Jan. 1, 1947	1,746,721	547,968	31.4	1947	227.08	121,651	1.73
Jan. 1, 1948	1,742,094	570,906	32.8	1948	256.04	129,530	1.62
Jan. 1, 1949	1,762,239	611,070	34.7	1949	240.94	103,537	1.47
Jan. 1, 1950	1,752,940	616,875	35.2	1950	277.96	81,984	1.05
Jan. 1, 1951	1,724,407	632,465	36.7	1951	332.99	91,622	1.06
Jan. 1, 1952	1,756,648	657,149	37.4	1952	329.30	100,694	1.15
Jan. 1, 1953	1,762,765	657,449	37.3	1953	350.96	102,843	1.15
Jan. 1, 1954	1,781,077	651,078	36.6	1954	282.92	92,584	1.19
Jan. 1, 1955	1,736,866	651,321	37.5	1955	317.89	91,480	1.07
Jan. 1, 1956	1,691,216	650,798	38.5	1956	331.19	102,477	1.14
Jan. 1, 1957	1,706,112	620,629	36.4	1957	322.40	111,422	1.25
Jan. 1, 1958	1,743,984	579,355	33.2	1958	268.26	108,523	1.34
Jan. 1, 1959	1,723,200	526,860	30.6	1959	304.41	108,186	1.30
Jan. 1, 1960	1,672,794	467,020	27.9	1960	291.60	110,006	1.37
Jan. 1, 1961	1,653,341	416,100	25.2				

[1] Not available.

Source: Age of cars, 1936 to date from American Railway Car Institute data; number of cars prior to 1936 from AAR Car Service Division reports; all other data from American Railway Car Institute reports.

BANKERS LEASING CORP.,
Boston, Mass., April 5, 1962.

HON. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SIR: We wish to submit the following statement for consideration by the Senate Finance Committee in connection with hearings presently being held on the proposed amendment to the Internal Revenue Code to allow an investment credit.

A tax investment credit for all industry, as an incentive to modernize production capacity, appears to be the most direct method of enhancing the ability of the United States to produce competitively. Its salutary effects will strengthen the country's international balance of trade, indirectly improve labor's economic environment, increase business profits, and ultimately return to the Government greater tax revenue.

In order for small business to receive equitable treatment under the bill, that portion relating to "certain leased property" under section 48(d) should remain substantively unchanged.

A number of decades ago any company which sought to obtain new equipment had three traditional ways to meet its financial requirements: from capital reserves; equity financing; or borrowing.

A survey made by the Bureau of the Census which covered 6,158 manufacturers revealed that a large number of small businesses experience great difficulty in obtaining medium- or long-term credit. A significant portion of small businesses reported the need for long-term loans but no source of supply.

As a result of this need, long-term net leasing of equipment has developed. In the Federal Reserve Bank of Boston study of "Leasing's Role in Machinery Financing" published in its official New England Business Review, September 1961, the following statements appear regarding the importance of lease financing to small businesses:

"External sources of funds * * * are extremely important for firms that are relatively new and small or are in the growth industries * * * established external sources, such as borrowing on collateral and buying on installment, *fail to adequately provide equipment financing.*

"A rather recent development in external financing which meets this need is leasing. It provides financing for almost all of the equipment's cost so that the firm can retain working capital. Its potential usefulness in reducing obsolescence, however, is not generally recognized.

"Installment financing is the most closely related alternative source of credit * * * *A financially weak firm may, however, be able to lease even though it cannot obtain credit from other sources.*

"Leasing represented * * * 47 percent of externally financed purchases [by New England manufacturers in 1960] * * * over four-fifths of the New England firms who have leased equipment employ less than 500 workers.

"The principal reason for using leasing is to conserve working capital, according to four-fifths of the respondents. This is of prime importance to *small firms and to rapidly growing companies* * * *."[Emphasis supplied.]

The net lease, applicable to virtually all types of production equipment, is one arranged with the lessee for the major part of the equipment's useful life. Most of the responsibilities of ownership (maintenance, insurance, and other costs) are borne by the lessee. The lease payments cover the cost of the equipment, the interest expenses, and administrative costs of the lessor, and, typically, a nominal profit to the lessor. This term financial technique is experiencing rapid growth and increasing acceptance to small business because of its lower most. Most net lessors will elect to pass the credit to net lessees.

The proposed Revenue Act of 1962 provides equitable treatment to lessees because under its terms the lessor may elect to treat the lessee as having acquired the property. The financial function of the net lease, the ownership responsibilities of the lessee, and the narrow range of the net lessor's profit are important considerations in treating the lessee as the owner for the tax investment credit. Because most lessors will be unable effectively to use the proposed tax credits, and because net leasing is substantively a financial technique for lessees, any method which does not provide for the net lessor to have the option of treating the net lessee as being the owner for purpose of the tax credit will defeat the intent of the bill and discriminate against those small businesses whose only means of financing acquisitions is the net lease.

Because the tax credits would be substantially unavailable to lessors, as illustrated below, the credits could not be passed to the lessees in other ways. Take for example, a lessor who acquires during the tax year $5 million of depreciable assets having lives of 8 years or more. At a possible rate of 7 percent, the investment credit would amount to $350,000. If the lessor had a pretax profit of $100,000 he would ordinarily incur a tax liability of approximately $46,500. If the investment credit would be applicable to offset no more than 25 percent of the tax in excess of $25,000, only $30,375 of the investment credit would be used, or 8.7 percent not of the cost of the qualified depreciable assets, but of the investment credit itself.

Assuming similar taxable income and similar investment credits in the years ahead, the lessor would never be able to use his carryforward, if any.

The right to treat the lessee as owner for purpose of the tax credit protects the Treasury Department because only one, lessor or lessee but not both, would have available the investment credit.

The small businessman, who so often has no other term financing source available other than leasing, will not be penalized. The spirit and intent of the incentive will be maintained.

So long as section 48(d) regarding "Certain Leased Property" remains substantively unchanged and enables the lessor to elect to treat the lessee as the owner of property, small business will have available both the financial techniques and the incentive to expand competitively.

Respectfully submitted.

ALVIN ZISES, *President.*

INTERNATIONAL BUSINESS MACHINES CORP.,
New York, N.Y., April 3, 1962.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: Examination of the report of the House Ways and Means Committee accompanying H.R. 10650, the proposed Revenue Act of 1962, indicates that it was clearly not intended that income used in the conduct of active American operations abroad such as equipment-leasing businesses should be treated as "passive" or "investment type" income.

The language of proposed section 952(e)(3) could be construed as applying to equipment rental payments received by the foreign subsidiaries of American companies whose business is equipment leasing.

As IBM's business is primarily a rental business, I am sure you can appreciate the importance we place on having the wording of this selection clarified.

Therefore, I am submitting the attached statement which includes a suggested amendment, with the request that it be placed before the members of the Senate Finance Committee for their consideration.

Very truly yours,

T. J. WATSON, Jr.

STATEMENT OF INTERNATIONAL BUSINESS MACHINES CORP. ON H.R. 10650 REGARDING INCLUSION OF RENTS AS FOREIGN-BASE COMPANY INCOME (PROPOSED CODE SEC. 952(e)(3))

The International Business Machines Corp. is engaged in the business of manufacturing, leasing, and selling accounting and data processing equipment. In its business abroad, IBM does not utilize foreign-base trading companies. Rather, IBM does business through branches and operating subsidiary companies of the IBM World Trade Corp., a wholly owned domestic subsidiary. These branches and subsidiaries provide equipment and related services in the same manner in which IBM operates in the United States. The bulk of the income of the subsidiaries consists of rental payments received for the use of business machines owned and serviced by the subsidiaries and leased to customers within the country of operation.

It is clear that those who drafted H.R. 10650 intended that income used in the active conduct of business such as equipment leasing should not be treated as "passive" or "investment type" income. The report of the House Ways and Means Committee states:

"Your committee, while recognizing the need to maintain active American business operations abroad on an equal competitive footing with other operating businesses in the same foreign countries, nevertheless sees no need to maintain deferral of U.S. tax where the investments are portfolio types of investments, or where the company is merely passively receiving investment income. In such cases there is no competitive problem justifying postponement of the tax until the income is repatriated" (p. 62).

The language of one part of section 13 of the bill could, if not clarified, lead to exactly the opposite interpretation and thereby serve to defeat the committee's objective.

Proposed code section 952(e)(3) provides as follows:

"(3) *Rents included without regard to 50-percent limitation.* All rents shall be included in foreign-base company income without regard to whether or not such rent constitutes more than 50 percent of gross income."

This provision could be construed as applying to equipment rental payments with the result that active income realized in the operation of foreign subsidiaries in the equipment-leasing business would be taxed currently to the domestic parent company.

Accordingly, it is requested that the Senate Finance Committee amend that section. The following language is suggested for the committee's consideration:

"(3) *Rents included without regard to 50 percent limitation.* All rents shall be included in foreign-base company income without regard to whether or not such rents constitute more than 50 percent of gross income: *Provided, however,* That income from the rental of personal property realized in the active conduct of a trade or business shall not be included in foreign-base company income."

CONSOLIDATED NATURAL GAS CO.,
New York N.Y., April 2, 1962.

Re H.R. 10650.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SIR: On behalf of Consolidated Natural Gas Co. and its operating subsidiary companies, I wish to protest the provisions in the proposed tax bill granting a 7-percent investment credit for industry generally, but only 3 percent for local gas distribution companies.

The lower tax credit for gas distributors is apparently based on the false assumption that this segment of industry is not engaged in a competitive business. Our gas distribution companies and other gas companies are constantly and vigorously engaged in direct competition with oil companies and coal companies in the market for industrial uses of energy and in space heating. Granting a 7-percent tax credit to these competing industries and a lesser credit to gas distributors would create an economic discrimination against gas companies in the energy market.

Whether the tax-incentive measure results in the construction of new facilities that might otherwise be postponed or curtailed, or whether it results in the lowering of prices to customers, the proposed bill discriminates against us and our 1,220,000 customers in over 800 communities in Ohio, Pennsylvania, and West Virginia. It likewise discriminates against 1,190,000 customers of nonaffiliated distribution companies in New York whom we supply with all or part of their gas requirements at wholesale.

Respectfully yours,

E. H. TOLLEFSON, *President.*

TENNESSEE GAS TRANSMISSION CO.,
Washington, D.C., April 17, 1962.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate,
Washington, D.C.

DEAR SENATOR BYRD: The purpose of this letter is to express the views of Tennessee Gas Transmission Co. with regard to the application of the proposed investment tax credit contained in H.R. 10650 to gas pipeline companies.

Tennessee is a natural gas company principally engaged in the business of transporting and selling natural gas in interstate commerce. Its main transmission system extends in a northeasterly direction from its sources of supply in Texas and Louisiana through the States of Arkansas, Mississippi, Alabama, Tennesee, Kentucky, West Virginia, Ohio, Pennsylvania, New York, New Jersey, Massachusetts, New Hampshire, Rhode Island, and Connecticut. Subsidiary companies serve the Chicago, upper Midwest area of the country and the State of Tennessee.

Tennessee believes that the investment tax credit properly applies to gas transmission systems. Accordingly, it endorses the provisions of H.R. 10650, excluding such systems from the definition of "public utility property."

Apparently, the primary argument advanced against the eligibility of gas pipeline companies for the investment credit is that they are just another regulated monopoly utility. From this conclusion it is argued that any credit would not induce or encourage additional investment in facilities and thus the principal purpose of the credit could not be fulfilled.

A brief review of the true nature of a gas transmission company makes it clear that such arguments fail to take into account certain basic characteristics of the industry. These distinguishing characteristics compel the conclusion that gas pipelines are quite different from the ordinary regulated utility and thus, under the criterion used by the Treasury, should be classified along with railroads as eligible for the credit.

Natural gas pipelines do not enjoy monopoly franchise areas, as do most utilities. While the Federal Power Commission is empowered under section 7(f) of the Natural Gas Act to designate service areas for pipelines, the Commission has never seen fit to exercise its power in this regard. On the contrary, in most large centers of population there is more than one pipeline competing for the sales to the single local distribution company. Gas transportation pipelines also compete with other transportation systems, such as railroads, oil pipelines, barges and ships. Furthermore, the product carried, natural gas, is highly competitive with other fuels. Far from enjoying a monopoly, gas pipelines are quite similar to railroads, trucking firms, and the other transportation systems. As transporters of an item in a competitive market they are no more closely related to the local public utility which they serve than are railroad or trucking firms related to the company for whom they transport merchandise.

For all practical purposes the Natural Gas Act, which regulates gas pipelines, does not empower the Federal Power Commission to require the expansion and extension of gas pipeline facilities. The determination, in the first instance, as to whether a gas pipeline expands is made by its management. Again, this distinguishes such companies from monopoly-type public utilities which, by virtue of their exclusive franchise areas, have an obligation to extend service to all members of the public demanding it. Because the question of expansion of facilities is basically a management decision, gas pipeline companies, as all other transporters, would clearly be subject to inducement by the tax considerations underlying the investment credit provisions of H.R. 10650.

Whatever conclusions may be reached by this committee with regard to the availability of the tax credit to utilities, the distinctions pointed out above between the ordinary utility and gas pipeline companies indicate the wisdom of the approach taken in H.R. 10650.

The Treasury, in its original recommendations to the House Ways and Means Committee, stated that the investment credit should not be granted to any of the so-called public utility corporations, including gas pipelines within that phrase. This approach was rejected by the committee and, subsequently, by the House of Representatives. The committee, in the course of drafting its bill, specifically removed gas pipeline companies from consideration as public utilities in recognition of the significant distinctions which exist. The pipelines were thereby allowed the full benefits of the investment credit. At a later date, reviewing the matter de novo, it determined that all companies defined as public utilities were entitled to approximately one-half the credit available to industry in general, but maintained the full credit for gas pipelines.

The facts which supported this determination, later adopted by the House of Representatives, are still valid. They still substantiate the conclusion of the House Ways and Means Committee that gas pipeline companies do not bear the same characteristics which serve to distinguish electric, telephone, water, sewage disposal, or domestic telegraph companies.

I feel that an objective analysis of the material presented herein impels the conclusion that gas pipeline companies, just as other transportation media, qualify for the investment credit. I therefore urge this committee to maintain the eligibility of such gas pipeline companies for an investment tax credit in whatever form that credit is presented to the Senate.

Respectfully,

W. C. Braden, Jr., *Vice President.*

National Association of Photo-Lithographers,
New York, N.Y., April 11, 1962.

Hon. Harry Flood Byrd,
Senate Office Building,
Washington, D.C.

Dear Senator Byrd: You have a tremendous job ahead of you with regard to the current tax revision bill. There are many sides to the picture and no doubt you will be confronted with many ideas on how to best handle this enormous problem.

Our association and the lithographing industry are very much affected by tax problems. Printing presses may last 20 years but they are no longer competitive after only a few years. The rapid change of doing things differently is the cause for this.

We agree to change—we agree to progress in design—but we must meet this challenge of change by modern methods. Technical progress is one method. A sound tax structure is another. Depreciation bulletin F is so outdated that it even tells us so on the flyleaf.

Our industry needs a much faster depreciation schedule. This alone would give a terrific spurt to a sick industry. We have a tentative plan which ties in the current tax credit idea with accelerated depreciation. This plan will be submitted to Mr. Horace Hart, Director of the Printing and Publishing Section of the Business and Defense Services Administration, Department of Commerce.

Our association is available to assist your office and we certainly do hope you will give us the opportunity.

Cordially yours,

WILLIAM J. STEVENS,
Executive Vice President.

THE WESTERN UNION TELEGRAPH CO.,
New York, N.Y., April 13, 1962.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance,
U.S. Senate,
Washington, D.C.

DEAR MR. CHAIRMAN: I shall appreciate having the attached statement incorporated into the record of the current hearings on H.R. 10650, the Revenue Act of 1962.

Additionally, I should like to point out that unlike the A.T. & T and other public utilities Western Union faces a uniquely different situation. This company today is confronted with the most threatening form of competition of its more than 110-year history within the telecommunications field, including the manufacturers of communications equipment.

Western Union is currently constructing a vast transcontinental microwave system in order to meet the rapidly growing demand for various forms of communications services in industry and in particular to meet the growing requirements of the defense agencies of our Government. This will also greatly assist Western Union in meeting this keen competition. When completed in 1965 this tremendous expansion undertaking will cost in excess of $375 million.

Since 1950 Western Union's average rate of return, with one exception, was just over 5 percent. The year 1960 showed rate of return of only 4.5 percent and the rate of return for 1961 is 3.9 percent. The Federal Communications Commission after extensive and comprehensive hearings embracing, among other factors, the adequacy of Western Union's domestic rate structure, in an opinion released July 24, 1958, reached the conclusion that "a fair rate of return for Western Union ranges from 7½ to 8 percent."

In summary, Western Union is engaged in a highly competitive business and is unable to earn a fair return on its investment. We submit that Western Union, therefore, should not be classified with the monopolistic utility group.

We therefore urge the Senate Finance Committee to amend section 2 of H.R. 10650 by conferring the full 7 percent credit on the telegraph industry and as so amended to recommend enactment of said section 2 of H.R. 10650.

Sincerely yours,

T. F. MCMAINS,
Vice President and Assistant to the President.

STATEMENT OF THE WESTERN UNION TELEGRAPH CO. ON CREDIT FOR INVESTMENT IN CERTAIN DEPRECIABLE PROPERTY

The Western Union Telegraph Co. wishes to record its emphatic approval of the tax credit for investment conferred by section 2 of H.R. 10650, although recognizing that other forms of tax incentive for plant expansion may be more or may be less effective for certain segments of industry.

It should be made clear, at the outset, that Western Union is not a utility in the sense in which that term is customarily applied to a regulated public service with a monopoly in its area of operations. Far from being a monopoly, Western Union must compete for its business with both the telegraph and voice services of the world's largest corporation, the American Telephone & Telegraph Co. (A.T. & T.'s revenues, incidentally, exceed $8½ billion annually, in contrast with Western Union's total of $275 million a year.) Moreover, Western Union must compete for much of its business with the air mail, built up in large measure by Government subsidies over the years, and with manufacturers of private microwave systems and innumerable other types of communications equipment.

Western Union, unlike the ordinary utility and unlike A.T. & T., does not enjoy the protection of stable revenues from standby or minimum charges for the services it provides. This distinction is clearly evident from the fact that, although the Federal Communications Commission has recognized 7½ to 8 percent to be an appropriate rate of return for the telegraph company, Western Union earned a return of 3.9 percent during 1961, while the American Telephone & Telegraph Co. earned an overall return of 7½ percent.

Western Union is now engaged in the greatest construction program in its 110-year history. This program, designed to meet the rapidly growing telecommunication needs of industry, Government, and the general public, will be completed in 1965, at a cost of about $375 million.

The contemplated credit for investment which would be conferred by section 2 of H.R. 10650 could be of substantial benefit to Western Union. Indeed, the allowance to Western Union of such credit could well be a deciding factor in determining the company's ability fully to activate the program contemplated for expanding the Nation's communications facilities by increasing its ability to serve military and other governmental agencies, business, and the public.

Some of the more important projects planned in Western Union's expansion program are described below:

1. *Transcontinental microwave network.*—Scheduled for completion this year is a new transcontinental microwave network capable of handling every known form of electric communication, including voice, data, facsimile, and video, at extremely high speeds and in large volume. This new, and entirely separate, national trunk network has been engineered and routed to avoid "target areas," and will add significantly to national defense.

2. *Datacom.*—Nearing completion for the Air Force, the Datacom system is essentially a huge, completely automatic electronic data processing network consisting of five switching centers interconnecting airbases, stations, depots, and contractors. This network is designed to assure faster reaction time in Air Force logistic support by speeding the exchange of information on aircraft, missiles, personnel, and supplies.

3. *Bomb alarm.*—A nationwide nuclear-bomb detecting system is also being installed for the Air Force. This system will play an important role in strengthening the Nation's military and defense capabilities.

4. *Emergency message transmission system.*—Additional defense systems are the emergency message automatic transmission systems (EMATS) serving the Joint Chiefs of Staff and the Air Force.

5. *Telex.*—Nationwide Telex service is planned through exchanges located in 181 cities by the end of 1964. This new teleprinter exchange service permits users to dial other subscribers instantly, regardless of distance, for message and data transmission. Telex now connects 50 cities, Canada, Mexico, and 59 countries abroad.

6. *Broadband switching service.*—To make the most advanced use of the new microwave network, Western Union proposes to install broadband switching equipment to provide subscriber-to-subscriber voice-band connections by pushbutton for transmitting voice, data, facsimile, or any other type of record communication.

7. *Record-voice service.*—Modifications of facility interchange contracts, recently executed with the Bell System, now make it possible for Western Union to meet the expanding needs of Government and industry by extending the range of its private wire services to include voice transmission. These modifications, together with the extensive broadband facilities being provided by Western Union's new transcontinental microwave system, greatly broaden the range of services the company can offer.

Completion of the construction program outlined above is of vital importance to the telegraph company. Leased wire systems, data transmission, microwave, Telex, and facsimile, all of which are a part of this program, hold a great potential for growth, and Western Union must expand its operations in these areas if it is to survive as an industry under private ownership. The day has passed when Western Union can rely on its public message business as its major source of revenue. Although telegrams are still important—they accounted for 61 percent of total landline revenue in 1960—the fact is that message volume has declined more than 45 percent during the period 1945–60, and, despite the company's best efforts, the adverse trend continues.

The company believes that the decline in public message revenue can be more than offset by revenues from private wire services and other new services. This view receives substantial support from the current report of the Federal

Communications Commission to the Congress, where, on page 97, referring to the progress the company is making toward completing its transcontinental microwave relay system, the Commission observes:

"This new broadband system, designed to carry all types of communication at high speed and in large volume, should be one of the most significant developments in Western Union's history. It will reduce the telegraph company's dependence on the Bell System for leased facilities and enable it to compete for substantially more of the communications market."

Adverting to the differential in the rate of credit accorded industry generally and the utilities, including the telegraph, the Committee on Ways and Means in its report accompanying H.R. 10650 explains the rationale of the lower rate in the case of the latter as follows:

"The investment credit in the case of most regulated public utilities is in effect 4 percent rather than 8 percent. The smaller credit is provided in such cases because much of its benefit in these regulated industries is likely to be passed on in lower rates to consumers, thereby negating much of the stimulative effect on investments. Moreover, the size of the investment in regulated public utilities, such as electric companies, local gas companies, telephone companies, etc., will in large part be determined by the growth of other industries, rather than their own."

The reasons advanced by the Ways and Means Committee for reducing the credit allowed the utility group do not apply in any degree to Western Union. There will be no diminution in the "stimulative effect" of the investment credit because of the necessity of passing much of such benefit on to Western Union customers in the shape of lower rates. The fact is that the company has been unable for more than 10 years to earn a fair return on its investment. Throughout the decade commencing 1950, the average rate of return on its landline operations, after eliminating the strike year 1952, was just over 5 percent. 1960 showed a rate of return of only 4.5 percent, and the return for 1961 was even less—3.9 percent.

The arguments in favor of a reduced credit for utilities generally revolve around the monopolistic gas and electric utilities. These utilities enjoy captive markets, guaranteed rates of return, and ready access to capital funds. As compensation for the obligation to serve the needs of the public, these utilities are assured of an adequate return. New investments made by these utilities satisfy growing consumer needs which the utilities are legally required to meet.

The inclusion of the transportation industry with industry generally is, no doubt, accounted for by the fact that the transportation group is in a highly competitive business and that the rates of return among the various members of the group are subject to considerable variation. The competitive problems confronting the transportation group have their counterpart in the problems facing Western Union in the record communication field. The loss in public message revenue which has occurred in the last 15 years, amounting to almost 50 percent, is, in large part, the result of inroads made by the constantly expanding tax-free subsidized airmail and the competition of the American Telephone & Telegraph Co. and its Bell System operating affiliates.

In concluding its presentation, Western Union reiterates its endorsement of the tax incentive principle. However, with equal earnestness, we submit that the facts hereinabove presented definitely establish that the telegraph company is deserving of equality of treatment with transportation companies and general industry. We petition, therefore, for an allowance to the telegraph industry of the full 7 percent credit. This credit will, unquestionably, assist Western Union materially in completing its improvement program. Initially, it would fulfill the primary objective to be attained—a greater incentive for modernization and expansion, and, secondly, the savings in income tax through application of the credit provisions would be available for additional expansion of existing facilities. Quite conservatively, we can aver that the extent of Western Union's construction program will be influenced substantially if the credits under consideration will be made available to the telegraph company.

New plant, with its greater capacity and greater communicating capabilities, would be designed to meet present and future communication needs. Completion of this plant is essential if Western Union is to compete effectively in the whole broad area of telecommunications, including voice, and if it is to bring to the public the benefits of such competition. Military and civil defense also must have advanced and superior communications if they are to keep pace with the increasing speed, range, and complexity of modern weapons and modern warfare.

These and other objectives of Western Union's building and expansion program will be materially aided and strengthened by a sound tax incentive. The Telegraph Co., therefore, respectfully petitions the Senate Finance Committee to amend section 2 of H.R. 10650 by conferring upon the telegraph industry the full 7 percent credit, and, as thus amended, to recommend for enactment said section 2 of H.R. 10650.

WESTERN UNION TELEGRAPH CO.,
By T. F. MCMAINS,
Vice President and Assistant to the President.

Dated New York, N.Y., April 13, 1962.

VULCAN MATERIALS CO.,
April 10, 1962.

Hon. HARRY FLOOD BYRD,
U.S. Senate, Washington, D.C.

DEAR SIR: I am enclosing comments which I have submitted to the Senate Finance Committee with respect to H.R. 10650 which was passed by the House of Representatives and which is now under review by the Senate Finance Committee.

I am sending this to you hoping it will be of interest to you in your consideration of this bill, particularly in view of the fact that Vulcan Materials Co. has plants located in the State of Virginia.

There have been indications in the newspapers that material other than that included in the House bill may be proposed for addition to the bill as passed by the House. Specifically, I have read that there is some thought of eliminating any allowance for entertainment expense, a proposal apparently made by the President, and that the present credits against tax in respect to dividend income of individuals should be deleted. In my opinion either of these moves would be unsound tax legislation. I cannot understand how it can be reasonably considered that to the extent that entertainment expenses are established as a cost of doing business that they should not be deductible in computing taxable net income. It is also inconceivable to me that the steps taken to minimize the inequities of double taxation on dividends should now be rescinded, particularly since the percentage of the population of the country which invests in securities is on the increase.

I hope these comments will be of assistance to you.

Very truly yours,

J. V. VAN PELT III,
Vice President-Finance and Controller.

STATEMENT OF VIEWS OF J. V. VAN PELT 3D, VICE PRESIDENT, FINANCE, VULCAN MATERIALS CO., BIRMINGHAM, ALA., ON PROVISIONS OF H.R. 10650

The following comments are submitted as being important considerations that should be reviewed before H.R. 10650 is accepted by the Senate as an amendment to the Internal Revenue Code of 1954.

Section 2

A credit against a tax liability imposed by the Internal Revenue Code of 1954 with respect to investments in certain depreciable property is provided by section 2 of the bill. Without consideration of alternative questions regarding the soundness of generally acceptable methods of computing depreciation for tax purposes, this section violates fundamental business and financial principles, and should be deleted.

(*a*) The purpose of section 2, as expressed in the report of the Committee on Ways and Means, House of Representatives, which is to accompany H.R. 10650 to the Senate Finance Committee, is to promote full employment, growth, and equity. This is to be accomplished by increasing the profitability of productive investment and by reducing the net cost of acquiring new equipment, thereby stimulating investment in capacity expansion and modernization.

(*b*) The provision would produce benefits to equipment manufacturers, since they have been making substantial discounts for a considerable period of time, in order to effect sales. The section 2 credit would relieve this type taxpayer to some extent of this charge against earnings. However, it does not seem equitable to subsidize one class of taxpayer who would benefit to the extent of

48 percent of the discount he avoided, by means of having the Federal Government make the discount to the purchaser in those cases where the purchaser operates on a profitable basis.

(c) As a matter of business practice the investment credit would generally have an impact on new investment and replacement decisions of marginal producers. Because of the risks in business, well-informed manufacturers measure the soundness of investment decisions against profitability tests, and the levels of return on investment. Provisions for contingencies used in such tests are normally of such magnitude as to make even a 7-percent reduction in the original cost of some portion of the investment substantially meaningless. Under the circumstances the credit would present a group of taxpayers with a tax reduction that had no fundamental economic justification.

(d) In general it is believed that a high degree of excessive productive capacity is present in most industries in the United States. To the extent that this provision would tend to induce marginal operators to add to such capacity would not only disturb already unstable price structures, but established producers would be subject to production difficulties resulting in layoffs of their employees. References to modernization of plants in the United States are predicated on well publicized collections of data with respect to the overage of equipment in use in the United States, without showing that national productivity is in anyway impaired by the continued use of equipment of an age beyond any particular number of years. However, were this credit able to induce a wholesale modernization of the equipment of already established producers, the immediate result would be: (1) addition to the presently existent productive capacity; and (2) employee layoffs because the only manner in which replacement programs can be justified is in terms of cost reduction. In the final analysis cost reduction is traceable to lowered employment costs either on the part of the manufacturer, or in terms of a lower demand upon the fruits of labor of his suppliers. If it is sound to artifically stimulate the economy, the national interest would be better served if government resources were used to stimulate demand in a much wider range of basic productive industries than just machinery and allied products.

(e) While the discussion of the credit has been coupled with plans regarding changes in administrative practices governing the deduction of depreciation as an expense in computing taxable income, the two matters are unrelated.

(f) It is difficult to understand how the Congress could, in the face of a Government deficit, introduce a revenue losing provision that does not clearly justify its position as a producer of greater national income. To justify this provision on the grounds that other sections of the amendment make up for the revenue loss represents an unrealistic line of reasoning. The other sections should represent good tax legislation in their own right, and thereby merit passage as means of raising essential tax revenues, or else they should not be included in the bill.

(g) In the event that the credit should be allowed, it is difficult to understand why it should be allowed with respect to investments made prior to date of enactment of the bill. Clearly, such a provision has no economic justification in terms of the principles which are supposed to be furthered by the amendment. It might be construed solely as a means of enlisting support through the route of a handout to a certain body of taxpayers for an otherwise unpopular provision.

Section 3

This section provides for the allowance as a deductible expense in computing income taxes of costs in connection with appearances, etc., with respect to legislation and should be approved. The effective date, however, should be changed to tax years beginning after December 31, 1961. To do otherwise would make costs incurred by those who made appearances, or consulted with the Internal Revenue Service in connection with the development of this legislation, subject to possible disallowance as a tax deduction under the present regulations. Such a result hardly seems justifiable.

Section 4

Restrictions on the deduction as ordinary and necessary business expenses of entertainment, amusement, or recreation costs are provided by section 4. Subject to the following two comments the provisions of this section appear to be reasonable.

A. The section would have been improved if it had specifically stated in paragraph (c) as an addenda to (D) "except that no member of the family of an employee of the taxpayer who is not also a bona fide employee of the taxpayer or a member of the family of the taxpayer who is not also a bona fide employee of the taxpayer, can be considered as having a business relationship to the taxpayer, other than for purposes of moving an employee or the taxpayer to a new permanent business location." Many of the abuses of travel and entertainment expenses to which public objection has been made, stem from the attendance of family members at gatherings held ostensibly for business purposes.

B. The section contains an amendment of section 162(a)(2) which should be deleted. This amendment changes the words "the entire amount" to "a reasonable allowance." Use of the term "reasonable" will almost defy definition by regulation, since conditions vary in different geographic areas, and from one type of business to another. Furthermore, no taxing authority can actually determine if the presence of all company employees on a particular trip was in fact "reasonable." If definition of the term "reasonable" is left to the whims of examining agents and the courts, inequities between taxpayers will automatically occur, and endless litigation will follow. Once the bona fides of an expenditure is established, it is difficult to understand the reason an arbitrary test of amount should be injected. It would seem to be a dengerous precedent to inject a test of "reasonableness" into the deductibility of ordinary and necessary business expenses, since an extension of this test could then be applied to plant beautification programs, decorations in executives' offices, or the class of personnel engaged. If a business management deems it desirable to operate a business on a particular cost level, it would seem justifiable that it pay a tax based upon the income produced from that operations base, not some level of income computed by a taxing authority after deleting cost elements from the profit results.

Section 14

A method that wil permit of the adoption of intelligent administration of depreciation practices is provided by section 14 and this section should be included in the bill as finally adopted.

Section 19

The bill provides for withholding of income tax at source, a provision designed to assess taxes on income that has heretofore illegally escaped taxation. The approach adopted in this bill does not seem to be justified, particularly in view of the concurrent efforts being made by the Internal Revenue Service to install electronic data processing equipment which will be able to match reported income by taxpayer identification numbers with information returns. The bill, to meet objections to claims of inequities, provides for the use of exemption certificates, which will impose a major clerical cost on both the debtor or dividend paying corporation and the paying agent, which will ultimately be deducted from the taxable income of the debtor or dividend paying corporation. At the same time the bill does introduce inequities against nontaxable pension trusts since it will deprive them, in the aggregate, of the use for some months of substantial sums which would otherwise be available for investment. Since the matching process referred to above must be undertaken if there is to be any adequate protection against tax revenue loss, it would appear that the withholding process is completely unnecessary. Instead, provisions should be made requiring all recipients of interest and dividends to obtain identification numbers, and the filing of information returns by the payors of the interest and dividends involved. As the bill is presently written, exemption certificates could actually be used as a means of sheltering illegal income.

GENERAL TELEPHONE & ELECTRONICS CORP.,
New York, N.Y., April 11, 1962.

HON. HARRY F. BYRD,
Chairman, Senate Finance Committee,
New Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: Enclosed for the consideration of the Senate Finance Committee, in connection with its hearings on H.R. 10650, is a statement of our company on section 2 of the bill, dealing with the proposed investment tax credit. As you will note, we respectfully urge that utilities, such as operating telephone companies, be included on the same basis as other companies within the benefits of any investment tax credit which is enacted.

Thirty copies of the statement are submitted so that it may be available for distribution to the press and the information of others concerned.

Very truly yours,

DONALD C. POWER.

STATEMENT OF GENERAL TELEPHONE & ELECTRONICS CORP., RE INVESTMENT TAX CREDIT (SEC. 2, H.R. 10650)

General Telephone & Electronics Corp. represents a major segment of the independent telephone industry operating in the United States. Our corporation, through 31 subsidiaries operating in 32 States, furnishes telephone service in the United States for more than 4,400,000 telephones in some 5,800 communities of about 12 million population. In addition, our operating subsidiaries serve more than 600,000 telephones in British Columbia in Canada, the Dominican Republic, and Haiti.

Overall, there are approximately 3,300 independent telephone companies (outside of the Bell System) providing basic and essential telephone service in this country.

General Telephone & Electronics Corp. is submitting this statement for the consideration of the Senate Finance Committee on section 2 of H.R. 10650, dealing with the proposed investment tax credit. The bill, as passed by the House, would provide a credit at the rate of 7 percent for eligible new capital investment in the case of business generally, but only at the rate of 3 percent in the case of new capital of public utilities, such as telephone companies. We submit that to grant public utilities a credit only at a rate substantially less than half that of other industry, or to eliminate utilities completely from the application of the credit, is inequitable and in conflict with the stated purposes of the credit and of the proposed tax legislation in general.

As the House Ways and Means Committee in its report on H.R. 10650 points out (H. Rep. 1447, p. 7), the President of the United States in his Economic Report this year stated:

"We must scrutinize our tax system carefully to insure that its provisions contribute to the broad goals of *full employment, growth, and equity.*" [Emphasis added.]

Also, as stated in the House report on the same page, the President indicated that the proposed tax legislation, and particularly the investment tax credit, is directly related to these goals.

The inequity of excluding public utilities is further highlighted by the fact that other major aspects of the administration's tax program would involve increased administrative or substantive tax burdens, which in general are shared by public utilities with other taxpayers.

With respect to the other purposes of the proposed legislation—stimulation of the growth of our economy, and increased employment through the stimulation of investment in plant expansion and modernization— it is manifestly important to include public utilities such as the General Telephone System within the benefits of the investment tax credit. While public utilities, of course, are required to provide adequate service, in many cases they have the option whether or not to make an investment at any particular time, just as in the case of other industries. This is true in the General Telephone System where a grant of a substantial tax credit for new investment in construction or plant modernization would tend to permit its companies to look more favorably on new capital investment for improved service and technological advancement, such as the introduction of electronic switching, a new concept in switching telephone circuits permitting faster and more diversified services.

Secretary of the Treasury Dillon stated as the basis of the recommendation that public utilities should be excluded from the benefits of the credit:

"* * * that public utilities are regulated monopolies with substantial assurance of a given rate of return on investment after tax." (See Secretary Dillon's statement on Apr. 2, 1962, before this committee, p. 16.)

Contrary to Secretary Dillon's statement, public utilities in no sense have an assured rate of return. On the contrary, regulatory authorities limit rather than guarantee a utility's return on investment.

Furthermore, while public utilities are regulated, they are not in the true sense of the word monopolies since they are subject to competition ,which has been steadily increasing in recent years. For instance, the telephone industry is subject to substantial competition from private communications systems including private microwave radio facilities which are now licensed by the FCC.

Under Secretary Dillon's proposal which would exclude public utilities from the benefits of the tax credit, the telephone industry would find itself in a position of competing, under the burden of regulation, with communication systems, which were both unregulated, and obtaining the full benefit of the tax credit.

An argument is advanced that no credit, or a smaller credit, should be afforded to public utilities because much of the benefit would be passed on by the State regulatory commissions in lower rates to consumers. However, the extent, if any, to which the benefits of a tax credit would be passed on to consumers is not now clear and would in any event depend on various factors affecting the particular telephone operating companies. To the extent that the benefits of the tax credit are passed on to consumers, directly in lower rates or indirectly in better service, this would be a very beneficial development for public utilities and the telephone industry in particular. It would enable us to provide better and more efficient telephone service at lower rates. It would also provide the very type of favorable stimulation to the economy, which is the stated purpose of the proposed tax legislation.

For the reasons set forth above, we urge that utilities be included, on the same basis as other companies, within the benefits of any investment tax credit which is enacted.

GENERAL TELEPHONE & ELECTRONICS CORP.
By DONALD C. POWER,
Chairman of the Board and Chief Executive Officer.

NATIONAL FEDERATION OF INDEPENDENT BUSINESS,
San Mateo, Calif., April 11, 1962.

Subject: Tax credits.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building,
Washington, D.C.

DEAR MR. CHAIRMAN: On behalf of the approximately 180,000 individual members of this federation, all active independent, smaller business, and professional people who know what it takes to meet a payroll, make a profit and pay taxes, and as a service to your committee and the Congress, we ask you to take note of the following position of our members on the administration's proposal for an 8 percent tax credit. We ask also that you enter this letter into the record of your committee's hearings on the matter.

We polled our members, one ballot and one vote for each, on this proposition as follows in our the Mandate No. 273 (March 1962): "Should Congress enact a tax credit of 8 percent on the price of new business equipment and plant investment, and on purchases up to $50,000 on used equipment?" We accompanied this presentation with objective arguments, setting forth both the desirable and undesirable features of the credit plan, as voiced by responsible authorities on either side of the question.

Tabulation of the results of this poll, based on signed reports received from federation district chairmen in our more than 2,500 Mandate voting chapters across the country, which were based in turn on the thousands of personally signed ballots which they received from their members and which the chairmen sent directly to their Members of the House of Representatives, showed 54 percent of those responding to the poll favoring the 8 percent tax credit plan, 43 percent opposing the plan, and 3 percent registering no opinion either way.

Thus, this poll put the federation on record for the 8 percent tax credit proposal. However, in justice to our members, and to all in Government, we are compelled to point out that in all probability the choice made in this poll may have been influenced heavily by a feeling on the part of Mandate voters that there was no alternative. Thus, there is good reason to feel that given a free choice our members might have selected other forms of relief as more useful. We point out that the majority vote in favor of the tax credit plan is the smallest registered on any tax revision proposal polled in the Mandate in recent years.

In support of this we mention the following:

(1) At the request of Senators, in the summer of 1961, we conducted a quick survey among the federation's more than 2,500 district chairmen on the administration's tax reform plan. Signed returns to this survey showed just slightly over 50 percent of the responding chairmen favoring the tax credit approach. By their comments a majority of these chairmen made it clear they were less than

enthusiastic about the tax credit, that they were favoring it only on the basis that half a loaf might be better than no bread at all. As you recall, we furnished you with a copy of our 245-page report on this survey, for your information and that of your committee.

(2) In our current "How's Business With You?" survey which we are making among our entire membership during the 12 months of 1962, we received during the months of January and February some 8,820 signed responses (these are all that have been tabulated to date). Some 6,657 of these respondents have called for tax reduction or revision. Their preferences were expressed as follows: (*a*) "plowback allowances" (of the H.R. 2, S. 2 type) were called for 3,571 times, (*b*) flat "rate reductions" were called for 2,326 times, (*c*) "faster depreciation" was called for 2,285 times, (*d*) and "self-employed" retirement (of the H.R. 10, S. 59 type) was called for 2,215 times. To be entirely objective, we have provided a column in the tax phase of this survey making it possible for members to register on "other" proposals. We think it highly significant that despite all the publicity given in press, magazines, radio, and other communications media concerning the 8 percent tax credit proposal, that few, if any, of our responding members have indicated a preference for the tax credit or mentioned it.

(3) Going back a little, we worked during the summer of 1960 with the Treasury Department and the Small Business Administration on a special survey of our chairmen on the question of depreciation reform. When asked in this survey (reports on which were submitted to the Treasury and SBA) their preferences as to changes which might be made in depreciation, in their signed responses they lined up their preferences as to the first choice as follows: (*a*) Freedom to follow own judgment as to lives and methods, (*b*) some form of depreciation adjustment to reflect increased price levels, (*c*) all depreciable assets grouped into broad class categories by statute, (*d*) further extension of additional first-year depreciation allowance, (*e*) further acceleration during early part of life of asset, such as triple declining balance, (*f*) legislation authorizing a detailed classification of assets along the lines of bulletin F, to be prescribed for general use subject to statutory percentage leeway as to useful lives or depreciation rates, (*g*) a selected program of accelerated depreciation for particular lives or lines of business which may demonstrate a need for encouragement in the national interest, and (*h*) issuance of a new, revised bulletin F for continued use as a guide only.

As to their second choices, they listed in order: (*a*) Freedom to follow own judgment as to lives and methods, (*b*) issuance of a new, revised bulletin F for continued use as a guide only, (*c*) some form of depreciation adjustment to reflect increased price levels, (*d*) two proposals tied here: further acceleration during early part of life of asset, such as triple declining balance, and further extension of additional first-year depreciation allowance, (*e*) all depreciable assets grouped into broad class categories by statute, (*f*) a selective program of accelerated depreciation for particular industries or lines of business which may demonstrate a need for encouragement in the national interest, and (*g*) legislation authorizing a detailed classification of assets along the lines of bulletin F, to be prescribed for general use subject to statutory percentage leeway as to useful lives and depreciation rates.

We call your attention particularly to the fact that in a general way the proposal in the 1960 chairmen survey for a selective program of accelerated depreciation for particular industries which may demonstrate a need for encouragement in the national interest is like the 8-percent tax credit plan. We point out that in the 1960 survey, responding chairmen put it in sixth position among eight possible first place choices, and in seventh position out of eight possible second place choices.

We recognize the goal at which the administration is aiming: to give American industry incentive to modernize. However, we believe that basically the problem is one of affording industry some measure of tax relief which will permit it to retain more of its earnings, and then to spend these savings as it sees fit and competitive pressures demand. There is, it seems to us, more than one way to do this. Certainly we recognize the responsibility and the right of the administration to make its recommendations. At the same time we feel that the smaller, independent business and professional people, who are living with tax problems daily, have a right to be heard. After all, who knows their problems more than they who must live with them day in and out? Therefore, who should have a better idea of the solutions which must be made? Who, better than they?

Thus, the federation's position is this: If it is a question of the 8-percent tax credit plan or nothing, a majority of our members support the program. However, we do honestly feel a much better job can be done, and if alternatives are possible we would recommend the following in preference, all of which are based on mandate polls of our membership:

[In percent]

	For	Against	No vote
(a) H.R. 10-S. 59: Assist self-employed professional and businessmen in financing their own private retirement programs, by exempting from tax the 1st 10 percent of yearly income they pay into these programs	70	27	3
(b) H.R. 422-S. 720: Permit businessmen to deduct from taxes additional costs they incur due to price increases in replacing worn out or outmoded plants and equipment	60	36	4
(c) H.R. 2-S. 2: Allow businessmen to deduct from taxes up to 20 percent of all earnings ($30,000 ceiling) which they reinvest in expansions of plants, inventories, and accounts receivable	80	18	2

Judging by percentage response, any one of the foregoing three will be of greater practical benefit to the smaller, independent business and professional people of our country than the 8-percent tax credit plan.

With all best wishes,

Sincerely,

GEORGE J. BURGER, *Vice President.*

AYRSHIRE COLLIERIES CORP.,
Indianapolis, Ind., April 10, 1962.

Hon. HARRY F. BYRD,
U.S. Senate Office Building,
Washington, D.C.

DEAR SIR: During the immediate future your Finance Committee will have under consideration the matter of the controversial investment tax credit. On behalf of our group of companies engaged in the mining of coal in Illinois, Indiana, and Kentucky, we urge your support of this measure as an aid in meeting the huge investment requirements currently required for expansion—or actually for replacement—of productive facilities.

Very truly yours,

H. E. LOHMANN.

MULLINS MANUFACTURING CORP.,
Warren, Ohio, April 12, 1962.

Hon. HARRY BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

SIR: We have been very disappointed to note that the Revenue bill of 1962 (H.R. 10650), as recently amended by the House, now provides only for a 7 percent tax credit with respect to certain new depreciable properties. In addition, the credit is now applicable only if the tax liability does not exceed $25,000 and where it does exceed $25,000, it will be applicable only to 25 percent of such excess.

In the original concept, the proposed tax credit was 8 percent, applicable to a tax liability of $100,000 and on 50 percent of the amounts in excess of $100,000.

We believe this new watered-down version will be inadequate and ineffectual and, as a consequence, will have no impact or influence in inducing corporations to engage in any extensive program for new capital investment. Under the bill, as presently amended by the House, we would not be influenced to spend 1 cent more and, therefore, this provision is but a "will-of-the-wisp."

It is our understanding that the tax bill is now before the Senate Finance Committee for its consideration, and we urge that you liberalize the terms of the tax credit if the administration really desires to promote a program for increased capital spending by industry. Better yet, we believe this objective could be more effectually achieved through basic changes liberalizing depreciation allowance schedules.

We would appreciate your giving our suggestions your serious consideration.

Very truly yours,

HARRY KROHNE.

NATIONAL LAWYERS GUILD,
New York, N.Y., April 11, 1962.

Hon. HARRY F. BYRD,
Chairman, Senate Committee on Finance,
Washington, D.C.

MY DEAR SENATOR BYRD: We have been giving consideration to H.R. 10650, the Revenue Act of 1962, now under consideration by your committee.

The major purposes of the Revenue Act of 1962, as set forth in its preamble, is to provide a credit for investments in depreciable property and to eliminate defects and inequities.

In our view, it is imperative that H.R. 10650 be amended to eliminate one of the most serious inequities present in the existing tax structure—the inequitable tax burden levied on those with little income. Moreover, remedial legislation in this direction will substantially increase the quantum of family spendable income, which is the soundest stimulus to productive investment. We believe the program we propose will be more effective in stimulating sound investment than the investment tax credit proposal initially proposed by the Kennedy administration and contained, with some revision, in the present bill.

For the fiscal year 1963, it has been estimated that the investment credit will result in a revenue loss of $1.8 billion without taking into account any increase in the level of investment. If there is even a minimum incentive, the revenue loss may well exceed $2 billion. It is significant that in the hearings on the tentative bill before the Ways and Means Committee, a very substantial segment of our society, including leading industrial organizations and labor, overwhelmingly opposed this provision. It has been aptly said that the provision represents a new frontier in the field of special tax concessions. The adoption of the investment tax credit proposal would grant a major tax windfall to corporations. The point cannot be overstressed that the potential beneficiaries do not lack the private funds necessary to meet expanded invested needs.

If our national economy is to make real progress in its growth, our attention must be focused on the pivotal sector—the increase in the volume of family spendable income. Tax measures should therefore be directed to those areas most affected—the lower income groups and the middle income groups.

The time for overhauling the Nation's income tax structure—to lighten the massive taxload on those with little income—is long overdue. The chief factors responsible for this oppressive tax burden are the substandard level of personal exemptions—$600 for each taxpayer and each of his dependents—and the high tax rate applicable to the lowest bracket of taxable income—20 percent. The $600 per capital exemption was first introduced in the adoption of the victory tax during World War II. The cold war has frozen this substandard exemption into the permanent tax structure. The 20-percent initial bracket rate is also an inheritance of World War II.

The fusion of the substandard personal exemption and the oppressive initial bracket tax rate have, in large measure, emasculated the fundamental principle of the income tax structure founded on ability to pay and has transformed it into an oppressive instrument bearing down most inequitably on those with least ability to pay.

Although the common impression among Americans is that the Federal tax system has a sharply progressive tax structure in which each person is taxed from 20 to 91 percent according to the amount of income he received, in actual fact this is far from true. In the higher income brackets, the rate at which taxes are actually being paid falls far below the scheduled tax rates. In contrast, the statistics reveal that lower income taxpayers are paying close to or at the scheduled tax rate. The income tax gap in respect to the higher levels of income stems from the fact that Congress has placed its stamp of approval on numerous special tax provisions which have made it easier for the individual in higher income tax brackets to avoid paying his scheduled tax. These provisions grant special immunities to particular types of income and to particular types of payments received only by those in the higher income tax brackets.

Once upon a time the Federal tax structure provided preferential tax treatment to those who earned their income; it now provides special benefits only for unearned income, particularly for dividends and capital gains. The split-income provision has granted extensive preferential tax treatment for married couples in the upper income brackets with practically no tax reduction enuring to the average worker or those with little income. The net effect of this preferential tax treatment for upper income married couples has been estimated to result in a loss of over $5 billion to the Federal Treasury. Congress could recapture this revenue in several ways. Thus the repeal of the 1948 statute would eliminate the bonanza reaped by upper income married couples in the non-community-property States but would not eliminate the preferential treatment enjoyed by married couples in community States. In addition, preferential treatment to married couples in community property States must also be eliminated.

The depletion allowance now granted to mining and other extractive industries is another example of how special tax benefits are available only to wealthy individuals and the largest corporations. Very few workers own any oil wells or establishments engaged in extraction of any type of mineral and metal, ranging alphabetically from asbestos to zircon. Total deductions for depletion by corporations are in the neighborhood of $4 billion and the revenue loss because of such allowances to corporations and individuals approaches $2 billion.

Because of these multitudinous escape provisions, there has been a serious erosion of the cardinal principle of income taxation—the levying of assessments according to the principle of ability to pay. It is inhibiting the growth of the American economy by cutting back the purchasing power available to low- and moderate-income families. It is beguiling the public at large into believing that America has a progressive tax system. The time has come to restore the ability to pay principle to the Federal income-tax structure.

In revamping the Federal income tax system, tax relief for low- and moderate-income families should be a cardinal objective. This can be achieved by increasing the level of personal exemptions and by applying a steeply lower rate to the first bracket of taxable income. It would also be realistic to consider reductions in the upper income tax rates. It is imperative that Congress take immediate action to close the numerous tax escape devices that now riddle the tax laws. Merely tinkering with a few minor amendments will not achieve the objectives crying for implementation. Nothing but a drastic major operation on the body of the tax structure can produce a healthy, vital, income tax structure.

The American people must be mindful that the astronomical level of defense expenditures seriously impedes the sound reformation of the Federal income tax structure. For the budget year 1963, defense expenditures of $52.7 billion have been requested in the President's budget. This mountainous figure underscores the people's stake in disarmament. Disarmament holds the key to genuine tax relief as well as opening the road to funds critically needed for education, medical care, medical research, urban redevelopment, and a host of other welfare programs so urgently needed by our people.

Toward the end of establishing a genuinely progressive income tax, the National Lawyers Guild favors immediate enactment of the following program:

(1) Level of personal exemptions should be substantially lifted above the present per capita level.

(2) Steep reduction shall be made in the rates applicable to the lower brackets of taxable income.

(3) Reduction should be made in the upper income tax brackets concomitant with the elimination of provisions according preferential tax treatment to those in the higher income tax brackets.

(4) The dividend tax exclusion and credit granted in 1954 should be appealed.

(5) The tax provision applying to capital gains should be radically revised so that (*a*) all realized capital gains should be included as income and taxed at the normal rates; and (*b*) the impact of taxing realized capital gains accumulating over a period of longer than 1 year should be moderated by allowing the owner to average out the gain over the length of time the asset was held.

(6) The depletion allowances should be revised so that individuals and corporations in the oil and mineral industries should be permitted deductions based on actual investments.

(7) Preferential treatment of the taxable income of all married couples should be eliminated.

(8) Tax exemption for interest on State and local obligations should be eliminated with a subsidy provided for State and local authorities to compensate for the increased interest rate that may result.

We respectfully request that this statement on the revenue bill of 1962 be inserted in the record of the hearings now being held by your committee.

We shall appreciate your acknowledgement of this communication and shall be grateful to receive the record of the hearings on the revenue bill of 1962.

Respectfully yours,

JOSEPH CROWN,
Chairman, National Committee on Taxation.

ISLAND CREEK COAL CO.,
Huntington, W. Va., April 11, 1962.

Re H.R. 10650.
Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: Island Creek Coal Co. which presently operates one mine in Buchanan County, Va., and is rapidly expanding new developments in that area, desires to make known its position on the investment tax credit provision of H.R. 10650. We recognize this provision as a controversial measure, but we strongly support it and the position stated by the National Coal Association.

Very sincerely,

CECIL H. UNDERWOOD.

STATEMENT OF NICHOLAS PICCHIONE, CERTIFIED PUBLIC ACCOUNTANT AND TAX CONSULTANT REPRESENTING THE NATIONAL STATIONERY AND OFFICE EQUIPMENT ASSOCIATION

Gentlemen, my name is Nicholas Picchione. I am a certified public accountant and tax consultant. I am making this statement as a representative of the National Stationery and Office Equipment Association in behalf of approximately 5,200 members most of whom are small business men and women.

I am not opposed to the 8-percent tax credit on investments of machinery and equipment as proposed by President Kennedy. However, as a result of a special study I have made, I find that the proposed 8-percent tax credit gives practically no incentive to expand and modernize to some 10 million subsmall business firms in America. I believe that due recognition and consideration should be given to this special group who unfortunately have been overlooked in the proposed tax legislation now under review by your committee. I sincerely recommend the following simple proposal consisting of two parts for your consideration.

Part I.—That the present 20-percent bonus depreciation on purchases of machinery and equipment up to $10,000 be raised to 100 percent.

Part II.—That the Small Business Administration create a new category for "Subsmall Business Firms" and that the application form for these firms be simplified in order to expedite granting of loans.

This program is not a give-away.

It is a real incentive for subsmall business firms to expand.

Attached to this statement is a five-page document containing four tables and other supporting statements in digest form in recognition of the fact that you prefer to-the-point material.

You will also find attached to this statement an article entitled "The 'Dome Plan' To Aid Small Business" which appeared in the April 1962 issue of the National Stationer. This article explains why the National Stationery and Office Equipment Association believes that the Dome plan "will truly aid small businessmen."

Also attached is a reprint of an article "Making Personal Campaign—Seeks Sub-Small Business Aid" which appeared in the Providence Sunday Journal Business Weekly on February 4, 1962.

I hope that the members of your committee will find the above proposal worthy of your favorable consideration.

NICHOLAS PICCHIONE.

PROVIDENCE, R.I., *April 17, 1962.*

BIOGRAPHICAL MATERIAL

Nicholas Picchione, senior partner of Nicholas Picchione & Co., certified public accountants, Providence, R.I.:

Chairman of Rhode Island Board of Accountancy.
Chairman of Federal Taxation Committee of Providence Chamber of Commerce.
Chairman of Federal Tax Institute of the University of Rhode Island.
Past president of Rhode Island Society of C.P.A.'s.
Member of American Institute of C.P.A.'s.
Member of American Accounting Association.
Member of National Association of Accountants.
Member of Rhode Island Advisory Council, Small Business Administration.
Lecturer and writer on tax subjects and author of the "Dome Bookkeeping Record."
Founder and president of Dome Publishing Co., Inc., Providence, R.I.

EXHIBIT A

U.S. BUSINESS RETURNS, YEAR 1958-59

TABLE A.—*Number of business returns by size of receipts*

	Total number of returns	Returns showing receipts under $100,000	Returns showing receipts over $100,000
Sole proprietors	8,799,711	8,530,692	269,019
Partnerships	953,840	784,097	169,743
Corporations	990,381	566,103	424,278
Total	10,743,932	9,880,892	863,040
Percent	100	92	8

TABLE B.—*Gross volume of receipts by business organizations*

[Dollars in thousands]

	Total gross volume of receipts all firms	Gross volume of receipts for firms with receipts under $100,000	Gross volume of receipts for firms with receipts over $100,000
Sole proprietors	$163,398,989	$100,295,335	$63,103,654
Partnerships	78,235,308	19,592,707	58,642,601
Corporations	723,553,433	16,633,404	706,920,029
Total	965,187,730	136,521,446	828,666,284
Percent	100	14	86

NOTE.—The top 650 corporations had gross volume of receipts of $262,288,756,000 or 27 percent of the total gross volume; 107 corporations had gross volume of receipts of $149,229,771,000 or 15½ percent of the total gross volume.

Prepared by Nicholas Picchione, CPA, tax research department, Dome Publishing Co., Inc.

TABLE C.—*Number of business returns filed*

	Total number of returns	Returns showing net profit	Returns showing losses
Sole proprietors	8,799,711	7,155,412	1,644,299
Partnerships	953,840	765,450	188,390
Corporations	990,381	611,131	379,250
Total	10,743,932	8,531,993	2,211,939
Percent	100	79½	20½

TABLE D.—*Number of business returns by size of income*

	Total number of returns	Returns showing losses	Returns showing net profit under $5,000	Returns showing net profit over $5,000
Sole proprietors	8,799,711	1,644,299	5,971,527	1,183,885
Partnerships	953,840	188,390	368,807	396,643
Corporations	990,381	379,250	299,920	311,211
Total	10,743,932	2,211,939	6,640,254	1,891,739
Percent	100	20½	62	17½

Prepared by Nicholas Picchione, CPA, tax research department, Dome Publishing Co., Inc.

EXCERPTS FROM NICHOLAS PICCHIONE'S ADDRESS BEFORE THE WESTERN NSOEA CONVENTION HELD AT SAN FRANCISCO, FEBRUARY 16, 1962

"Since the 10 million small firms handle 14 percent of the Nation's volume of business, these firms will receive, collectively, approximately $238 million in tax credit as compared to $1.46 billion in credit going to less than 900,000 large firms. My study further shows that 650 giant corporations who handle 27 percent of the Nation's business will get $459 million in credit and that 107 supergiant corporations who handle 15½ percent of the Nation's business will get $263½ million in credit. Thus, 107 supergiant corporations will get $25½ million more credit than 10 million small business firms."

THE DOME PLAN

"In order to correct this imbalance, I offer the Dome plan. Leave the 8-percent credit on capital improvement as is. This tax credit should give big business the incentive it needs to expand. But what about helping 10 million small firms in the country. They need incentive too. Since this 8-percent tax credit gives these firms practically no incentive to expand or modernize, let's do something that will. The solution is rather simple. Congress saw fit to help these small business firms by passing a law in 1958 allowing a 20-percent bonus depreciation on purchases of machinery and equipment up to $10,000. Congress can now come to the aid of these small firms by simply raising the 20-percent bonus allowance to 100 percent."

HOW THE DOME PLAN HELPS SMALL FIRMS

"Suppose a stationer wants to modernize his business by buying new equipment costing $8,000. Let us assume that his books show a net profit of $10,000 before deducting the 20-percent bonus depreciation. His present tax as an unmarried person would be $1,648. How can this stationer finance the cost of the equipment and pay his income taxes too? By allowing 100-percent bonus depreciation, this stationer would not have to pay any taxes for this year only, and with his tax savings he could be better able to finance the cost of the equipment. The 100-percent bonus depreciation helps when help is most urgently needed—the year of expansion and improvement. The U.S. Treasury Department gains because the business will grow and prosper—more profits means more taxes." (See attached illustration.)

Illustration.—A stationer, unmarried, with net profit of $10,000 before deducting first year 20-percent bonus depreciation. During the year he purchased equipment costing $8,000.

	Present law	President Kennedy's plan	The Dome plan
Net profit: Before 20 percent bonus depreciation	$10,000.00	$10,000.00	$10,000.00
Less—20 percent bonus depreciation	1,600.00	1,600.00	8,000.00
Net profit after bonus depreciation	8,400.00	8,400.00	2,000.00
Standard deduction (10 percent)	840.00	840.00	200.00
Net income	7,560.00	7,560.00	1,800.00
Personal exemption	600.00	600.00	600.00
Net taxable income	6,960.00	6,960.00	1,200.00
Tax due	1,648.00	1,648.00	240.00
8 percent tax credit (8 percent of $8,000)	0	640.00	640.00
Tax liability	1,648.00	1,008.00	(1)

1 None, plus a carry-forward tax credit of $400.

Excerpts From Nicholas Picchione's Speech on Proposal for New Category Under SBA for "Subsmall Business"

The Kennedy administration is overlooking two opportunities to extend a helping hand to the small businessman.

1. The granting of 100 percent first year bonus depreciation to small business on new equipment.

2. The establishment of a new Small Business Administration category for "subsmall firms" and making available to these firms "quickie loans" backed by a 100 percent Government guarantee. Under the SBA definition, a small business is a manufacturing firm employing 250 employees or less, a wholesale firm with annual sales of no more than $5 million or a retail or service firm with annual sales of up to $1 million. SBA makes no distinction between small and "subsmall" business firms. I believe this oversight should be corrected. I propose that SBA establish a "subsmall business" category that would include businesses with a sales volume of less than $100,000 annually or employing less than 20 persons.

Of the 9,880,892 business firms in the Nation having a sales volume of less than $100,000 annually, about 6 million have less than 20 employees and the remainder are of the "Ma and Pa family" variety having no employees except the proprietors.

It is this vast segment of the Nation's economy which I believe the Kennedy administration has overlooked. "These are the people who represent the backbone of the American economy—the independent businessmen and women struggling for survival."

As an added aid to subsmall business, I propose that the 100 percent Government-backed "quickie loan" be made available by the SBA to these firms in amounts up to $10,000. I believe the SBA could assist these subsmall firms by developing simplified loan application forms which could be presented to the applicant's bank and in 10 days the loan could be granted, subject to the approval of the local SBA office. To guard against "fly-by-night" operations, the SBA could set up certain eligibility requirements such as a capital equity double that of the loan and a stipulated length of time a firm must be in business before qualifying for a loan.

[From the Providence Sunday Journal Business Weekly, Feb. 4, 1962]

Making Personal Campaign—Seeks Subsmall Business Aid

The Kennedy administration is overlooking two opportunities to extend a helping hand to the small businessman, according to a prominent Providence certified public accountant and businessman.

Nicholas Picchione, senior partner of Nicholas Picchione & Co., certified public accounting firm, and president of the Dome Publishing Co., has launched a personal campaign to rectify the situation.

He has reached the ears of Rhode Island's Senators, John O. Pastore and Claiborne Pell. He hopes to present his case to some members of President Kennedy's circle of advisers. Meanwhile he is stating his case publicly in talks given in different parts of the country and in private discussions as chairman of the Federal taxation committee of the Greater Providence Chamber of Commerce.

Mr. Picchione said he does not believe President Kennedy's oversight is deliberate. His objective, he said, is to bring these "errors of omission" to the President's attention.

The two positive steps Mr. Picchione believes the Kennedy administration should take to aid small business are these:

1. The granting of 100 percent first year depreciation bonuses to small business on new equipment purchases. This would be in addition to the 8-percent tax credit President Kennedy already proposes for industry on investment in new plant and equipment.

2. The establishment of a new Small Business Administration category for "subsmall firms" and making available to these firms "quickie loans" backed by a 100-percent Government guaranteee.

Mr. Picchione has compiled figures to show that large business and industrial enterprises will derive most of the benefit from the Kennedy proposal for an 8-percent tax credit on capital investment.

The Picchione study, based on a breakdown of tax returns made in 1959 by individually owned businesses, partnerships, and corporations, shows that 107 giant corporations doing 15.5 percent of the Nation's business would receive $25.5 million more in investment tax credit than would the Nation's 9,880,892 small businesses which handle 14 percent of the Nation's business volume.

Mr. Picchione said the 9,880,892 small firms, all of them so classified because their sales are less than $100,000 annually, would receive $238 million in tax credit under the 8 percent proposal while the 107 giant corporations would receive $263.5 million. His study showed that $1.46 billion in investment tax credit would go to 863,040 business firms with annual sales in excess of $100,000.

The accounting firm head is the first to admit that many of the 863,040 firms with annual sales in excess of $100,000 are now classified as small business by the Federal Government's Small Business Administration.

Under the SBA definition, Mr. Picchione said, a small business is a manufacturing firm employing 250 employees or less, a wholesale firm with annual sales of no more than $5 million or a retail or service firm with annual sales of up to $1 million. He said the SBA makes no distinction between small and "subsmall" business firms.

Mr. Picchione believes this oversight should be corrected. He proposes the SBA establish a "subsmall business" category that would include businesses with a sales volume of less than $100,000 annually or employing less than 20 persons.

Of the 9,880,892 business firms in the Nation having a sales volume of less than $100,000 annually, about 6 million have less than 20 employees and the remainder are of the "Ma and Pa family" variety having no employes except the proprietors, Mr. Picchione said.

It is this vast segment of the Nation's economy which Mr. Picchione believes the Kennedy administration has overlooked. "These are the people who represent the backbone of the American economy—the independent businessmen and women struggling for survival," he declared.

Mr. Picchione proposes that a positive incentive program be developed for this subsmall business category.

He believes the 8 percent tax credit proposal for industry should stand because it will give big business the incentive it needs to expand.

He is convinced incentive can be extended to subsmall business if Congress would provide these businesses with a first year 100 percent bonus depreciation on yearly purchases of machinery and equipment up to $10,000. He noted that Congress in 1958 passed a law providing a 20 percent bonus depreciation for small business. He suggested this be raised to 100 percent.

To explain how the 100 percent bonus depreciation would work, Mr. Picchione offered the hypothetical case of an unmarried grocer who recorded a $10,000 net profit in a year during which he purchased equipment costing $8,000.

Under the present tax law, providing for the 20 percent bonus depreciation in the first year, the tax liability of the grocer would be $1,648. Under President Kennedy's plan, which would add the 8 percent tax credit on the equipment purchase, the tax liability would be $1,008.

Under the Picchione plan, the grocer could deduct the entire $8,000 paid out for equipment because of the 100 percent depreciation bonus available in the year in which the purchase is made.

After the grocer deducts his personal exemption of $600 and a standard 10 percent for other exempt items, he would owe a tax of $240. But this liability would be wiped out by the 8 percent investment tax credit which would come to $640.

Mr. Picchione said the 100 percent bonus depreciation would give subsmall business help when it is needed most urgently—during the year the expansion or improvement is made.

As an added aid to subsmall business, Mr. Picchione proposes that the 100 percent Government-backed "quickie loan" be made available by the SBA to these firms in amounts up to $10,000.

Mr. Picchione believes the SBA could assist these subsmall firms by developing simplified loan application forms which could be presented to the applicant's bank and in 10 days the loan could be granted, subject to the approval of the local SBA office.

To guard against "fly-by-night" operations, he said the SBA could set up certain eligibility requirements such as a capital equity double that of the loan and a stipulated length of time a firm must be in business before qualifying for a loan.

J. L. G.

[From the National Stationer, April 1962]

THE DOME PLAN TO AID SMALL BUSINESS

NSOEA endorses the principles set forth in Mr. Nicholas Picchione's dome plan to aid "subsmall business," as presented at the recent western convention and exhibit held in San Francisco. Here's what prompted Mr. Picchione to launch his personal campaign for legislation to aid "subsmall business," and an explanation of what the proposal is.—Editor's note.

Mr. Nicholas Picchione, president of Dome Publishing Co., Providence, R.I., and senior partner in Nicholas Picchione & Co., certified public accounts, is an authority on tax matters. He has lectured and written extensively on tax subjects, and is the chairman of the Federal taxation committee of the Providence chamber of commerce. When Mr. Picchione explained his personal campaign to aid subsmall business to the officials of NSOEA, he was immediately asked to present the program to NSOEA members at a recent manufacturers' division meetings, and subsequently at the western convention and exhibit staged by NSOEA in San Francisco.

One thing is apparent: Mr. Picchione's proposals, if adopted by legislators, would be a boon to small businessmen—a category which encompasses nearly all members of this association. For this reason, NSOEA endorses and supports Mr. Picchione's proposal, and will back his efforts to get the Dome proposal into the light of national attention and into the field of Government action.

What is contained in the proposals makes good sense—and we urge your support. Write to Mr. Picchione, to NSOEA, and to the congressional and administration people who are now cognizant of the proposal so that they will be aware of your interest and support. And write to your Congressmen stating briefly what you know about the proposal, and urging their interest and cooperation.

STATUS OF THE DOME PROPOSAL IN GOVERNMENT

Thus far, Mr. Picchione, besides presenting his proposal under NSOEA's auspices at its official meetings, has submitted it to Rhode Island's Senator John O. Pastore, who in turn has referred the proposal to Mr. Stanley S. Surrey, Assistant Secretary, Treasury Department. Mr. Surrey has commented that the proposal is being given immediate attention, and that the many facets of the proposal would require some time for analysis by his Department. He will advise Senator Pastore of the results of the administration's analysis.

WHY THE DOME PROPOSAL

Last year (see the April 1961 issue of the National Stationer), NSOEA endorsed a piece of legislation called the Curtis-Ikard-Sparkman bill, which was based on the principle of tax credit on reinvestment of earnings. This bill was designed as an aid to small business, and, in its original form, would have done much for small business. However, though the bill was endorsed by the administration, and President Kennedy submitted a revised version to Congress (which would still have been a substantial aid to small businesses), Congress trimmed, revised, and oversimplified the bill so that while the reinvestment of earnings principle is still its basis, the bill in its present form (the President's tax proposal, with its 8-percent-reinvestment clause) has lost all its value to small businessmen.

Mr. Picchione points out that the administration has overlooked two aspects of the problem in its search for tax legislation to spur business development. One is depreciation allowances. He notes that in 1958 Congress passed a law providing small businesses with a 20-percent bonus depreciation allowance on yearly purchases of machinery and equipment up to $10,000. Why not raise this allowance?

HOW THE DOME PROPOSAL WORKS

If Congress looked favorably on the 20-percent bonus depreciation, and the Treasury does not stand (in the long run) to lose any income, why not spur buying of machines and equipment now, by allowing a yearly bonus of 100 percent depreciation on new purchases of equipment? This is the essence of the Dome proposal with regard to tax relief for subsmall businesses. Mr. Picchione has prepared charts to show the tax picture for small businessmen under the present setup, under the President's proposal for an 8 percent tax credit, and under a combination of the administration plan and the Dome plan. One of these charts is reproduced on this page, and shows at a glance how tax savings could be effected that would aid and encourage small businessmen to plow their money back into their businesses. The Government ultimately will lose no money, since a tax credit for depreciation would have been realized over a period of years anyhow.

Mr. Picchione endorses the President's tax proposal for an 8-percent reinvestment tax credit. He criticizes it only because it proves to be an aid to big business much more than an aid to small business. Supporting this contention he quotes from the Internal Revenue Services report on "U.S. Business Tax Returns, 1958–59," to show that under President Kennedy's plan, 107 giant corporations would receive $263.5 million in tax credit, while some 10 million subsmall firms, handling 14 percent of the Nation's business will receive only about $238 million in tax credits from this program. The imbalance is that 107 corporations receive about $25 million more in tax relief than 10 million small firms put together. A complete analysis of these figures is available upon request.

ESTABLISHMENT OF A NEW SUBSMALL CATEGORY IN SBA

Part 2 of Mr. Picchione's proposal calls for the establishment of a new category for subsmall businesses in the SBA and making available to these firms "quickie loans" backed by a 100-percent Government guarantee. He proposes that the category should include business with a sales volume of less than $100,000 annually, or employing less than 20 persons. He points out that there are some 10 million firms which would qualify for assistance and classification under such a "subsmall business" arm of SBA. These are the people Mr. Picchione feels the administration is overlooking. He said, "These people represent the backbone of the American economy—the independent businessmen and women struggling for survival."

NSOEA cannot help but feel that Mr. Picchione's proposal deserves a fair hearing. It will be presented again at some of NSOEA's 1962 district meetings. We hope you will do what you can to urge the Government to study and consider the Dome proposal—another step in the fight for legislation that will truly aid small businessmen.

J. J. S.

BEST AVAILABLE COPY

Illustration.—A stationer, unmarried, with net profit of $10,000 before deducting first year 20-percent bonus depreciation. During the year he purchased equipment costing $8,000.

	Present law	President Kennedy's plan	The Dome plan
Net profit before 20 percent bonus depreciation	$10,000	$10,000	$10,000
Less 20 percent bonus depreciation	1,600	1,600	8,000
Net profit after bonus depreciation	8,400	8,400	2,000
Standard deduction (10 percent)	840	840	200
Net income	7,560	7,560	1,800
Personal exemption	600	600	600
Net taxable income	6,960	6,960	1,200
Tax due	1,648	1,648	240
8 percent tax credit (8 percent of $8,000)	0	640	640
Tax liability	1,648	1,008	(1)

[1] None, plus a carry-forward tax credit of $400.

MINNEAPOLIS GAS CO.,
Minneapolis, Minn., April 17, 1962.

Hon. HARRY F. BYRD,
Senate Office Building,
Washington, D.C.

DEAR SENATOR: May I presume upon your time by writing you with reference to H.R. 10650 presently pending before the Senate Finance Committe which you have so long and ably presided over.

The American Gas Association through the manager of its Washington Office, Mr. Curtis Morris, has filed with your committee a statement with reference to this measure. Our company is in hearty accord with the position taken by the American Gas Association. May I add a few brief comments relative to the same matter.

First, the testimony of Secretary Dillon referred to in the American Gas Association communication would deny our consumers the benefits of this act. We believe that we should be treated in the same manner as the rest of industry. While I realize that discrimination by classes can be made in treating with tax laws, our overall economic situation should afford uniformity of treatment.

Second, Mr. Dillon's testimony implies that we are in a noncompetitive business. This is not correct. We compete actively with coal, oil, and electric companies. This is well set forth in the communication which you received from the American Gas Association.

Finally, the Minneapolis Gas Co. has no source of fuel within the geographic outlines of the State. We are attempting in all ways to improve the economy of our locality and our State, and we feel that the incentives offered in this bill should be made available to all segments of industry and commerce.

Cordially yours,

GERALD T. MULLIN, *President.*

NASSAU COUNTY DEPARTMENT OF FRANCHISES,
Mineola, N.Y., April 18, 1962.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Senate Office Building, Washington, D.C.

DEAR SENATOR BYRD: I contacted your committee for permission to testify at the current tax hearings and was informed that it was too late. I therefore am submitting this statement which I wish to have included with the testimony:

This office would like to be on record in support of H.R. 10650, particularly the tax credit provisions as they affect omnibus, transit, railroad, and other private carriers transporting passengers within the metropolitan areas.

I urge support for the following reasons:

(1) The urban transportation industry has been faced with a decline in patronage in recent years despite the fact that this industry may well contribute

toward the solution of traffic congestion problems in urban areas. A large part of this decline has been due to the difficulties faced by many such transportation companies to finance new equipment. At the same time it has been found that new buses, for example, generate new ridership and regain lost patronage. The 7 percent tax credit proposal for capital investment would therefore become a major factor in the improvement of the urban transportation industry.

(2) Application of the tax credit proviso to the transit industry would comply with some of the administration's recent proposals concerning urban transportation, specifically with the need to rehabilitate metropolitan passenger service. Any relief which the transit industry might now receive will ultimately reduce the amount of subsidies it ultimately will need to receive.

(3) Specifically in my county of Nassau, N.Y., several of the bus companies are forced to provide service with relatively outdated equipment. For example, 1 busline operating 14 routes with 20 buses has at present 1 bus of vintage 1960 in service, all others date from 1946 to 1952. My research indicates that this type of situation prevails in many suburban communities throughout the country. Any incentive to modernize would therefore play an important role in the rehabilitation of an important segment of the public services industry.

Respectfully submitted.

EDWARD J. MORRIS, *Director*.

(Whereupon, at 5:20 p.m., the committee was recessed, to reconvene at 10 a.m., Tuesday, April 10, 1962.)

[redacted]

REVENUE ACT OF 1962

TUESDAY, APRIL 10, 1962

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, D.C.

The committee met, pursuant to recess, at 10:15 a.m., in room 2221, New Senate Office Building, Senator Harry F. Byrd (chairman) presiding.

Present: Senators Byrd, Kerr, Smathers, Gore, Hartke, Williams, Carlson, and Morton.

Also present: Senator Hickenlooper of Iowa.

Elizabeth B. Springer, committee clerk; and Colin F. Stam and L. M. Woodworth, Joint Committee on Internal Revenue Taxation.

The CHAIRMAN. The committee will come to order.

We are honored to have as our first witness today Senator Norris Cotton, of New Hampshire. Senator won't you be seated and proceed with your statement.

STATEMENT OF SENATOR NORRIS COTTON, U.S. SENATOR FROM THE STATE OF NEW HAMPSHIRE

Senator COTTON. Mr. Chairman, I appreciate the opportunity to appear before your committee in opposition to section 19 of H.R. 10650.

This section, which provides for the withholding of 20 percent of interest and dividends is, in my opinion, not only impractical but borders on the verge of dishonesty. It could be called taxation by temporary theft.

It is impractical because it will be an administrative nightmare, not only for millions of taxpayers, but for banks, savings and loan associations, insurance companies, corporations, and for the Internal Revenue Service itself. The cost of administering this section will be stupendous. It has been estimated that over 500 million accounts will be affected.

It borders on dishonesty because, despite all attempted safeguards, it must result in massive overwithholding of income from millions of persons, widows, elderly retired people and others, who own little, or no, tax whatever but who will have to wait months for income which belongs to them and which they need badly for day-to-day living. What will they live on while awaiting their refund?

It discourages thrift because, when our people once experience the paperwork necessary to obtain their refund of taxes which they never really owe, they will be reluctant to deposit their funds in banks and other savings institutions.

But regardless of all these particular points, I am bitterly opposed to this step because it will further complicate and undermine the strength of our whole tax system by adding redtape, expense, and annoyance, and by attempting to substitute rigid enforcement in millions of minor items for honest and conscientious compliance by taxpayers. After all, the individual's conscience is the foundation stone of our tax system. Without it, there aren't enough enforcement officers or jails in the land to enforce collection.

The CHAIRMAN. Thank you very much, Senator Cotton.

The committee will come to order.

The first industry witness is Mr. Clarence L. Turner, Pennsylvania State Chamber of Commerce.

The next witness is Mr. Arthur B. Sinkler, the Hamilton Watch Co.

The next witness is Mr. Thomas Power of the National Restaurant Association.

The next witness is Mr. Frank G. Hathaway of the National Club Association.

The next witness is Mr. Robert E. Yaw of the Advertising Specialty National Association.

The next witness is Mr. Richard L. Hirshberg of the National Coal Association.

The next witness is Mr. Bert C. McCammon, Jr., assistant professor of marketing, graduate school of business, Indiana University.

Mr. McCammon, will you take a seat, sir, and proceed?

STATEMENT OF DR. BERT C. McCAMMON, JR., ASSISTANT PROFESSOR OF MARKETING, GRADUATE SCHOOL OF BUSINESS, INDIANA UNIVERSITY; ACCOMPANIED BY DR. ALBERT HARING, PROFESSOR OF MARKETING, GRADUATE SCHOOL OF BUSINESS, INDIANA UNIVERSITY, BLOOMINGTON, IND.

Mr. McCAMMON. Mr. Chairman and distinguished members of the Committee on Finance. My name is Bert C. McCammon, Jr., and I am an assistant professor of marketing in the graduate school of business at Indiana University.

My colleague, Prof. Albert Haring, one of the Nation's leading authorities on marketing, and I testify today on behalf of the Point-of-Purchase Advertising Institute, a nonprofit association that represents national advertisers, point-of-purchase display manufacturers, and other firms interested in display advertising.

During recent years, both Professor Haring and I have done considerable research in the field of sales promotion, and we firmly believe that the passage of section 274(b), H.R. 10650, in its present broad form could have an adverse effect on our economy.

Section 274(b) stipulates that donors cannot treat "business gifts" as tax deductible expenses when (1) the donee is an individual, and (2) the value of such gifts exceeds $25 per donee during the latter's taxable year.

Furthermore, section 274(b) defines "business gifts" as any item excludable from the gross income of the recipient.

After carefully analyzing section 274(b) and after reading published reports of previous testimony before this committee, Professor

Haring and I are convinced that the Treasury Department is interested in restricting or eliminating the practice of sellers giving their customers valuable personal gifts.

By declaring that expenditures for such gifts are not tax deductible, section 274(b) is designed to discourage sellers from giving their customers mink coats, deep freezers, cases of whisky, paid holidays, jewelry, and other goods and services that are intended for the personal consumption of the recipient and are not used by him in his normal business operation.

Thus, section 274(b) is designed to eliminate situations in which buyers and sellers can live in tax-free luxury. Unfortunately, section 274(b), in effect, defines "business gifts" as anything of value given by donors to individual donees.

This broad definition of "business gifts" could be interpreted to include all sales promotion devices and services given by manufacturers to their individual retail customers. These sales aids are used in the normal business operation of both the donor and the donee and are not intended for the personal consumption of either of them.

Thus, sales promotion devices and services are perfectly legitimate business aids that differ markedly from our normal understanding of personal gifts. However, as indicated, section 274(b) fails to clearly distinguish between these two types of goods and services.

If the section, as now phrased, is passed and if expenditures for sales promotion devices and services are subsequently classified as nondeductible expenses, the resulting decline in sales promotion activity would have an adverse effect on our economy and, in particular, on small businesses which cannot afford large advertising programs using paid media. A list of various promotions, devices and services appears on the remainder of page 2 and pages 3 and 4; the length of the list alone indicates the scope and variety of the types of promotional assistance offered to retailers by manufacturers.

Each year manufacturers give retailers a sizable number of sales promotion devices including:

(1) Temporary point-of-purchase displays for use in retail stores (banners, pennants, product spotters, counter displays, shelf-talkers, etc.);

(2) Semipermanent and permanent point-of-purchase displays for use in retail stores (illuminated signs, clocks, wire racks, wooden fixtures, etc.). Exhibit I contains a comprehensive list of the type of point-of-purchase displays given to retailers;

(3) Advertising literature to be mailed to consumers (statement enclosures, pamphlets, new-customer letters, lost-customer letters, etc.);

(4) Newspaper matrices and radio and television commercials for use in retail advertising programs;

(5) Advertising films for use in theaters and on television;

(6) Catalogs and other published material for use in retail stores;

(7) Inventory and financial control forms; and

(8) Dealer identification signs.

Also manufacturer personnel:

(1) Prepare and conduct retail direct mail campaigns;

(2) Train retail sales personnel;

(3) Develop and maintain basic and model stock plans for retailers;

(4) Train retail service personnel;

(5) Premark merchandise and attach retail brand identification when requested;

(6) Maintain unit control records for retailers;

(7) Stock retail shelves with merchandise and erect retail displays;

(8) Develop and install retail accounting systems;

(9) Provide management consulting assistance, including specialized advice on store layout, retail advertising, and personnel relations; and

(10) Conduct product demonstrations in retail stores and at consumer shows.

(The exhibit I referred to follows:)

EXHIBIT I. TYPES OF POINT-OF-PURCHASE DISPLAYS

Can and bottle toppers.
Related item displays for counters, floors, and window.
Deep-etched glass signs for counter, backbar, wall (illuminated and non-illuminated).
Transparent plastic self-sticking signs, counter, wall, window, shelf, door.
Decals for counter, wall, window, shelf, door.
Shadow-box displays.
Racks of wood, metal, wire, for counter, floor, wall.
Rubber ad mats for floor and counter.
Moving letter displays.
Display baskets for counter.
Display cartons for counter and floor.
Display shipping cartons.
Merchandiser displays for window, counter, and floor.
Mobiles.
Plaques.
Wall posters.
Fabric banners for window and wall.
Illusion displays (projector displays).
Exhibition displays.
Wallboards.
Self-selector displays for wall, floor, counter.
Window banners and streamers.
Over-wire banners.
Easel-back cards for floor, end display, windows.
Tuck-in cards for floor and end display.
Self-adhesive strip displays for gondola and shelf molding.
Self-adhesive tape displays.
Light-cord displays.
Displays at checkout counter.
Window cutouts.
Floor cutouts.
Magazine ad reprints.
Plastic molded signs for wall, window, counter.
Blowup of product.
Sound displays.
Demonstrator displays.
Lighted signs of all materials for window, wall, counter.
Three-dimensional displays of all materials for window, counter, floor.
Departmentalizing display.
Change tray display.
Changing scene display.
Self-adhesive footprints and arrows on floor and wall.
Mechanical book display.
Mechanical mannequin display.
Molded ceramic figurines of trademark or character.
Displays using fluorescent papers and inks.
Flasher displays for counter, window, and floor.

Heat rotor displays for windows, bars, restaurant tables, and counters.
Mirror displays for windows, backbars (usually lighted and moving).
Large itinerant displays for counter, window, and floor.
Clock displays.
Turntable displays for counter, window, and floor.
Indoor electric signs.
Supermarket basket displays.
Shelf toppers.
Backbar menu signs.
Enameled signs for wall and window.
Cash register signs of many materials.
Dioramas for walls and windows.

Source: Merchandising Executives Club, New York City.

Mr. McCAMMON. In many cases, the cumulative value of these promotional devices and services exceeds $25 per retailer, the limit specified in section 274(b). Thus, a high percentage of the manufacturer's promotional expenses will be nondeductible if section 274(b) is broadly interpreted to include promotional materials and services.

All of the sales promotion devices and services cited above are employed in normal business operation; none are intended to be used for personal consumption purposes.

Manufacturers offer promotional assistance to retailers in order to obtain adequate merchandising support at the local level.

Retailers accept such assistance because it increases their sales and/or reduces their expenses and thus contributes to greater operating efficiency. Consequently, sales promotion is an integral and important part of the marketing process.

In conjunction with advertising and personal selling, it increases the level of consumption and reduces retail prices in our society.

Contrary to popular opinion, manufacturers spend a sizable amount annually on sales promotion programs. Mr. Sidney Dea, director of marketing services for McCann Erickson, Inc., estimates that national advertisers spend nearly twice as much on sales promotion programs as they do on their national advertising campaigns;[1] and Mr. Richard Hodgson, former executive editor of Advertising Requirements, contends $6 billion is spent annually for promotional materials.[2]

Expenditures for point-of-purchase displays represent an important part of this total outlay. The Point-of-Purchase Advertising Institute, using a restrictive definition, estimates that manufacturers spent approximately $480 million on point-of-purchase displays in 1961.

Printers' Ink magazine, using a broader definition of point-of-purchase display materials, estimates that over $1.5 billion is spent annually on this medium.[3]

These are bona fide business expenses that should be deductible for tax purposes like any other legitimate out-of-pocket outlay.

Section 274(b) specifies that manufacturer expenditures for "business gifts" above $25 per year are not tax deductible when the recipient is an individual, but are deductible when the recipient is a corporation.

Furthermore, section 274(b) defines the term "business gift" so broadly that it could include sales promotion devices and services.

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[1] Alfred Gross, "Sales Promotion" (2d edition), the Ronald Press Co., New York, 1961, p. 16.
[2] Dick Hodgson, "Sales Promotion Comes of Age," Advertising Requirements, June 1959.
[3] "New Era in Point-of-Purchase," Printers' Ink, Oct. 10, 1958.

This creates a paradoxical situation; manufacturers could provide unlimited amounts of promotional assistance to corporate retailers and deduct for tax purposes all of the expenses incurred. In sharp contrast, promotional expenditures incurred on behalf of sole proprietorships and partnerships are basically nondeductible.

Most retail enterprises in the United States are relatively small firms organized as sole proprietorships or partnerships and thus are treated as individuals for tax and other purposes.

The U.S. Census of Business, 1958, indicates that 1,499,523 retail establishments or 83.8 percent of all such establishments are operated as sole proprietorships or partnerships.

These enterprises generate annual sales of approximately $91.9 billion or 45.6 percent of total retail sales and represent the bulk of small business firms in our economy.[4]

The small retailer lacks the resources to employ specialists in his organization and thus he must rely on manufacturers for promotional and merchandising assistance. Without such assistance, small independent merchants would be severely handicapped in competing against larger corporate retailers.

Manufacturers, of course, provide small retailers with promotional and merchandising assistance since this activity insures them that their products will be effectively marketed at the local level.

Section 274(b), in effect, discourages the continuation of this close relationship between manufacturers and small retailers. Manufacturers, basically unable to deduct their sales promotion expenses for tax purposes, would undoubtedly reallocate their marketing dollars. In the process, the small retailer would be denied the assistance he needs to compete against larger rivals.

Professor Haring and I recommend that section 274(b) be rewritten so that bona fide sales promotion expenses are fully deductible for tax purposes.

This can be accomplished by redefining the term "business gift." In defining a "business gift" as any item excludable from the gross income of the recipient, as done in section 274(b), the Treasury Department is clearly attempting to prohibit the diversion of existing profits to nontaxable use.

The promotional devices and services furnished to retailers by their suppliers are provided with the expectation that the taxable profits of both supplier and retailer will be increased rather than decreased.

Consequently, Professor Haring and I recommend strongly that the definition of a "business gift" in section 274(b) of H.R. 10650 be modified so that it shall not include the promotional materials, services, or devices commonly provided by suppliers (donors) without charge to trade customers (donees) for use in the latters' normal business operation.

Other possible economic consequences of section 274(b) are discussed in greater detail on the following pages.

If section 274(b) is passed and if the broad interpretation of "business gifts" is retained, manufacturers' sales promotion expenditures will decline. This could have the following adverse effects on our economy:

[4] "U.S. Census of Business: 1958, Retail Trade," vol. I, Bureau of the Census, Department of Commerce, Washington, D.C.

1. THE TREND TOWARD SELF-SERVICE RETAILING COULD BE IMPEDED, PERHAPS REVERSED

Self-service retailing is a proven method of reducing operating expenses and consumer prices.

In all self-service stores, point-of-purchase displays and other promotional devices serve as substitutes for sales personnel. This substitution of impersonal for personal selling methods enables retailers to offer better values to consumers.

During the last decade an increasing number of retailers have converted their operations to self-service. Supermarkets, the originators of the self-service concept, currently account for approximately 72 percent of all foodstore sales.[5]

Also, 60 percent of all drug and variety stores now operate on a self-service basis; and self-service discount department stores, the newest form of retailing to emerge, generate an aggregate sales volume equal to 6 percent of total general merchandise sales.[6]

All of these establishments operate on a lower gross margin percentage than conventional full-service retailers; in many cases customers save as much as 15 percent by patronizing self-service instead of full-service stores.

The self-service discount department store, as an illustration, operates on a gross margin of between 20 and 25 percent as compared to the conventional department store's gross margin of approximately 36 percent.[7] This sizable difference in gross margin percentages also prevails in other lines of retail trade.

Since section 274(b) effectively restricts the use of promotional materials, it could impede or perhaps reverse the growing trend toward self-service retailing.

The operators of self-service stores rely on point-of-purchase displays and other promotional devices to stimulate customer purchases, to circulate customer traffic throughout the store, to provide customers with product information, and to perform other necessary functions. Without such sales aids, the concept of self-service becomes unworkable; and retailers would probably begin to use more and more sales personnel. This would inevitably result in increased operating expenses and higher consumer prices.

2. RETAIL EFFICIENCY AND PROFITS COULD BE REDUCED SUBSTANTIALLY

Retailers have a high ratio of fixed-to-variable expenses. Professor Holdren, for example, estimates that 90 percent of the average supermarket's expenses are fixed,[8] and similar ratios of fixed-to-variable expenses exist in other lines of retail trade.

Because of this relationship, the average retailer can substantially reduce per unit costs if he increases his sales. Since retailing is an intensely competitive industry, these economies are inevitably passed on to consumers in the form of lower prices.

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[5] "Facts in Grocery Distribution," 1961 edition, Progressive Grocer, New York, 1961.

[6] Schuyler F. Otteson and Bert C. McCammon, Jr., "Changes in Retail and Wholesale Markets," to be published in the proceedings of the Paul D. Converse Awards symposium, University of Illinois, Champaign, Ill., 1962.

[7] Same as footnote 6.

[8] Bob R. Holdren, "The Structure of a Retail Market and the Market Behavior of Retail Units," Prentice-Hall, Inc., Englewood Cliffs, N.J., 1960, p. 40.

The findings of impartial research studies undertaken by the U.S. Department of Agriculture, Cornell University, Indiana University, Progressive Grocer magazine, and the Point-of-Purchase Advertising Institute clearly indicate that point-of-purchase displays and other promotional devices dramatically increase retail sales and thus reduce per unit costs.

The definitive Dillon study, as an illustration, reports that "an average grocery item on special display sells 652 percent better than from normal shelf position." [9]

Other studies indicate that special displays can substantially increase the sales of such diverse products as toys, cosmetics, paint rollers, sportswear, toiletries, and work clothes.[10]

Currently, most of the point-of-purchase displays and other promotional devices used are provided by manufacturers, and retailers rely heavily on such assistance to maintain sales and to reduce per unit costs. The withdrawal of this assistance could substantially reduce retail efficiency and profits.

If manufacturers are forced to reduce their promotional expenditures as a result of the passage of section 274(b), retailers will be forced to develop their own promotional materials or do without. In either case, retail efficiency and profits could suffer.

Today, manufacturers design and produce promotional materials because they can perform this function at a lower per unit cost than can retailers.

By placing orders for thousands of promotional pieces, manufacturers can employ specialized resources and can obtain the cost savings inherent in long production runs.

These two factors enable them to design and produce better promotional material more economically than would be the case if retailers performed this function.

Thus the passage of section 274(b) could result in reduced sales and higher costs at the retail level.

3. MANUFACTURER'S MARKETING PROGRAMS WOULD PROBABLY BE LESS EFFECTIVE AND MORE COSTLY

All medium-size and large manufacturing firms have sales and advertising departments. Also, most have a sales promotion department. Sales promotion personnel, in addition to many other duties, develop programs for wholesalers and retailers to insure that the manufacturer's product line is adequately promoted and merchandised in the field.

Without such supporting activity, both advertising and field selling would be relatively ineffective.

If section 274(b) is passed, many manufacturers will reduce promotional activity and/or eliminate the sales promotion department.

However, the dollars saved will be illusory, since both selling and advertising costs will have to be increased substantially to offset the loss of effective promotional programs.

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[9] George E. Kline, "How To Build More Profits Into Your Special Display Program," Progressive Grocer, January 1960, p. 1.

[10] See series of Fact Reports published by Point of Purchase Advertising Institute, Inc. New York.

4. CONSUMER PURCHASING COULD DECLINE BECAUSE FEWER NEW PRODUCTS WOULD BE BOUGHT AND OLD PRODUCTS WOULD BE REPLACED LESS FREQUENTLY.

A high percentage of consumer purchases are discretionary and postponable. During recent years per capita income has increased rapidly and consumers have more spending power today than ever before.

If our economy is to expand, consumers must allocate a high percentage of this newly acquired income to consumption. A reduction in consumption below previous rates will create unemployment and below-capacity operations.

Thus, manufacturers must develop an array of exciting new products, and retailers must merchandise these products creatively to maintain an expanding economy.

Point-of-purchase displays and other promotional devices are particularly effective in encouraging housewives to try new products and to make discretionary and postponable purchases.

The Du Pont studies, for example, indicate that housewives in supermarkets make 50.9 percent of their purchase decisions after they enter the store,[11] and approximately 16 percent of all purchase decisions in drugstores are made after customers arrive.[12]

A high percentage of these purchases are made because new products are attractively displayed and new ideas are compellingly presented. Without this in-store excitement, many purchases would probably not be made and the rate of consumption would decline.

Thus, section 274(b) which could restrict the use of promotional materials could have a substantial impact on our economy.

The CHAIRMAN. Thank you.

The next witness is Richard H. Dickson, Jr., of the Indiana Wire & Specialty Co.

The Chair would like to explain to those who were absent when their names were called, I am going through the list and then we will start again at the top.

We are glad to have you.

STATEMENT OF RICHARD H. DICKSON, JR., PRESIDENT, INDIANA WIRE & SPECIALTY CO., INC., INDIANAPOLIS, IND.

Mr. DICKSON. Mr. Chairman and distinguished members of this committee, my name is Richard H. Dickson, Jr., and I am president of Indiana Wire & Specialty Co., Inc. I am also chairman of the board of directors of the Point of Purchase Advertising Institute, in which capacity I serve without pay.

I am appearing before this committee only as president of Indiana Wire & Specialty Co., Inc., and at that company's expense.

I am doing so because in the judgment of my company's counsel, the inclusive definition of the term "gifts" in subparagraph (b): Gifts, section 274 of the proposed legislation H.R. 10650, Revenue Act of 1962, constitutes a potential threat to the existence of our business.

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[11] "Sixth Du Pont Consumer Buying Habits Study," E. I. du Pont de Nemours & Co., January 1960.

[12] Research finding of study in progress undertaken by one of the authors and sponsored by the Point-of-Purchase Advertising Institute, Inc.

My company has 96 employees and is one of the largest of several hundred small businesses engaged in performing a highly specialized and vital function in the distributive process.

We design and manufacture point-of-purchase advertising displays which are used in stores to increase the sale of consumer products.

This is accomplished because the displays provide a convenient means to place the merchandise in a better location where it will be exposed to more customers and also because the displays are carefully designed to show the product in an attractive and accessible manner.

As in the case of various kinds of signs and display made from other materials such as cardboard, metal, plastic, or wood, our products are used in connection with the general practice known as sales-promotion activities.

Although our products are eventually used in some kind of store, we sell them to the manufacturers of various consumer's goods who then offer them to the various stores in which their products are sold.

Gentlemen, I will give you two examples to illustrate this transaction. We sell displays to the Coca-Cola Co. which in turn gives them to oil service stations which, as a matter of fact, are likely to be individual donees, 9 times out of 10, because of franchise arrangements with major oil companies.

We sell displays to Eastman Kodak Co., who give them to supermarkets, drugstores, department stores, photographic stores, and so forth, which may be either corporate or individual donees. When a display is used, both the manufacturer of the product and the store benefit through increased sales to the consumer. This has been amply demonstrated by a vast amount of research.

These photographs will perhaps be helpful in establishing the kind of product made by my company.

(The photographs referred to were made a part of the committee files.)

Mr. DICKSON. Historically advertising displays have always been given to the retailer by the advertiser. In this respect, point-of-purchase displays are no different from any other form of advertising which is paid for by the manufacturer and produces benefits for both the manufacturer and retailer in the form of increased sales. They are simply a form of advertising used right in the store.

My concern is that this time honored and established practice on the part of manufacturers of consumers goods of giving point-of-purchase displays to their customers, the stores, can cause these displays to be construed as nondeductible to the manufacturer due to the broad and inclusive language of "Subparagraph (b): Gifts."

I am advised by counsel that displays given to the store constitute gifts as presently defined in the proposed statute. This definition would apply to more than 90 percent of all products manufactured by my company and hundreds of others engaged in similar activities.

The consequence of this interpretation would be to put my company out of business. The reason is that an insuperable burden of recordkeeping and legal restrictions would be placed upon our customers, the manufacturers of consumer's goods.

As presently written the act places a limitation of $25 on the value of gifts made to an individual or partnership, which can be deducted from the donor's income in any one year.

It should be noted that while this language does not apply to donees who are incorporated, its practical application does.

The reason is that the Robinson-Patman Act restrains manufacturers from preferring one retailer as against another with respect to special concessions.

Therefore, any manufacturer who elected to give displays only to incorporated retailers would immediately find himself in violation of the act.

If a manufacturer elected to give displays to incorporated stores on a deductible basis and to unincorporated stores on a nondeductible basis, he would be confronted with the burden of investigation and recordkeeping, which in itself, would be sufficient to dissuade him from using any displays.

It is true that the majority of displays cost substantially less than $25 but this provides no relief from the language as presently drawn. Many large advertisers give away several displays during the course of the year and the definition of the term "gifts" is so broad as to also include other forms of sales promotion activities, such as contest, merchandising plans, free sampling, and so forth.

The advertiser's problem of keeping track of accumulative annual cost of all such varied materials given to each and every one of these retail outlets would be an insurmountable one.

It is not my purpose to plead the case for other forms of sales promotion, except as it relates to my own company's problem.

I do think the committee should realize, however, that discontinuance of these activities would have a drastic adverse effect upon the effectiveness of the overall sales effort with a consequent reduction in employment due to lower consumption. Product does not find its way automatically into the hands of the consumer. It must be sold.

I hold no quarrel with the intent to eliminate the practice of influencing customers by means of lavish gifts. Our company does not and has not condoned this method of selling.

As a matter of fact, I believe the practice is definitely on the wane. More and more companies have instituted policies forbidding their employees to accept or their suppliers to give such gifts.

I cannot help but question, however, whether the Treasury Department can possibly enforce this section of the act, assuming that it applied only to personal gifts, without incurring expense completely out of all proportion to the possible revenue to be realized.

It seems to me that a function so vital to the economy as a whole as sales promotion activity deserves to be specifically exempted from the provisions of subparagrph (b) so that the intent of Congress shall be absolutely clear. As a matter of fact, all other subparagraphs of section 274 are much more specific than subparagraph (b).

In his testimony before this committee, April 2, Treasury Secretary Dillon is preported to have opposed the basis provided by the House of Representatives for separating expenses directly related to the actual conduct of business from those of a personal nature as "a vaguely defined line" that will generate "considerable controversy and litigation."

What I am asking here is that the language of subpargraph (b) be clarified for the precise purpose of avoiding this same "controversy and litigation."

This is all the more necessary in view of "Subparagraph (g): Regulatory Authority," which stipulates that the Secretary shall prescribe such regulations as he may deem necessary to carry out the purposes of this section.

It is my fear that regardless of the present intent of this legislation, regulations may be issued at some future date which, perhaps inadvertently, may cause point-of-purchase displays to be considered as gifts.

This would produce the whole chain of events whereby our customers, the manufacturers, would find themselves confronted with the hopeless task of determining the corporate status of each of their customers so as to comply with this act and the Robinson-Patman Act and then maintaining records to show the exact total value of all sales promotion material given to each store in any one year.

The inevitable consequence would be that sales promotion activities would simply be abandoned as too costly. Small companies, such as my own, lack the resources to fight such a regulation in the tax courts.

In addition, we would find ourselves in the peculiar position in which the regulation affected us only indirectly through our customers who are in the main, large corporations. The results would surely be an end to my company and the many similar small concerns which make up our industry.

With all the foregoing in mind, I therefore earnestly recommend that this committee amend the language of this act by inserting the following under "(2) Special rules":

> For purposes of paragraph (1) advertising and promotional materials made available to retailers or wholesalers for the direct business benefit of both donor and donee shall be excluded.

Thank you.

The CHAIRMAN. Thank you very much, Mr. Dickson.

My great friend and very distinguished Senator is here to present the next witness.

The Chair recognizes Senator Hickenlooper.

Senator HICKENLOOPER. Mr. Chairman, I want to thank you for your courtesy and to make a very abject apology to you this morning. The man I want to introduce to you as the next witness is an old and valued friend of mine from my hometown, and that is a part of my interest in his testimony here this morning. He was about fifth on the list of witnesses, and I told him that I would be honored to come down and present him to you this morning and asked him to come to my office.

He did come to my office and was in my office at my request and so if there is any delay in his appearing here it is completely my fault and I, therefore, apologize but I appreciate your indulgence.

I do want to present to you and to the committee, Mr. Chairman, Robert E. Yaw, who represents today all the advertising specialty industry.

Mr. Yaw is the head of an old specialty advertising company in my home city of Cedar Rapids, which has been in existence as a successful advertising specialty company of some considerable size for approximately 50 years.

I have been thoroughly acquainted with this institution for 40 years myself.

I can only commend his integrity and his zeal and his business ability to you in connection with the testimony which he will give to you.

Again, I want to thank you in presenting Mr. Robert Yaw.

The CHAIRMAN. You are always very welcome, Senator, to the meetings of the committee.

Senator HICKENLOOPER. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Yaw, will you take a seat, sir, and proceed.

STATEMENT OF ROBERT E. YAW, PRESIDENT, SOUVENIR PEN & PENCIL CO., CEDAR RAPIDS, IOWA, ON BEHALF OF THE SPECIALTY ADVERTISING INDUSTRY

Mr. YAW. I am indebted to you, Senator Hickenlooper, for your presentation and so is our industry.

Mr. Chairman and gentlemen of the committee, I am Robert E. Yaw, president of Souvenir Pen & Pencil Co., a producer of advertising pens and pencils in Cedar Rapids, Iowa.

Today I am here to speak not only for myself as a small businessman, but also because I have been selected as spokesman for the specialty advertising industry, specifically on behalf of the Advertising Specialty Guild International and the Advertising Specialty National Association, the two trade associations of our industry.

Even more specifically I am here to speak for more than 350,000 people who make their livelihood in our industry and an even larger number of small and large businesses throughout our country who need and use our advertising in the conduct of their business.

I believe you have before you a list of some of these manufacturers and distributors of specialty advertising businesses located in your home State. All these, along with the others I have mentioned, will be measurably and unjustifiably hurt by a portion of the legislation on which this hearing is being held.

I refer to section 4(a) of H.R. 10650.

I would like to explain why our industry will be inequitably affected by this section of the proposed legislation, and specifically how a 14-word change in wording will, not only remove the inequity, but will do so without removing the real evils you are commendably trying to correct and without any loss of the revenue you are trying to gain.

It is my hope today to clarify the matter and to propose a correction that will avoid the economic injustice without in any way diluting the true intent of the bill.

Frankly, we do not believe it was ever the intent of the sponsors of this legislation to hurt specialty advertising, nor any other forms of advertising. We fear this is happening rather by misunderstanding.

The misunderstanding I refer to lies in that portion of the bill wherein gifts and specialty advertising are considered to be one and the same. The truth is, they are not at all the same, nor comparable.

Here's why:

Gifts, so far as this legislation is concerned, are understood to be, in a sense, "payola"—gifts of considerable value, designed to influence the recipient by their very value, and the obligation under which their acceptance places the recipient. We are opposed to this ill-advised practice as I believe all Americans are.

The present controls the bill places on this gift practice should effectively eliminate this objectionable problem.

At this point, gentleman, we want to state that specialty advertising never has been accused, by anyone familiar with it, as being in any way related to gifts.

Specialty advertising is just what its name implies—a specialized way of getting an advertiser's message to his prospects. It is one of many advertising media widely used by all forms of business in America.

Specialty advertising is not a gift—it has no intrinsic value for the simple reason that nothing carrying a prominently imprinted advertising message can possibly have a resale value.

Our form of advertising uses items familiar to all of you on which advertising messages are prominently imprinted in order to carry them to the desk, pocket, or home of the advertiser's prospect.

The item used is merely a carrier of the advertisement, just as radio, TV, magazines, and newspapers carry advertisers' messages.

I refer to advertising items such as ash trays, monthly calendar cards, yardsticks, matchbooks, pencils, almanacs, ball pens, calendars, I have many of them here, which are typical examples of our form of advertising. They are truly miniature billboards that place advertising on your office wall, in your pocket, in your home. They are in no sense gifts intended to influence you by their value—they hope only to impress you with their message.

A gift carries no advertising imprint, it is a gift. Advertising is advertising. Its name should not be blackened by unintentionally associating it with "payola" and influence peddling. We are as opposed to these as you are.

Let me put specialty advertising even closer to your understanding. I am sure each of you, at campaign time, use bumper signs, windshield stickers, badges, pencils, ball pens, and many other forms of advertising to carry your message to the voters. You never think of any of these as buying votes with gifts. Neither do those to whom you distribute your message in these ways.

That they have no retail value whatsoever is well known to you, if ever you tried to sell what you had left over after election time. They are then useless to you—or to anyone. They had served their advertising purpose, and that was the only purpose you ever intended.

If specialty advertising is not specifically excluded from section 4(a) of H.R. 10650, simple equity will not be done. Instead inequity will be legislated because specialty advertising is merely one form of advertising, and it will be taxed while no other form of advertising is taxed.

Our industry cannot survive under such handicap.

Thousands of people making their livelihood from our form of advertising will be legislated out of employment. We do not believe that is your desire.

Added to the injustice of condemning our form of advertising by associating it with gift influence, is that part of this legislation which would adversely affect not only our industry but every small and large business in America. This would come about because classifying us with gifts would require every businessman to keep an audit of each of his business prospects and the amount of advertising used on each.

He would have to do this in order to prove that he did or did not exceed the limitation.

I don't believe I need spell out the economic impossiblity of such recordkeeping for small and large business nor the near impossible policing of such a system by the Internal Revenue Service. It would be as if each of you had to keep a record of the value of advertising given each of the voters in your campaign.

The simple solution to justice and equity in this problem, gentlemen, may be done by a very minor amendment to section 4(a) of H.R. 10650 as follows:

Page 26, line 6: Change the period after the word "chapter" to a comma, and thereafter add the following:

but does not include any specialty advertising item which carries a clearly imprinted advertisement.

A copy of this statement, plus a separate copy of this suggested amendment to the bill is before you. It is submitted for the record.

On behalf of my industry and the thousands of Americans dependent upon it. I thank you for this opportunity to lay our request before you. We are dependent upon you to see that we may continue as a vital segment of that part of our country's economic fiber called small business.

We are confident you gentlemen will agree that justice and equity cannot be served by legislating against one form of advertising and not against others.

Justice and equity can be served by the amendment we propose or by any improvement of the language on which your committee decides. For your support of this proposal, I thank you.

(The proposed amendment referred to follows:)

PROPOSED SENATE FINANCE COMMITTEE AMENDMENT TO H.R. 10651[1]

Page 29, line 6: Change the period after the word "chapter" to a comma, and thereafter add the following: "but does not include any specialty advertising item which carries a clearly imprinted advertisement."

The CHAIRMAN. Thank you very much, Mr. Yaw, you have made a very impressive statement and the Chair will see that the amendment is considered in executive session by the committee.

Mr. YAW. Thank you, sir.

The CHAIRMAN. Thank you.

The next witness is Mr. Leo P. Roth of the National Licensed Beverage Association.

Proceed, Mr. Roth.

STATEMENT OF LEO P. ROTH, FORMER PRESIDENT OF THE NATIONAL LICENSED BEVERAGE ASSOCIATION

Mr. ROTH. Thank you, Mr. Chairman. My name is Leo P. Roth. I am a small businessman, a restaurant and tavern operator in Minneapolis, Minn. I appear here today as spokesman for the National Licensed Beverage Association, a trade association composed of ap-

[1] The purpose of the proposed amendment is to insure that advertising items such as calendars, key cases, pens and pencils, ash trays, thermometers, memo pads, and other similar articles imprinted with the name of an advertiser and distributed by him without condition of sale to prospects and customers, will continue to be classified as "ordinary and necessary" advertising expense within the meaning of secs. 162 and 212.

proximately 40,000 restaurant and tavern owners located in 28 States and the District of Columbia.

This association selected me to come to Washington to voice their most vigorous protest against two of the features of the 1962 revenue bill which most vitally affect their business, their own personal welfare and the welfare of their employees.

Many of these 40,000 men and women, I am sure, would gladly come to Washington to tell this committee their own views, in their own way, if they could bear the expense and spare the time.

All of our members are small businessmen. Because of the large number of members of our association, it is difficult to describe the various types of operations in which they are engaged.

Some of them place great emphasis on providing entertainment for their patrons and guests, while others do not. A great number of our members cater to private parties sponsored by business concerns as goodwill entertaining.

And that's one of the reasons I am here, fully aware of the big responsibility imposed on me to explain the problems and the fears of our members over several features of the new tax bill and to pass along their united appeal for help.

As a vital force in America's business life and also as loyal, patriotic American citizens, we are in full agreement with those who advocate the removal of tax inequities and opportunities for tax evasion.

But we do not believe that the end justifies the means or that there has been shown any need to jeopardize or cripple our businesses in order to remove tax inequities or to end evasion.

Section 4 as it now stands admittedly would seriously curtail, if not eliminate, bona fide goodwill entertaining. When businessmen fear that money spent on entertaining to promote goodwill cannot be deducted, they will refrain from making such expenditures with the result that our members and their employees will be the first to suffer.

It should be kept clearly in mind that when we talk of the employees of the 40,000 members of NLBA, we are referring to hundreds of thousands of workers, many of whose jobs are being put in the balance by the provisions of this bill.

Goodwill entertaining by its very nature does not generally consist of business discussions. The business that has traditionally evolved from goodwill entertaining has been incidental, but it has been definitely linked with such entertainment since the dawn of trading.

Is that what Congress wants to destroy? Does it want to make it more difficult for a businessman to make the contracts that will keep him in business?

Does it want to curtail the restaurant business and destroy the jobs of hundreds of thousands of the men and women whose livelihood depend on work in our restaurants?

The 40,000 restaurant and tavern operators for whom I speak do not believe that Congress, or the American people, want to punish the multitude of honest people for the sins of a few.

Get tough with the cheaters by all means, but please don't kill the dog to catch the flea.

We love our dogs, and our experience has been if we kill them in order to catch the flea, we might find that although we have killed our dog, the flea has survived.

We understand that the Treasury Department is looking for easier ways of doing its work of audit and investigation and, while we can sympathize with their objectives, we can't find the justification for them. This approach reminds me of the story of the investigative code of a western police officer in 1872, who described it as follows:

There is a great deal of laziness in it; it is far pleasanter to sit comfortably in the shade, rubbing red pepper into a poor devil's eyes than to go about in the sun hunting up evidence.

I hold in my hand a printed document showing that the Department of State has asked for money to promote good will for the United States in its activities abroad.

I refer particularly to testimony by a representative of the State Department in a hearing before the subcommittee of the Committee on Appropriations of the House of Representatives, 87th Congress, which reads:

The representation we are asking for is very similar to the expense-type claims that American business pays its representatives and salesmen. The same type of activity is carried on by American business.

It is obvious that the State Department was asking for money to be spent on promoting good will for the United States and that such expenditures are in no way different from those incurred by American businessmen for the promotion of good will for their businesses.

I now refer to section 3. The bill recognizes the right of legislators to be informed and the right of business people to make their views known to legislators.

However, it would deny the deductibility of expenditures in conveying this same information to voters in a referendum measure where they are exercising a legislative function and where they should be entitled to the same information.

In reality, this section involves our right to speak out to inform the public of our position on matters at issue in public referendums. I think someone already has described this section as "censorship by taxation," and that is the way it looks to us.

This "censorship by taxation" hits the operators of the food and beverage business directly in the solar plexus whenever a local option election is called in any area of those States which provide for such referendums on an issue involving the sale of alcoholic beverages.

We have to defend ourselves—defend our business—against such moves.

The most effective way to combat those who seek to destroy our business is through informing the voters of the facts involved—and the best medium we have found to inform the voters is through advertising.

Advertising costs money—lots of money—and yet under section 3 we are allowed no tax deduction whatever for the cost of these informational programs.

We cannot inform the public of our position or the economic value of our business to the public without paying the full cost of the advertising program. There is no tax credit for the cost of such defense.

The tax bill before you recognizes, as shown by the House Ways and Means Committee report, that—

it is * * * desirable that taxpayers who have information bearing on the impact of present laws, or proposed legislation, on their trades or businesses not be discouraged in making information available to Members of Congress or legislators at other levels of government.

Yet, when the public, through initiative and referendum procedures, vote on specific proposals, the voters are to be denied the "information * * * necessary to a proper evaluation on their part of the impact of present or proposed legislation."

The complete lack of logic shown in this situation is matched by the rank injustice to a business which may depend for its very existence on the voters' determination in a referendum.

We are grateful to the committee for the courtesy and attention with which our presentation has been heard. We have full confidence that the explanations we have offered on two sections of the bill which vitally affect our members and their employees will be considered carefully by the committee.

Thank you.

The CHAIRMAN. Thank you very much, Mr. Roth. You have made a very interesting statement.

The next witness is Mr. William W. Mee, the Point-of-Purchase Advertising Institute.

Mr. MEE. Thank you, Mr. Chairman.

The CHAIRMAN. Take a seat, sir, and proceed.

STATEMENT OF WILLIAM W. MEE, EXECUTIVE DIRECTOR, POINT-OF-PURCHASE ADVERTISING INSTITUTE, NEW YORK, N.Y.

Mr. MEE. My name is William W. Mee. I reside on Pine Hill Drive in Huntington, N.Y. I am executive director of the Point-of-Purchase Advertising Institute, with offices at 11 West 42d Street, New York, N.Y.

The Point-of-Purchase Advertising Institute is a national media association representing 215 producers of signs and displays. These companies account for approximately 60 percent of the estimated $480 million expended for point-of-purchase materials annually.

I attach, hereto, marked "Attachment A," a list of its members. I have also attached, marked "Attachment B," a list of its officers and directors.

On behalf of the 215 producer-supplier members of this institute, the bulk of which represent small business, unionized companies, unable to maintain representation in Washington, I respectfully request that the members of this committee thoughtfully review the language contained in H.R. 10650 under section 274, "Disallowance of Certain Entertainment, Etc., Expenses," page 28; subsection B, "Gifts"; and under subsection G on page 33, "Regulatory Authority."

Our industry submits that the language in both these subsections is unnecessarily broad and general in nature.

We believe the language in its present form is possible of interpretation which might include advertising and sales promotion material customarily made available either without charge or on a cooperative basis to retailers by manufacturers of consumer goods for business purposes, exclusively.

Point-of-purchase advertising materials are those advertising signs and displays made available to retailers by their suppliers, the national and regional advertisers.

Examples of these materials would include a metal or plastic outdoor sign attached to a retail outlet; a lithographed or silk-screened banner or display for in-store use; a wire, metal, or wood merchandising unit for counter or floor use.

A more complete range of these materials are shown in our 1961 merchandising award hall of fame brochure, a copy of which is attached, marked "Attachment C."

(Pamphlet referred to as attachment C was made a part of the committee files.)

Basically, these materials are designed to:

(*a*) Catch the attention of passerby traffic.

(*b*) Register advertising messages for the products of the supplying company.

(*c*) Build traffic for the retailer.

(*d*) Assist the retailer in directing in-store traffic.

(*e*) Assist the retailer in actually selling merchandise.

As seen from the illustrations in attachment C, these materials are designed to attract the attention of the consumer when he or she is in or near a retail outlet and to register advertising messages—to identify, in the case of signs, an outlet as a location where the consumer can secure a nationally or regionally advertised product.

Inside the store, signs and displays are utilized to attract the attention of the consumer and to prompt her, either through impulse or reminder, to make a purchase which she might otherwise have forgotten or not made.

As we view these materials, we see them as advertising exclusively, without intrinsic value to the retailer—and of business value only.

But, because of the broad nature of the language in subsection B, we are concerned that over a period of years the intent of the Treasury Department might change, and that these materials, which play a very important part in the merchandising pattern of today's retailing, might be included under the provisions of this bill.

Subsection G, dealing with regulatory authority, and which puts in the hands of the Secretary or his delegates, the ability to prescribe those regulations as he may deem necessary to carry out the provisions of this section, gives us cause for concern.

We recall that 5 years subsequent to the initial passage of this bill in 1954, the Internal Revenue Service issued a regulation which disallowed those funds expended for the promotion or defeat of legislation This regulation came as a complete and unexpected shock to the business fraternity.

Our organization sees any possible limitation on the effectiveness of retailers to adequately merchandise their place of business to the consumer trade as increasing the already high failure rate among retailers at all levels—a rate that is approaching the 1939 level.

We also see as a possible threat the decrease in the rate of consumer spending at a time when the administration is looking for an increased rate of consumer spending to maintain the economy at a high level.

I would like to quote from a presentation by Secretary of Commerce, Luther A. Hodges, presented March 29 at the Second Annual Washington Conference on Business-Government Relations in Marketing sponsored by the American University in Washington, D.C.

In context, Mr. Hodges was dealing with the high rate of unemployment and low rate of industrial operations.

I quote:

With further expansion in consumer buying, idle plant capacity will be absorbed and pressures exerted for expansion. Then men will be recalled to work and will in turn feed the economy and contribute to the general upswing.

The key, therefore, is the consumer, and his decision to buy or not to buy. And the responsibility of the marketing profession should be clear—how to put the consumer dollar into circulation.

Now although we do not feel that subsection B was designed to relate to promotion material, because these materials are a vital means in advertising, we feel that the Treasury Department in H.R. 10650 is coming dangerously close to eliminating them and to stifling in-store advertising.

If these promotional aids ever fall under the interpretation of this subsection, the point-of-purchase industry as it exists today will cease to function.

Faced with taxation on legitimate advertising material as well as a most difficult burden of recordkeeping, the buyer will simply stop buying and turn his dollar to other means of advertising.

The consequences to the point-of-purchase advertising industry are predictable. An industry which provides employment for at least 25,000 individuals would cease to exist, and the tax revenues derived from the industry would be lost.

The Point-of-Purchase Advertising Institute respectfully recommends that the language in subsection B of H.R. 10650 be amended to include under special rules, page 28, line 12 "C":

For purposes of paragraph one, advertising and promotional materials made available to retailers by advertisers will be excluded.

If it is not possible for the Senate Finance Committee to amend section 274(b), we respectfully request that this committee clearly indicate that it is not the intent of the Congress to deem as gifts those advertising and promotional materials produced by the point-of-purchase advertising industry inasmuch as these advertising and promotional materials have no intrinsic or personal value.

The CHAIRMAN. Thank you very much, Mr. Mee. The Chair will see your amendment is brought to the attention of the committee in executive session.

(Attachments A and B referred to follow:)

[Attachment A]

POINT-OF-PURCHASE ADVERTISING INSTITUTE, INC., NEW YORK, N.Y., MEMBERSHIP LIST

January 12, 1962

PRODUCER/SUPPLIER

R. C. Adams Displays, Inc., 215 East 37th Street, New York, N.Y., Charles G. Gerwig, sales manager.

Advance Display Co., 1724 N. Winchester Avenue, Chicago, Ill., R. J. Meinsen, vice president, sales.

Advertising Art Production Co., Inc., 1701 Walnut Street, Philadelphia, Pa., David Cooperson, president.

Advertising Metal Display Co., 4620 West 19th Street, Chicago, Ill., L. O. Krueger, president.
Advertising Products, Inc., 3204 Beekman Street, Cincinnati, Ohio, R. J. Rhode, president.
Alpha Corp., 800 Northern Boulevard, Great Neck, Long Island, N.Y., Ralph L. Godfrey, president.
Alldec Corp., 1511 West 38th Street, Chicago, Ill., Joseph E. Nathan, executive vice president.
Amelia-Robin Paper Sculptures, 131 State Street, Boston, Mass., Eliot Agush, president.
American Art Works, Inc., 711 Fifth Avenue, New York, N.Y., Sumner Levine, president.
American Manufacturing Co., 124 Chestnut Street, Chattanooga, Tenn., W. P. Milner, vice president.
American Mounting & Finishing Inc., 715 Carnegie Avenue, Cleveland, Ohio, Ernest Dusek, president.
American Sign Co., 920–26 State Avenue, Cincinnati, Ohio, Gus J. Reininger, president.
Architectural Displays, Inc., 301 East 22d Street, New York, N.Y., Sid Dauman, president.
Arlington Aluminum Co., 19011 West Davison, Detroit, Mich., Grant Folin, president.
Arrow Display Associates, 325 West Glenwood Avenue, Philadelphia, Pa., Stanley D. Ginsburg, partner.
Arrow Manufacturing Co., Division of Electrical Products Corp., 1210 North Main Street, Los Angeles, Calif., E. V. Bacigalupo, general manager.
Arvey Corp., 300 Communipaw Avenue, Jersey City, N.J., Walter Winter, vice president and general manager.
Atlantic Display Division, Atlantic Container Corp., 48–08 30th Place, Long Island City, N.Y., Arthur Feldman, president.
Austin & Austin, Inc., 1775 Broadway, New York, N.Y., Herman R. Pollenz, executive vice president.
Elliot J. Axelrod Associates Inc., 141 East 44th Street, New York, N.Y., Elliot J. Axelrod, president.
Bates Printing Co., 1132 West 14th Place, Chicago, Ill., Fred J. Vacek, partner.
Bel-Aire Process, Inc., 5333 Vermont Avenue, Detroit, Mich., William Isherwood, president.
Bemiss-Jason Corp., 3250 Ash Street, Palo Alto, Calif., W. E. Jason, president.
Benco Plastics, Inc., 3008 Industrial Parkway West, Knoxville, Tenn., Edward E. Judy, president and treasurer.
Leon L. Berkowitz Co., 1317 Filbert Street, Philadelphia, Pa., Leon L. Berkowitz,, president.
Bish Creative Display, Inc., 5808 North Lincoln Avenue, Chicago, Ill., Lorenz Buescher, president.
Black Box Collotype Studios, Inc., 4840 West Belmont Avenue, Chicago, Ill., Henry F. Kroeger, Jr., president.
Bristol Motors Division, Vocaline Co. of America, Inc., Coulter Street, Old Saybrook, Conn., Charles M. Murphy, vice president, sales.
The Buhl Press, Inc., 215 West Ontario Street, Chicago, Ill., Carl R. Buhl, president.
The J. M. Callan Co., 664 North Rush Street, Chicago, Ill., Joseph M. Callan, president.
A. Carlisle & Co., 645 Harrison Street, San Francisco, Calif., A. P. Crist, Jr., vice president.
Carter and Galantin Corp., 710 West Jackson Boulevard, Chicago, Ill., Henry Carter, president.
Cavanagh Printing Co., 1523 South 10th Street, St. Louis, Mo., F. C. R. Rauchenstein, president.
Central States Paper & Bag Co., Inc., 5221 Natural Bridge, St. Louis, Mo., David J. McKay, Jr., secretary.
Century Display Manufacturing Corp., 80 Boylston Street, Boston, Mass. J. R. Teich, vice president.
Century Industries, Inc., Beeco Division, 521–35 West 35th Street, Chicago, Ill., Hoyne Greenberg, general manager.

Chanal Plastics Corp., 63-20 Austin Street, Rego Park, N.Y., Albert E. Karp, president.
The Chaspec Manufacturing Co., 342 West Putnam Avenue, Greenwich, Conn., Charles Peckar, president.
Chicago Cardboard Products Co., 1250 North Homan Avenue, Chicago, Ill., Richard W. Mueller, executive vice president.
Chicago Display Finishing Co., 1301 Armitage Avenue, Melrose Park, Ill., H. K. Snyder, Jr., president.
Chicago Show Printing Co., 2635 North Kildare Avenue, Chicago, Ill., Robert R. Snediker, president.
Claremould Plastics Co., 200 Wright Street, Newark, N.J., George A. Clare, president.
Colonial-Hites Co., 228 Parson Street, West Columbia, S.C., H. A. Brown Jr., vice president.
Colonial Neon Co., Inc., 2901 Tonnelle Avenue, North Bergen, N.J., John C. Sabatini, president.
Color Corporation of America, 610 South Armenia Avenue, Tampa, Fla., Joseph H. Snyder, president.
Color Metal Sign Co., 31st and St. Clair Avenues, East St. Louis, Ill., John M. Massey, president.
Consolidated Lithographing Corp., Carle Place Post Office, Long Island, N.Y., Walter J. Ash, vice president, sales.
Consolidated Mounting & Finishing Co., Inc., 5010 Kneeland Street, Elmhurst, N.Y., Samuel B. Stein, vice president, sales and creative division.
Container Corp. of America., 900 North Ogden Avenue, Chicago, Ill., Frank W. Copeland, general manager, display division.
Continental Lithograph Corp., 952 East 72d Street, Cleveland, Ohio, Paul R. Kall, secretary and sales manager.
Cooper Display Associates. 723 East California Boulevard, Pasadena, Calif., Herbert H. Cooper, president.
Copeland Displays, Inc., 635 West 23d Street, New York, N.Y., Samuel Krebs, president.
Cousino Electronics Corp., 1945 Franklin Avenue, Toledo, Ohio, Joseph C. Meldt, vice president, general sales.
Creative Displays, Inc., 230 East Ohio Street, Chicago, Ill., Ronald H. Taub, president.
Crown Wire Manufacturing Corp., River Road at Garden Place, Edgewater, N.J., Michael Thal, secretary.
Dealer Sales Builders Co., 1736 Stockton Street, San Francisco, Calif., Foster L. Clute, president.
Dechar Corp., 75 Roebling Street, Brooklyn, N.Y., Edouard Dechar, president.
Dimensional Products, Inc., 2200 North 31st Street, Milwaukee, Wis., Richard H. Van Den Berg, president.
Display Corp. of America, 281 East Allegheny Avenue, Philadelphia, Pa., Harry Mazur, Secretary-treasurer.
Display Corp. of Milwaukee, 521 North Broadway, Milwaukee, Wis., L. A. Sauer, president.
Display Finishing Co., Inc., 21-16 44th Road, Long Island City, N.Y., Harold Epstein, treasurer.
Display Mart, Inc., 325 Minna Street, San Francisco, Calif., Aaron I. Friedman, president
The Donaldson Art Sign Co., Inc., 2125 Donaldson Avenue, Covington, Ky., W. Donaldson Brown, president
The Dyment Co., 1163 East 40th Street, Cleveland, Ohio, Elwood Dyment, president
Edinger-Wyckoff, Inc., 1410 Spruce Street, Stroudsburg, Pa., William S. Wyckoff, president
Edwards & Deutsch Lithographing Co., 4633 West 16th Street, Chicago, Ill., Arthur F. Meding, president and treasurer
Einson-Freeman Co., Inc., Starr & Borden Avenues, Long Island City, N.Y., N. J. Leigh, chairman of the board.
Embosograf Co. of Illinois, 1430 West Wrightwood Avenue, Chicago, Ill., M. W. Temkin, vice president
Empire Color Lithographers, Inc., 200 Varick Street, New York, N.Y., Stanley Charles, vice president

Everbrite Electric Signs, Inc., 1440 North Fourth Street, Milwaukee, Wis., Carl H. Wamser, president
Eye-Beam Displays, Inc., 263 East State Street, Milwaukee, Wis., Elmer L. Stein, president
I. Fenster & Sons, Inc., 50 Washington Street, Brooklyn, N.Y., Harry Fenster, president
Fome-Cor Corp., 812 Monsanto Avenue, Springfield, Mass., Edmund S. Childs, director of marketing
Forbes Lithograph Manufacturing Co., Post Office Box 513, Boston, Mass., Raymond D. Balcom, president
Fuller Displays, Inc., 5-39 48th Avenue, Long Island City, N.Y., William Marsh, president
A. S. Gilman, Inc., 5855 Grant Avenue, Cleveland, Ohio, R. G. Merrick, vice president and general manager
The J. W. Glaser Corp., 35 Larkin Plaza, Yonkers, N.Y., Jules W. Glaser, president
Goodren Products Corp., 101 West Forest Avenue, Englewood, N.J., O. Morley Tanney, vice president.
Grace Sign & Manufacturing Co., 3601 South Second Street, St. Louis, Mo., Pierre Grace, president
Gugler Lithographic Co., 400 North Michigan Avenue, Chicago, Ill., Paul Godell, director, creative display division
Reynolds Guyer Agency of Design, 1821 University Avenue, St. Paul, Minn., Reynolds Guyer, director
Haft & Sons, Inc., 950 Kent Avenue, Brooklyn, N.Y., Alexander L. Haft, director of sales
Hankscraft Co., Display Motor Division, Reedsburg, Wis., Sheldon M. Wengel, general manager
Hanson Manufacturing Co., Inc., 1960 Virgil Boulevard, Princeton, Ind., Robert P. Hanson, president.
Wm. Melish Harris Associates, 600 West Putnam Avenue, Greenwich, Conn., William Melish Harris, president
Hartland Plastics, Inc., 340 Maple Avenue, Hartland, Wis., Paul E. Champion, sales manager
C. F. Heinisch & Associates, 2329 Stockbridge Road, Akron, Ohio, Charles F. Heinisch, owner
The Hennegan Co., 311 Genessee Street, Cincinnati, Ohio, Robert B. Ott, vice president
Hinde & Dauch Division, West Virginia Pulp & Paper Co., 407 Decatur Street, Sandusky, Ohio, Howard Stumpf, display division manager
The Hollis Press, Inc., 380 Second Avenue, New York, N.Y., Mrs. Helen S. Freidin, president
Hollywood Advertising Co., 114 East 32d Street, New York, N.Y., Jack Steinberg, president
Ideal Mechanisms, Inc., 22-01 41st Avenue, Long Island City, N.Y., Leonard Nachtman, sales manager
Igelstroem-Oberlin, Inc., Massillon, Ohio, J. A. Wolf, president.
Indiana Wire & Specialty Co., Inc., 935 Daly Street, Indianapolis, Ind., Richard H. Dickson, Jr., president.
Industrial Electric, Inc., 3227 Magazine Street, New Orleans, La., Ralph Davis, manager—plastics division.
Industrial Lithographic Co., Inc., 405 Park Avenue, New York, N.Y., Arthur C. Elsberg, director of sales.
Inland Displays, Division of Inland Lithograph Co., 328 South Jefferson Street, Chicago, Ill., James T. Igoe, Jr., president.
Inland-Magill Weinsheimer Corp., 4545 Touhy Avenue, Lincolnwood, Chicago, Ill., A. J. Borre, executive vice president.
Interstate Boochever Corp., 18-09 Pollitt Drive, Fair Lawn, N.J., S. Paul Boochever, president.
Jay Electronics, Inc., 65-37 Fresh Meadow Lane, Flushing, N.Y., Sanford Jay, president.
Johnstons & Associates, Inc., 517 East Crosstown Parkway, Kalamazoo, Mich., Louis P. Johnston, president.
Jorgenson & Co., 500 Sansome Street, San Francisco, Calif., James C. Kirkman, vice president.

Robert Kayton Associates, Inc., 635 West 54th Street, New York, N.Y., Robert Kayton, president.
Keeler & Dunkel, Inc., 406 Lincoln Building, 1367 East 6th Street, Cleveland, Ohio, John N. Keeler, president.
Kirby-Cogeshall-Steinau Co., Inc., 606 East Clyborn Street, Milwaukee, Wis., Richard E. Vogt, president.
Kleen-Stik Products, Inc., 7300 West Wilson Avenue, Chicago, Ill., Jerry Zalkind, executive vice president-General sales manager.
Kleentear, Inc., Division of Charles Offset Co., Inc., 621 Sixth Avenue, New York, N.Y., Allen Bortner, president.
Richard A. Klein, Inc., 51 East 42d Street, New York, N.Y., Richard A. Klein, Jr., vice president.
Kulka Electric Corp., 633–643 South Fulton Avenue, Mount Vernon, N.Y., William Kulka, vice president.
Lakeside Plastics, 407 South Dearborn Street, Chicago, Ill., William P. Levine, president.
Lane Display Corp., 524 West 43d Street, New York, N.Y., Harold Levy, secretary.
Martin Lewis Associates, 705 Arch Street, Philadelphia, Pa., Martin Lewis, partner.
Litho-Paint Poster Co., 525 North Noble Street, Chicago, Ill., Vernon A. Mock, president.
Lustra-Cite Industries, Inc., 331 Kent Avenue, Brooklyn, N.Y., Michael M. Halpern, president.
Majestic Creations, Inc., 37–03 Woodside Avenue, Woodside, N.Y., Ben J. Seger, president.
Manufacturers Products, Inc., 7552 North Teutonia Avenue, Milwaukee, Wis., W. A. Meyer, president.
Carl T. Mason Co., Box 275, Addison, Ill., Jay Stead, president.
The Massillon-Cleveland-Akron Sign Co., 681 First Street, SW., Massillon, Ohio, Norman W. Allison, vice president-sales.
Masterack Displays, Division of Southern Spring Bed Co., 290 Hunter Street, SE., Atlanta, Ga., Brittain Pendergrast, vice president.
Frank Mayer & Associates, Inc., 4727 North Teutonia Avenue, Milwaukee, Wis., Frank G. Mayer, Jr., president.
The Mayland Co., 236 West 27th Street, New York, N.Y., Edward Adler, owner.
Mechtronics Corp., 325 Center Avenue, Mamaroneck, N.Y., Curtis A. Anderson, president.
Melco Wire Products Co., 4420 San Fernando Road, Glendale, Calif., Melvin J. David, president.
Melrose Displays, Division of Melrose Wire Products, Inc., 150 Dayton Avenue, Passaic, N.J., Melvin Cohen, president.
Mercury Advertising Printers, 245 Franklin Avenue, Brooklyn, N.Y., Joseph A. Durso, owner.
Merit Displays Corp., 3 East 26th Street, Paterson, N.J., Norman Cohen, president.
The Meyercord Co., 5323 West Lake Street, Chicago, Ill., Spencer Burns, manager, POS Department.
Midland Metal Products Co., 2309 Archer Avenue, Chicago, Ill., Jack Zidek, partner.
Miller Manufacturing Co., Inc., 7th and Stockton Streets, Richmond, Va., Robert G. Woodhead, manager, sales and development.
Miller-Regent Display Associates, 71 West 35th Street, New York, N.Y., John D. Miller, owner.
Mirro-Products Co., 1196–09 Tate Street, High Point, N.C., C. R. Wisenburg, president.
Monticello Manufacturing Corp., 2200 South J Street, Elwood, Ind., F. Dan Hoose, president.
Jerry Moss, Inc., 107 East 31st Street, New York, N.Y., Jerome A. Moss, president.
Mulholland-Harper Co., 5800 Tacony Street, Philadelphia, Pa., Dewees F. Showell, vice president and general manager.
Louis Nadelson, Inc., 74 Fifth Avenue, New York, N.Y., Walter Richer, executive vice president.
Nashville Display Manufacturing Co., Post Office Box 491, Nashville, Tenn., C. B. Rollins, Jr., partner.

Neon Products, Inc., Neon Avenue, Lima, Ohio, Saul Seigel, director, advertising and sales promotion.
Nixon-Baldwin Chemicals, Inc., Nixon, N.J., W. A. Olsen, vice president, promotional sales.
Northwest Screenprint Co., 3051 North Rockwell, Chicago, Ill., Michael S. Halperin, president.
Oberly & Newell Lithograph Corp., 350 West Street, New York, N.Y., E. K. Whitmore, president.
The Ohio Advertising Display Co., 950 Kenyon Avenue, Cincinnati, Ohio, Howard Frankel, president.
The Ohio Thermometer Co., 33 Walnut Street, Springfield, Ohio, David W. Welday, vice president.
Palmer Associates, 16 West 40th Street, New York, N.Y., Carl Bergmann, president.
Parry Sign Sales, 420 North Vermont Avenue, Los Angeles, Calif., E. T. Parry, president.
Perma Wire Display Corp., 72 Greene Street, New York, N.Y., Ares Davidian, president.
Phelps Manufacturing Co., Inc., 914–920 North 15th Street, Terre Haute, Ind., R. D. Phelps, executive vice president.
The Photoplating Co., 215 Northeast 5th Street, Minneapolis, Minn., Harlan K. Nygaard, president.
Pioneer Mounting & Finishing Co., Inc., 12–01 34th Avenue, Long Island City, N.Y., David Lansky, president.
Plasti-Line, Inc., Dutch Valley at Broadway, Post Office Box 5066, Knoxville, Tenn., Harry W. Brooks, president.
Plasti Signs, Inc., Subsidiary, Sign Crafters, Inc., 2021 North Kentucky Avenue, Evansville, Ind., Thomas R. Watson, president.
Pocatone Displays, Inc., 148 Lafayette Street, New York, N.Y., Mortimer A. Lehmann, treasurer.
P.O.P. Displays, Inc., 8000 Cooper Avenue, Glendale, N.Y., Elliott R. Loew, president.
Poster Products, Inc., 3401 West Division Street, Chicago, Ill., R. L. Burke, president.
Pratt Poster Co., Inc., Printcraft Building, Indianapolis, Ind., Ryland D. Pratt, Jr., president.
Price Bros., Inc., 4301 West Madison Street, Chicago, Ill., Louis E. Price, president.
The Progress Lithographing Co., Section Road and Pennsylvania Railroad, Cincinnati, Ohio, E. H. Sundermann, president.
Rapid Mounting & Finishing Co., 310 West Polk Street, Chicago, Ill., Walter S. Neumann, vice president.
The Ravenware Co., Inc., 360 Scholes Street, Brooklyn, N.Y., Richard G. Galef, vice president.
The Reytrim Manufacturing Co., Inc., Royersford, Pa., William R. King, sales manager, display division.
M. M. Robbins Associates, Inc., 207 East 87th Street, New York, N.Y., Maurice M. Robbins, president.
Robertson Sign Co., 14 North Lowry Avenue, Springfield, Ohio, Robert A. Henson, vice president, sales.
Rohm & Haas Co., Washington Square, Philadelphia, Pa., Dr. David A. Rothrock, sales manager, plastics department.
St. Louis Mounting & Finishing Co., 4520 Enright Avenue, St. Louis, Mo., Clifford H. Misenhelter, president.
Salescaster Displays Corp., 1010 East Elizabeth Avenue, Linden, N.J., Warren G. Heide, president.
Sales Communication, Inc., Division of Communications Affiliates, Inc., 485 Lexington Avenue, New York, N.Y., Jack Scheckowitz, manager, display department.
Schmidt Lithograph Co., 720 North Michigan Avenue, Chicago, Ill., Marion D. Cloud, vice president.
Thomas A. Schutz Co., Inc., 8710 Ferris Avenue, Morton Grove, Ill., William D. Caddell, president.
Simmons-Woodward, Inc., 1519 Tower Grove Avenue, St. Louis, Mo., Paul C. Simmons, Jr., president.

Snyder & Black & Schlegel, Inc., 415 Knollwood Road, White Plains, N.Y., O. H. Stark, vice president and general sales manager.
Spangler Sign Corp., 3227 B Street, Philadelphia, Pa., Bernie Spangler, president.
Spring-A-Way Displays of California, Inc., 1420 West 5th Street, Santa Ana, Calif., L. W. Patterson, president.
Standard Manufacturing Corp., 2021 Lee Street, Evanston, Ill., Louis I. Hadden, president.
Standard Printing Co., 201 North 3d Street, Hannibal, Mo., D. C. Worra, sales manager.
W. L. Stensgaard & Associates, Inc., 346 North Justine Street, Chicago, Ill., W. H. Stensgaard, president.
Stout Sign Co., 6425 West Florissant Avenue, St. Louis, Mo., Ward W. Patterson, president.
Sweeney Lithograph Co., Inc., Subsidiary, Federal Paper Board Co., Inc., 20 River Road, Bogota, N.J., William H. Glover, president.
Tel-A-Sign, Inc., 3401 West 47th Street, Chicago, Ill., A. A. Steiger, president.
Texlite, Inc., 3305 Manor Way, Dallas, Tex., L. A. Erickson, president.
Thomson-Leeds Co., Inc., 250 East 51st Street, New York, N.Y., Chester L. Thomson, president.
Timely Products, Inc., 308 Rogers Road, Des Moines, Iowa, John E. Hadley, president.
Timely Service, Inc., 1269 Atlantic Avenue, Brooklyn, N.Y., Leo J. Fidler, president.
Topflight Corp., 160 East 9th Avenue, York, Pa., E. W. Huber, president.
Transparent Advertising Corp., 2800 College Point Causeway, Flushing, N.Y., Arnold A. Pollard, president.
Trans-World Display Corp., 16 East 34th Street, New York, N.Y., Jerome D. Kramer, president.
Ullman Gravure, Inc., 319 McKibbin Street, Brooklyn, N.Y., David V. Morgan, president.
Morton Ullmann Corp., 551 Fifth Avenue, New York, N.Y., Morton Ullmann, president.
The U.S. Printing & Lithograph Division of Diamond National Corp., 733 Third Avenue, New York, N.Y., Ray Dubrowin, director, promotion office sales merchandising.
Venco International, Inc., 36 West 44th Street, New York, N.Y., L. Frederick Cain, president.
Vue-More Corp., Division of Brevel Products Corp., 601 West 26th Street, New York, N.Y., Robert O. Soman, sales manager.
Vulcan Industries, Division Ebsco Industries, Inc., 1st Avenue North at 13th Street, Birmingham, Ala., W. Oliver Cox, director of marketing.
The Weiller Co., Castor Avenue and Amber Street, Philadelphia, Pa., Eugene W. Weiller, president.
Wells Badger Corp., 225 West Capitol Drive, Milwaukee, Wis., David H. Wells, president.
Wesco Associates, Inc., 10 Columbus Circle, New York, N.Y., Alexander L. Ewing, president.
Stanley Wessel & Co., 420 North Michigan Avenue, Chicago, Ill., Stanley L. Wessel, president.
Wescott Paper Products Co., 450 Amsterdam Avenue, Detroit, Mich., Joseph R. Chirillo, executive vice president.
The Williams Co., 230 East 69th Street, Chicago, Ill., Paul V. Williams, partner.
Winston Associates, Division of Growth Capital, Inc., 819 Bulkley Building, Cleveland, Ohio, Larry Winston, associate.
York Display Finishing Co., Inc., 240 Kent Avenue, Brooklyn, N.Y., Joseph Brooks, president.
Zerbo, Inc., 159 East 64th Street, New York, N.Y., V. J. (Bill) Zerbo, president.
Zimmerman Products Co., Inc., 316 South 16th Street, St. Louis, Mo., Jay V. Zimmerman, president.
Zipprodt, Inc., 29 East Madison Street, Chicago, Ill., E. David Zipprodt, president.
Ad Animation, Inc., 114 East 32d Street, New York, N.Y., Richard Heinz.
Alvimar Manufacturing Co., Inc., 1881 Park Avenue, New York, N.Y., Alan P. Friedlander, president.

Robert Brian Associates, Inc., 1271 Avenue of the Americas, New York, N.Y., Robert M. Sandelman, president.
Brorsen & Wenner, Pier 33, San Francisco, Calif., James K. Brorsen, president.
Columbian Display Corp., 547 South Clark Street, Chicago, Ill., Bernard J. Miller, Jr., president.
Ledan Reproductions, Inc., 7 Park Avenue, New York, N.Y., Daniel W. Leo, president.
M. W. Display Corp., 2640 Touhy Avenue, Chicago, Ill., John Webb, president
MacNaughton Lithograph Co., Inc., 460 West 34th Street, New York, N.Y., Albert Merson, president.
Jas. H. Matthews & Co., 3968 Forbes Avenue, Pittsburgh, Pa., Paul A. Fitzsimmons, merchandising manager.
Parker Metal Decorating Co., Howard and Ostend Streets, Baltimore, Md., Winslow H. Parker, president.
Sterling Packaging Products, 811 South Fulton Avenue, Mount Vernon, N.Y., Sidney A. Grossman, president.
Publinel, 172 Quai de Jemmapes, Paris 10 e, France, Guy G. Esculier, president.

FOREIGN PRODUCER MEMBERS

Acro Marketing, Ltd., Arco House, Emerald Street, London, England, R. F. T. Edwards.
Adept Displays, Ltd., 955 Amherst Street, Montreal, Quebec, Canada, Mrs. Hedy Popper, president.
H. J. Chapman & Co., Ltd., Adglow Division, Ledbury Park, Ledbury, Herefordsshire, England, George M. Kertesz.
Creative Display Advertising, Ltd., 850 York Mills Road, Don Mills, Ontario, Canada, Vincent De Vita, Jr.
Daly Display, Ltd., 488 Kensington Street, St. James, Winnipeg, Canada, Charles Gervais.
Delmar Studios Co., Ltd., 83 Torbarrie Road, Downsview, P.Q., Canada, Jack Ford, vice president-general manager.
Display & Marketing Co., Ltd., 170 Bexley Road, Avery Hill, Eltham, London, England, John W. Ongley.
French Packaging & Point-of-Purchase Advertising Institute, 3 rue la Boetie, Paris, France, Pierre J. Louis.
General Advertising, Inc., 2200 Victoria Street, Lachine, Canada, M. O. Kirsch, president.
Leon Goodman Displays, Ltd., 10 Cork Street, London, England, Leon Goodman.
Leon Goodman Displays S. R. L., Galleria De Cristoforis 1, Milano, Italy, Pietro Baragiola.
Gorrie Advertising, Ltd., 200 Bridgeland Avenue, Toronto, Ontoria, Canada, Harold Bruce Gorrie, president.
The London Press Exchange, Ltd., 110 St. Martin's Lane, London, England, J. Tealford Beasley.
Marketing Design, Ltd., 4492 St. Catherine Street, West, Montreal, Quebec, Canada, Herbert M. Korenberg, president.
National Marketing, Ltd., 310 Victoria Avenue, Montreal, Quebec, Canada, W. D. McGurrin, president.
S. A. Des Ets Perfecta, 279 rue des Palais, Bruxelles, Belgium, J. R. Righenzi.
Neon Electric Signs, Ltd., 1-9 Cecil Street, South Melbourne, Victoria, Australia, David O. Switson, director.
Planned Sales, Ltd., 1067 Yonge Street, Toronto, Ontario, Canada, W. H. Hornell, sales manager.
Print Processes Sales, Ltd., Empson Street, Bromley-By-Bow, London, England, S. Chillingworth, managing director.
The Sackville Press, Ltd., Welbeck Way, Welbeck Street, London, England, W. J. S. Clutterbuck.
Scera, 40 rue Hemet, Aubervilliers, Paris, France, Joseph F. Lotthe, vice president.
Smeets Lithographers, Weert, the Netherlands, H. E. Smeets.
Syndicate de la Publicite, sur le lieu de Vente (S.P.L.V.), S.P.A.P., 9 rue Vezelay, Paris, France, M. Jacques Gruenberg.
Trapinex Limited, 176-188 Acre Lane, Brixton, London, England, Donald J. Hill.

ADVERTISER/AGENCY MEMBERS

AC Spark Plug Division, General Motors Corp., 1300 North Dort Highway, Flint, Mich., W. C. Lee, director, district marketing.

Advertising Publications, Inc., 630 Third Avenue, New York, N.Y., Jack C. Gafford, vice president.

American Oil Co., 910 South Michigan Avenue, Chicago, Ill., Alfred P. Meaume, specialist-reseller, advertising.

Anheuser-Busch, Inc., 721 Pestalozzi Street, St. Louis, Mo., E. F. Schmidt, merchandising director.

The Atlantic Refining Co., Inc., 260 South Broad Street, Philadelphia, Pa., Edwin R. Cox, Jr., sales promotion manager.

Atlas Supply Co., 744 Broad Street, Newark, N.J., A. C. Hindon, assistant advertising and sales promotion manager.

N. W. Ayer & Son, Inc., West Washington Square, Philadelphia, Pa., Thomas F. Maxey.

P. Ballantine & Sons, 57 Freeman Street, Newark, N.J., Paul E. Storin, display supervisor.

Jas. Barclay & Co., Ltd., Post Office Box 3382, Detroit, Mich., L. S. Gilette, advertising manager.

Batten, Barton, Durstine & Osborn, Inc., 383 Madison Avenue, New York, N.Y., Paul Freyd, vice president.

Best Foods, Division of Corn Products Co., 717 Fifth Avenue, New York, N.Y., Rocco S. Fasulo, P.O.P. assistant.

Bristol-Myers Co., 630 Fifth Avenue, New York, N.Y., Frederick W. Bristol, merchandising display manager.

Calvert Distillers Co., 375 Park Avenue, New York, N.Y., Leonard Asher, sales promotion manager.

Campbell-Ewald Co., General Motors Building, Detroit, Mich., D. A. Hodgson, account executive.

Carling Brewing Co., 9400 Quincy, Cleveland, Ohio., Patrick J. Higgins, merchandising manager.

The Coca-Cola Co., 310 North Avenue, N.W., Atlanta, Ga., A. D. Lawton, advertising department.

Dow Chemical Co., Post Office Box 426, Midland, Mich., James J. Burlingame.

Eastman Kodak Co., 343 State Street, Rochester, N.Y., Donald M. Lewis, Jr., assistant director, sales promotion.

Falstaff Brewing Corp., 5050 Oakland, St. Louis, Mo., Roy D. Sherwood, P.O.S. manager.

Ford Motor Co., 20000 Rotunda Drive, Dearborn, Mich., R. C. Cunningham, manager, merchandising service department.

Foremost Dairies, Inc., 425 Battery Street, San Francisco, Calif., Bruce A. Steele, merchandising coordinator[1]; T. E. Drohan, product manager; F. Fornia.

Four Roses Distillers Co., 375 Park Avenue, New York, N.Y., Mort Mazor, national sales promotion manager.

Fruit of the Loom Corp., 112 West 34th Street, New York, N.Y., Anthony S. Faranda, director, merchandise presentation.

Gardner Advertising Co., 914 Olive Street, St. Louis, Mo., merchandising director.

General Foods Corp., 250 North Street, White Plains, N.Y., Arthur Messinger, director, product promotion.

Genessee Brewing Co., Inc., 100 National Street, Rochester, N.Y., James P. Duffy, advertising manager.

William E. Hartman & Co., 16883 Wyoming Avenue, Detroit, Mich., Robert G. Hartman, partner.

Heinz Art, Inc., 114 East 32d Street, New York, N.Y., Richard Heinz, president.

Johnson & Johnson, 500 George Street, New Brunswick, N.J., W. E. Sawyer, director, merchandising services.

Kessler-Hunter Distillers Co., Division Seagram Distillers, Inc., 375 Park Avenue, New York, N.Y., Murray Koff, director of advertising.

Klau-Van Pietersom-Dunlap, 744 North Fourth Street, Milwaukee, Wis., William M. Carpenter, vice president, public relations.

Liebmann Breweries Inc., 36 Forrest Street, Brooklyn, N.Y., Walter H. Liebmann III, advertising manager.

Merchandising Design Counselors affiliated with Walter Landor & Associates, Landor Building, Pier 5 North, San Francisco, Calif., Nicholas Newbeck, director.

Mr. Boston Distillers, Inc., 1010 Massachusetts Avenue, Boston, Mass., A. E. Bourassa, advertising manager.

Benjamin Moore & Co., 548 Fifth Avenue, New York, N.Y., Donald R. Bateman, merchandising manager.

National Brewing Co., 3720 Dillon Street, Baltimore, Md., Kenneth G. Blair, director of merchandising.

National Lock Co., 1902 Seventh Street, Rockford, Ill., Merritt J. Yale, assistant advertising manager.

Richard E. Paige, Inc., 95 Madison Avenue, New York, N.Y., Richard E. Paige, president.

Pepsi-Cola Co., 500 Park Avenue, New York, N.Y., Alan W. Finley,[1] associate merchandising manager; John W. Garabrant,[1] advertising display manager.

Personal Products Corp., Van Liew Avenue, Milltown, N.J., E. Bereza, director of purchasing, advertising, and merchandising material.

Philip Morris, Inc., 100 Park Avenue, New York, N.Y., A. C. Gens, sales promotion manager.

The Pillsbury Co., Pillsbury Building, Minneapolis, Minn., Jim E. Marsalis, sales promotion manager.

Printers' Ink, 635 Madison Avenue, New York, N.Y., Fred Decker, advertising manager.

Quality Bakers of America Cooperative, Inc., 120 West 42d Street, New York, N.Y., Robert L. Schaus, advertising manager.

Radio Corp. of America, 30 Rockefeller Plaza, New York, N.Y., Ralston H. Coffin, advertising and sales promotion administrator.

Revlon, Inc., 666 Fifth Avenue, New York, N.Y., Stanley Sussman, merchandising director.

Sales Management, 630 Third Avenue, New York, N.Y., Philip Salisbury, publisher.

Schenley Industries, Inc., Empire State Building, 350 Fifth Avenue, New York, N.Y., Bishop McLeod, product services manager.

Scott Paper Co., International Airport, Philadelphia, Pa., Gordon A. Nichols, assistant merchandising manager.

Seagram Distillers, Inc., 375 Park Avenue, New York, N.Y., Edward D. McCabe, national sales promotion manager.

The Seven-Up Co., 1300 Delmar Boulevard, St. Louis, Mo., J. M. Thul, advertising manager.

Southern States Cooperative, Inc., Seventh and Main Streets, Richmond, Va., W. M. Corwin, director, information publication services, George C. Deems.

Spot Magazine, 6 West 57th Street, New York, N.Y., David Flasterstein, editor.

Stark, Wetzel & Co., Inc., 602 West Ray Street, Indianapolis, Ind., John S. Ashby, Jr., manager, sales promotion department.

The Stroh Brewery Co., 909 East Elizabeth, Detroit, Mich., A. W. Bentler, sales promotion manager.

J. Walter Thompson Co., 420 Lexington Avenue, New York, N.Y., Ward F. Parker,[1] vice president; William H. Murphy.

The Upjohn Co., 7171 Portage Road, Kalamazoo, Mich., John L. Deal, advertising manager.

Hiram Walker, Inc., Post Office Box 3382, Detroit, Mich., Fred L. Fisher, national sales promotion manager.

Warner-Lambert Pharmaceutical Co., consumer products division, 201 Tabor Road, Morris Plains, N.J., Sidney Sawyer,[1] purchasing agent; Joseph McCourt, market research manager.

Wembley, Inc., 910 Poeyfarre Street, New Orleans, La., Moise B. Bloch, advertising and sales promotion manager.

FOREIGN ADVERTISER-AGENCY MEMBERS

Asahi Breweries, Ltd., 1 Kyobashi 3-Chome, Chuo-ku, Tokyo, Japan, Tamesaburo Yamamoto, president.

Beecham Foods Ltd., Great West Road, Brentford, Middlesex, England, R. G. Sands.

British Nylon Spinners Ltd., 68 Knightsbridge, London S W 1, England, I. G. Ross, economics information officer.

Dominion Dairies Ltd., 235 Walmer Road, Toronto, Ontario, Canada, W. A. Irwin,[1] Director of Advertising, C. E. McMonagle, Director of Marketing, F. L. Hart, president.

[1] Voting member.

W. Gregg & Co. Ltd., 51 Forth Street, Dunedin, New Zealand, Charles D. Baker.
Charles W. Hobson Ltd., 12 Conduit Street, London W 1, England, Nicholas A. Kaye.
Mac Robertson Pty. Ltd., Advertising Department, Argyle Street, Fitzroy N 6, Melbourne, Australia, J. D. Morris.
Ab Marabou, Sundbyberg, Sweden, Clas Bohman, Marketing director.
Margarinbolaget Ab Stargatan 8, Stockholm 0, Sweden, Goran Digmar.
Molson's Brewery Ltd., 1555 Notre Dame Street, East, Montreal, Quebec, Canada, E. B. Savage, Jr.
Publiunion Italiana, Via A. Volta 11, Milano, Italy, Dr. Bruno Arcangeli.
Shimizu Advertising Co., 43 Higashimatsushita-Cho, Kanda Chiyodauko, Tokyo, Japan, Kimiaki Shimizu.
Ab Svenska Telegrambyran, Norra Hamngatan 40, Gothenburg, Sweden, Bertil Waborg.
J. Walter Thompson Co. Ltd., 40 Berkeley Square, London W 1, England, Bernard Wratten, Merchandise Department Manager.

[Attachment B]

POINT-OF-PURCHASE ADVERTISING INSTITUTE, INC., NEW YORK, N.Y., OFFICERS AND DIRECTORS, 1961–1962

Revised: January 17, 1962

OFFICERS

Chairman of the Board: Richard H. Dickson, Jr., Indiana Wire & Specialty Co., Inc.
President: Harry Fenster, I. Fenster & Sons, Inc.
Treasurer: Carl Bergmann, Palmer Associates.
Executive Director: William W. Mee, POPAI Headquarters.

DIRECTORS

	Term of office expires at annual meeting in—
Richard H. Dickson, Jr., Indiana Wire & Specialty Co., Inc. (Indianapolis)	1962
Ray Dubrowin, The United States Printing & Lithograph Co	1962
Arthur C. Eisberg, Industrial Lithographic Co	1962
Harold Epstein, Display Finishing Co., Inc	1962
Robert Kayton, Robert Kayton Associates, Inc	1962
Harry G. Mazur, Display Corporation of America (Philadelphia)	1962
John D. O'Hara, Plasti-Line, Inc. (Knoxville)	1962
A. A. Steiger, Tel-A-Sign, Inc. (Chicago)	1962
Howard Stumpf, Hinde & Dauch Div., West Virginia Pulp & Paper Co. (Sandusky)	1962
Morton Ullmann, Morton Ullmann Corp	1962
Jerry Zalkind, Kleen-Stik Products, Inc. (Chicago)	1962
Carl Bergmann, Palmer Associates	1963
William D. Caddell, Thomas A. Schutz Co., Inc. (Morton Grove)	1963
Leo J. Fidler, Timely Service, Inc	1963
Paul Godell, Gugler Lithographic Co. (Chicago)	1963
Samuel Krebs, Copeland Displays, Inc	1963
Louis C. Krueger, Advertising Metal Display Co., (Chicago)	1963
*Robert R. Snediker, Chicago Show Printing Co	1963
*David W. Welday, The Ohio Thermometer Co., (Springfield)	1963
Marion D. Cloud, Schmidt Lithograph Co., (Chicago)	1963
Sheldon M. Wengel, The Hankscraft Co. (Reedsburg, Wis.)	1963
Harry Fenster, I. Fenster & Sons, Inc	1964
William M. Jason, Bemiss-Jason Corp., (Palo Alto, Calif.)	1964
William R. King, The Reytrim Manufacturing Co., Inc. (Royersford, Pa.)	1964
N. J. Leigh, Einson-Freeman Co., Inc	1964
Ben J. Seger, Majestic Creations, Inc	1964
O. H. Stark, Snyder & Black & Schlegel, Inc	1964
O. Morley Tanney, Goodren Products Corp. (Englewood, N.J.)	1964
Chester L. Thomson, Thomson-Leeds Co., Inc	1964
Richard E. Vogt, Kirby-Cogeshall-Steinau Co., Inc. (Milwaukee)	1964
David H. Wells, Wells-Badger Corp., (Milwaukee)	1964

*New board appointments.

(Attachment C will be found in the committee files.)

The CHAIRMAN. The next witness is Mr. J. B. Wold, of the Fly Ash Arrestor Corp.

Mr. Wold, will you take a seat, sir, and proceed?

STATEMENT OF JAMES B. WOLD, EXECUTIVE VICE PRESIDENT, THE FLY ASH ARRESTOR CORP., BIRMINGHAM, ALA.

Mr. WOLD. Mr. Chairman and members of the committee, my name is James B. Wold. I am executive vice president of the Fly Ash Arrestor Corp. of Birmingham, Ala. I appreciate the opportunity to appear before you.

For some time, there has been a continuing barrage of statements out of Washington, and from other sources, regarding business entertainment and related activities.

Ostensibly, the purpose has been to publicize abuses as regards tax deductions for the cost of such activities.

At times, however, some of the statements have seemed to go beyond the tax aspect of the problem, and imply general criticism of the activities themselves.

Regardless of whether such moralistic implications have been intended, a cloud of misunderstanding seems to have enveloped the area. I know that there has been some feeling in business circles that opposition to tax changes in the area is likely to be interpreted as condoning lavish living on taxfree money.

The objective of good business management is minimization of costs and maximization of profits. Poor judgment in regard to costs inevitably will mean inadequate results in regard to profits.

Entertainment and related business expenses are costs, and any business which purposefully inflates costs in this or any other area would place itself at a disadvantage in regard to its competitors.

Instead of tempting abuses by well-managed businesses, the area of entertainment and expense accounts is one in which the management has even greater interest in preventing abuses than has the Government.

Nevertheless, entertainment, travel and related activities have been an inherent part of doing business as long as there has been any such thing as business.

Such activities have long included the use of clubs as places for conducting business and making contacts, the bestowing of gifts upon past or potential customers, and entertainment of all sorts and descriptions.

It is well known that these attributes of doing business are, whether tax rates are low or high, conducted on a more lavish scale in foreign countries and by foreign businessmen than in America and by American businessmen.

Hence, any arbitrary restrictions imposed on the American businessman in these respects will increase his disadvantage as regards foreign competitors, especially as the latter step up their efforts to expand sales in our domestic market.

It is something of an incongruity that, at the same time the administration is promoting a program to further reduce tariffs on foreign goods (and is proposing in connection therewith various ameliorative devices to compensate for harm done to American industries, communities and workers), it is advancing a proposal which will make it more difficult for American business to attract and hold customers.

Another aspect of entertainment and expense accounts, which seems to have received little attention, is that generous expenditures in these areas may be more important to the small, unknown business, than to the large, established business.

Sales and profits are built only as the products or services offered become known on the market. To restrict the freedom of decision of the small businessman in regard to expenditures of any kind which might contribute to the building of his business would be a poor service to him and to the future of our free economy.

In light of these and other considerations, it seems to me that the section of H.R. 10650 in regard to entertainment and expense accounts is misdirected, unfair and unnecessary.

On page A28 of the House Ways and Means Committee report on H.R. 10650, it is stated that this section—

provides generally that certain expenses deductible in full under present law will be partially or completely disallowed.

The text goes on to state that since the section—

is a disallowance provision exclusively, no expense would become deductible by reason of its enactment—

and further, if I read the language correctly, that the deductibility of the expenses in question must first be established under existing law, before they would be disallowed in whole or in part under the proposed law.

The existing law is that which allows the deduction in full of expenses which are "ordinary and necessary" in the conduct of a business activity.

Thus, it is evident that the purpose of the new provision is to permit something less than full deduction of expenses which are in fact "ordinary and necessary."

The "ordinary and necessary" rule is the cornerstone of tax policy in its adaptation tc preestablished business practices.

I submit to you that it would be a serious and far-reaching step to abridge this rule in legislation. The result would be to substitute Government decision for management decision as to what is good business.

In some cases, if the rule is abridged, businessmen would forgo expenditures because the loss of the tax deduction would increase the expense of the affected activity beyond its economic value.

In other cases, business management would be obliged to incur the expense regardless of the tax penalty. When this happened, the affected business would be forced to pay taxes on something in excess of true income.

This would transform the "net income" concept of our tax laws into a "gross receipts" concept. It has often been held that a "gross receipts" tax is a desirable concept because it permits the use of minimum rates to achieve a given revenue yield. It is an unnatural act to blend a "gross receipts" concept of tax base with a "net income" concept of tax rates. Carried very far, there wouldn't be any business left on which to levy taxes.

Despite the statements in the House committee report, I realize that some may say that the provisions in question would not fundamentally alter the "ordinary and necessary" rule, but would simply make certain that the rule is not abused as regards entertainment and related expenses.

If the only problem is that of abuse, however, it would seem to me that no change in law is needed—only adequate and efficient administration of existing law.

Stated differently, under existing law the Commissioner of Internal Revenue has the authority to disallow claimed expenses which do not accord with the "ordinary and necessary" rule, or which are in excess of what would be reasonable under this rule to the extent of such excess.

It is true that some efforts of the Commissioner to disallow expenses in these respects have been thwarted, or abridged, by court decisions.

Knowing the zeal of the tax collector, however, it would be my belief that this is a healthy process.

I do not know of any case in which a court has held that its decision in this area was based on inadequate law.

In a contrary vent, the distinguished liberal jurist, Justice Cardozo in *Welch* v. *Helvering*, commented:

> One struggles in vain for any verbal formula that will supply a ready touchstone. The standard set up by the statute is not a rule of law; it is rather a way of life. Life in all its fullness must supply the answer to the riddle (290 U.S. 111–1933).

I would take this as a warning by Justice Cardozo that any attempt to enmesh business judgment in a more specific statutory formula would inevitably have harsh and unexpected results.

I do not mean to suggest that there is no problem of "abuse" as regards entertainment and related expenses. No doubt some people attempt to use entertainment and expense accounts as a means for drawing down tax-free income.

It would seem to me, however, quite inconsistent with our traditions of jurisprudence to penalize or harass the law-abiding business or businessman in order to get at those who commit the abuses.

From this frame of reference, it seems to me that the proposed provisions would constitute "statutory" abuse of normal business rights, and that this would be compounded by "regulatory" abuse.

I suppose no one would disagree that the Commissioner of the Revenue Service is not infallible, that he can be wrong, and that he has been wrong in many of the cases which have gone to the courts.

From a legal standpoint, the fact that he is or has been wrong (within the meaning and intent of existing law) enables the taxpayer to avoid unjust payment of tax.

However, when statute law is substituted for business judgment, and such statute law provides specific authority for the development of regulatory or administrative law, as would be the case if the provisions in question were enacted, the taxpayer's opportunity for protection in the courts would be correspondingly limited.

No matter how sympathetic a court might be for the plight of a taxpayer caught in the mesh of such restrictive statutory language, or regulatory language specifically implementing the statute, its hands would be tied if the Commissioner's decision were found to be consistent with the legislative intent.

Any legislative abridgement of the "ordinary and necessary" rule would have the result of depriving the taxpayer of his "day in court."

The House Ways and Means Committee's report provides an estimate of revenue gain of $125 million annually from enactment of these provisions. It would be interesting to know how much of this total is estimated on the basis of preventing abuses which otherwise would happen under existing law, and how much would result from restriction of business judgment as to what expenses are ordinary and necessary.

It seems generally agreed that, by more vigorous enforcement, the Commissioner of the Revenue Service could pick up most of the revenue involved in the first category.

It would be my opinion, my very strong opinion that the Government has no claim to and should not be seeking any of the revenue involved in the second category.

Going beyond the section on entertainment and expense accounts, and looking at H.R. 10650 as a whole, it seems questionable to me whether this legislation as drafted would make any important contributions to tax equity, and obvious that it would not relieve any significant amount of the tax restraint on economic progress.

Instead, it seems to me that this legislation is more oriented to the creation of new inequities, and that its promotion as serving the purposes of economic growth tends to sidetrack the real problem insofar as the public and the Congress is concerned.

The real problem of Federal taxation is the excessive burden placed on capital accumulation and use. This burden comes from uneconomic tax rates and methods, which serve to restrict new capital accumulations on one hand, and to convert a great deal of accumulated capital into current Government spending on the other.

Such policies in the past have been advocated and defended on the basis that they permit a lesser tax burden on citizens in average and lower income circumstances.

Such thinking overlooks the fact that the value of all current incomes is derived from capital invested in the past, and that incomes will increase in the future only as a result of the accumulation and use of new capital.

Capital that is accumulated is always put to work. Hence, the more that is accumulated, the greater will be the increase in the real income of all citizens in the years ahead.

It is extremely shortsighted, and a disservice to citizens whose incomes are on the low side, to pretend to favor them taxwise by taxing away so much of the capital which, if left in the free economy, would brighten their economic futures.

My company has long supported the Herlong-Baker legislation, which would reform the tax rates and methods which provide the greatest impediment to capital formation.

Unfortunately, the House Ways and Means Committee has not reported out this legislation for consideration of the entire Congress.

In view of the stress which the administration has placed on the connection between tax policy and economic growth, in promoting H.R. 10650, I should think that this committee would not hesitate to consider the national interest in amending H.R. 10650 by substituting the Herlong-Baker legislation for most if not all of the provisions thereof.

One of the values to be served by fundamental reform of tax rates and methods would be that of eliminating the temptation for tax evasion.

To the extent that abuses in the entertainment and expense account area are due to the high rates, enactment of the Herlong-Baker legislation would solve this problem at its source.

I realize that a return to prudence and discipline in regard to Federal expenditures would be necessary if the Herlong-Baker legislation were to be fully effectuated.

It is my belief that enactment of this legislation would help create the conditions necessary to its effectuation.

As the economy responded to more moderate tax rates, an important result would be to enlarge the base for Federal taxes. Over the long run, this would be the best insurance that all legitimate demands on the Federal Treasury could be met without recurring budget crises, repetitive doses of red-ink financing, and steady increases in the public debt.

In brief summary, therefore, the Herlong-Baker legislation would restore vitality to the private economy, and fiscal integrity to the Federal Government. It would be worth a lot of sacrifice in current spending to achieve these results.

Thank you.

The CHAIRMAN. Mr. Wold, thank you for your very able statement, sir.

We will return to the regular schedule.

The next witness will be Clarence L. Turner, president of the Pennsylvania State Chamber of Commerce.

Is Mr. Turner in the room?

The next witness will be Arthur B. Sinkler, of the Hamilton Watch Co.

Take a seat, Mr. Sinkler.

Mr. SINKLER. Thank you, sir.

The CHAIRMAN. You may proceed.

STATEMENT OF ARTHUR B. SINKLER, PRESIDENT OF HAMILTON WATCH CO., LANCASTER, PA.

Mr. SINKLER. Mr. Chairman, my name is Arthur B. Sinkler and I am president of Hamilton Watch Co., of Lancaster, Pa. I am appearing on behalf of my own company, Elgin National Watch Co., Bulova Watch Co., and the American Watch Association. This includes all jeweled-lever watch companies—domestic manufacturers and importers alike.

We ask your earnest consideration of a problem which has arisen concerning the tax treatment of presentation awards made to employees for length of service or for safety achievement.

I am sure every member of this committee knows that it has long been a custom of American corporations to honor employees who have given many years of service, and to present them with some keepsake, usually inscribed, as a token of appreciation. This ceremony has become truly a tradition in American business.

A recent survey made by McGraw-Hill Research of New York indicated that 84 percent of the large manufacturing corporations in this country have award programs for long-term service, usually 25 years. Often the awards are presented upon retirement.

Another survey conducted by Benson & Benson of Princeton, N.J., showed that such presentations are favored by three of every four office and factory employees. They are an important human relations factor in industry and add something personal and intangible to the American worker's job.

In this traditional ceremony, the traditional present is a fine watch. One of the surveys mentioned shows that over half of the corporations which give length-of-service awards include watches.

The sale of watches to employer corporations has become a very substantial part of the total sale of watches by watch companies whose brand names are associated with quality. In the case of some companies these sales are about 25 percent of total watch sales.

In the interest of the health and safety of industrial employees, it has also become customary to recognize outstanding records of safety. These programs save many lives and prevent many crippling accidents. About 30 percent of the large American corporations give such awards.

From these facts the committee can see that discontinuance of this custom would be at once a loss of a valuable human factor in American industry and a very serious financial blow to many jeweled watch companies.

But the practice will be discontinued if the employee is taxed on the value of the award as compensation, or if the companies are denied a deduction of the cost as a business expense.

It would certainly be incongruous for the employer to make a gift to an employee and then withhold from his pay check an amount required to pay Federal income tax on its value. Very little good will would result.

In the past, employers have deducted the cost of such awards, where reasonable, as an ordinary business expense; and the employee, in turn, has not had to report the award as income, treating it instead, in the spirit with which it was given, as a gift received in recognition of long and valued service.

Such awards, where reasonable, were not subject to withholding taxes, since they fell within the clear intent of the exception provided in regulation section 31.3401(a)-1(b)(10) for privileges of—

> relatively small value and * * * furnished by the employer merely as a means of promoting the health, good will, contentment, or efficiency of his employees.

We wrote to the Committee on Ways and Means and requested that such awards be excepted from the $25 annual limitation placed upon deduction of gifts to an employee.

The committee's report recognized the problem and made it clear that the $25 limit would not apply. However, in so doing the committee apparently has taken the position that such awards are not gifts, raising the question of their status as compensation taxable to the employee.

The report said (pp. 19–20):

> The only purpose of this section is to disallow deductions in certain cases and therefore this bill does not affect the question of the includibility or excludability of an item in income of any individual. The rules presently applicable

under present law will continue to govern in this respect. Thus, for example, while pins or watches presented to an employee upon his retirement will not be regarded as gifts under this provision, this bill will have no effect in determining whether the recipient of the pin or watch will be taxed on their value.

We earnestly submit that it is desirable for industry and workers in general and for the watch industry in particular that the bill should clarify the tax status of the recipient of length of service and safety awards.

The worth and essential character of employee relations were, of course, recognized in the House bill, and some provisions were inserted to insure that the proposed legislation with respect to the disallowance of certain entertainment expenses did not unnecessarily inhibit valid employee relations programs.

Thus, proposed section 274(d)(5) provides that entertainment or recreation expenses will not be disallowed under proposed section 274(a) where such expenses are incurred primarily for the benefit of employees (other than officer or shareholder employees).

The report of the House Ways and Means Committee states, at page 25, that—

this category is intended to pertain to the usual employee fringe benefit programs, such as expenses of operating a company swimming pool or baseball diamond, as well as the expenses of the annual company picnic or Christmas office party.

The House bill recognizes that the operation of such employee relations programs is desirable and that expenses related to their maintenance are properly deductible by employers.

To insure that such expenses continue to be allowed as deductions, the bill provides by express exception that they are not to be considered as nondeductible entertainment expenses under proposed section 274(a).

We believe that reasonable and bona fide awards for length of service or for safety achievement should be treated as gifts and that an exception similar to that for other fringe benefits should be provided.

Certainly the custom of awarding some gratuity to deserving employees is as much a part of bona fide employee relations as is the operation of a company swimming pool, the maintenance of a baseball diamond, or the conduct of office parties in holiday seasons.

Since the awards have not been taxed in the past there can be no revenue loss. If the amendment is restricted to length of service and safety awards and limited to $125 it cannot be abused.

It seems clear to us that the Treasury Department should have no objection, since the custom we ask the committee to preserve is a desirable one and not of a character which this bill is or should be designed to eliminate.

Thank you very much.

The CHAIRMAN. Thank you very much, Mr. Sinkler, for a very clear statement.

Any questions?

Senator HARTKE. Mr. Chairman, I just have a comment to make. It is not really a question, but in regard to the similar matter of gratuities and incentives, I had a disturbing letter from one of my constituents writing about the social security law which provided at the time for a $1,200 limitation before the change was made.

He was earning $1,100 under his contract, $1,110 and he said Christmas time they gave him a $100 Christmas gift which threw him over the $1,200 and caused him as a result of his gratuity to forfeit his entire month's social security payment but with the net result that the $100 Christmas donation was taxed to the extent of $93 making a net gain for him of $7, because he received a $100 Christmas gift.

I wonder if these things don't present problems in this nature when we try to make a distinction as to gratuities and making a distinction as to items of worth or value or actual money.

I have no other comments.

The CHAIRMAN. Thank you.

Senator KERR. I would like to make an observation, Mr. Chairman.

The CHAIRMAN. Senator Kerr.

Senator KERR. I happen to belong to one of the business organizations the witness has been talking about and one of its customs is that it has a 25-year club.

I guess there are 200 people in it each one of whom has received as an award on becoming a member of the 25-year club a Hamilton watch.

In fact, I received one myself. I must say that I think the statement of the witness to the effect that such a custom in an organization is beneficial to the morale and productivity of the employees and I think that the position of the witness is pretty well taken.

I must say that I didn't know that that part of your business was as significant as you have indicated it is.

Mr. SINKLER. Very much so, sir.

Senator KERR. You have done quite a job in developing it, and I think you should be commended for it.

The CHAIRMAN. Thank you very much, Mr. Sinkler.

The next witness is Mr. Thomas Power, National Restaurant Association.

Take a seat, sir.

STATEMENT OF THOMAS W. POWER, WASHINGTON COUNSEL, NATIONAL RESTAURANT ASSOCIATION

Mr. POWER. Mr. Chairman, my name is Thomas Power. I am Washington counsel for the National Restaurant Association. I have filed a rather lengthy statement with the committee but I would prefer to comment on it briefly rather than read it in its entirety.

The CHAIRMAN. Your prepared statement will appear following your testimony.

Mr. POWER. Our association represents approximately 100,000 restaurants in the United States.

Senator KERR. How many?

Mr. POWER. Around 100,000, Senator Kerr, through direct membership in the association and through 135 State and local associations such as the Oklahoma association which is affiliated with us.

Our principal concern with the tax bill is on the expense account section but we would like to comment briefly on the tax credit feature of the bill.

As a service industry we feel that tax credits militate against our interest. We cannot understand why a tax subsidy should be given to industry using machines at the expense of industries using manpower at a time when unemployment is our country's principal problem.

There seems to us to be many ways to stimulate gross national product that is the productivity of our country, such as by stimulating investment in promotion, research, in accounts receivable, in inventory, and innumerable other ways.

Tax credits in our opinion would be the most likely to aggravate the unemployment problem. They will lead to tremendous job losses in the restaurant industry.

I think this effect will result because of the fact that we in our industry will substitute vended restaurant meals sold through coin-operated machines for served restaurant meals. This is a classic example of the overall economic effect of the tax credit proposal, because it really amounts to the substitution of the sale of a good for the sale of a service.

The tax credit approach we can understand for the purpose of increasing efficiency to better meet international competition, but we cannot understand the approach when unemployment is our country's principal problem.

Our principal concern, however, as I indicated earlier, is the expense account section of the tax bill and the administration's proposal to disallow goodwill and entertainment.

Our studies would indicate the expense account market involves approximately $2 billion annually in food and beverage entertainment in the United States.

Of this $2 billion market, we would estimate there is approximately $1 billion in wages and tips involved. Our studies are derived from a survey made by the General Foods Co., as to the amount of money being spent on food and beverages in restaurants, night clubs, et cetera, as business expense.

Senator SMATHERS. May I ask a question right there? I am not clear.

Mr. POWER. Yes.

Senator SMATHERS. That $2 billion expended for food and beverage a year——

Mr. POWER. Food and beverage, entertainment, business entertainment a year; yes, sir.

Senator SMATHERS (continuing). That is not the total?

Mr. POWER. That is not travel, that is not gifts, but——

Senator KERR. That is not the total of the restaurant business; that is the total of the part of it that is business.

Senator SMATHERS. That is what I want to find out.

Is this the total of the part of the business that you say is credited to entertainment?

Mr. POWER. That is right, food and beverage business entertainment—that would be $2 billion of a total $16 billion industry.

Senator SMATHERS. So the $16 billion——

Mr. POWER. Would be the total public restaurant industry.

Senator SMATHERS. And this $2 billion——

Mr. POWER. Is presently deductible by businessmen as entertainment or meals while on business travel status.

In that $2 billion figure we would estimate there is approximately $1 billion in wages and tips and that would involve approximately 400,000 jobs.

We are not opposed to legislation designed to eliminate abuses in the expense account area. We recognize their validity but we think that any restrictions on expense accounts should recognize the legitimate needs of businessmen.

Senator SMATHERS. May I ask another question, Mr. Chairman?

The CHAIRMAN. Yes.

Senator SMATHERS. The other day I heard somebody say—that was suggested by a question asked—if you eliminated the deductibility for entertainment so far as restaurants were concerned, the restaurants would then have a cheaper meal, and because the meal would be less expensive undoubtedly more people would eat it, and thereby they would make up in greater volume of business that which they would lose by virtue of entertainment.

Do you think that is a very valid argument?

Mr. POWER. No, I don't, Senator. I think it is a very invalid argument. Loss of the business market would not result in reduced cost or in cheaper meals. The only way to cut prices would be to cut labor cost. Let me give you a practical example.

Sardi's Restaurant in New York: He has two restaurants, one caters to the business clientele, one caters to the general public. In the restaurant that caters to the business clientele the price is higher because of the service given and the time that the customer spends in the restaurant. His labor cost in that restaurant is exactly twice what it is in the other restaurant.

The only way he could adjust to the elimination of the business market, which is 12½ percent of the total industry market, would be to cut in half labor costs in his second restaurant, and reduce prices, I don't think he would ever pick up this volume at reduced prices but to the extent he was successful, the total effect would be a drop in wages equal to the drop in prices.

Now, most restaurant operators complain that they cannot decrease their prices without decreasing labor and most operators claim they cannot cut labor. They need the manpower they presently have unless they go into some operation like vending.

Senator SMATHERS. Do you also speak for the Restaurant Workers Union?

Mr. POWER. No; we do not speak for them directly.

However, the Hotel & Restaurant Workers Union did join with us in a statement to the House Ways and Means Committee and in a letter to Congressman Mills, chairman of the House Ways and Means Committee, and took a position in opposition to the proposed elimination of entertainment expenses, as did the Musicians Union and five other internationals with memberships in excess of 3 million workers.

So, organized labor is very definitely divided on this particular issue, particularly those areas of organized labor that would be directly affected through job loss.

I believe that Herman Kenin, president of the American Federation of Musicians appeared before this committee.

Turning to the specific sections of H.R. 10650, I direct your attention to the proposal to eliminate the Cohan rule, and to require the substantiation of business entertaining and travel expenses.

This section we do not believe will result in a loss of sales in the restaurant industry. It will impose a burden on our industry as far as records are concerned. We will be constantly deluged by requests by business customers for receipts.

Nevertheless, we think it is a reasonable requirement of businessmen, and we have no particular objection to it.

There does seem to be one technical aspect regarding the elimination of the Cohan rule that seems to have been overlooked by the House Ways and Means Committee, and that is the application of double disallowance in the event that the substantiation by records provision is not met.

For example, if I were on an expense account and I failed to keep records or to meet the requirements of the new proposal, even though they be ordinary and necessary expenses, and even though my employer has no control over the records that I keep, the expenses not meeting that substantiation section would be disallowed. To me these unsubstantiated expenses would be treated as income. To my employer they would be treated as nondeductible and subject to corporation tax, rather than as deductible wages.

Now, the House did make an exception for reimbursed expenses as far as the entertainment provision is concerned.

In other words, if I entertained and the expense was disallowed to the corporation it would not be disallowed to me. It would not be treated as my personal income. In section 274(c) the burden and the responsibility should be on the person who is doing the spending to keep the records. It does not seem fair to disallow the expense to the employer who does not have it within his capacity to see to it that the records are kept.

What we would suggest is that if the expenses are ordinary and necessary, but records are insufficient, the expenses should be treated as wages to the employee for which he is taxable and the employer is not taxable.

Maybe another specific example will illustrate the point: Under existing law many lawyers have a contract with a client for a fee plus expenses.

Under H.R. 10650 the lawyers entertainment expenses could be disallowed to his client for failure of meeting the recordkeeping provision yet the lawyer could sue his client for the recovery of the expenses because they were ordinary and necessary.

We would recommend specific language on this point which is contained in my statement:

Section 274(c) shall not apply to expenses, paid or incurred by the taxpayer in connection with the performance for him of services by another person, whether or not such other person is his employee under a, reimbursement or expense allowance arrangement with such other person.

The CHAIRMAN. What pages are you on now?

Mr. POWER. I am referring to the second page on the 6th line from the bottom, the last paragraph quoting—

we would recommend that section 274(c) shall not apply to expenses paid or incurred by the taxpayer in connection with the performance for him of services by another person (whether or not such other person is his employee) under a reimbursement or expense allowance arrangement with such other person.

All this would do is to keep the present law in effect. If the expenses were ordinary and necessary, and then the rule of double disallowance would not apply. The burden of the recordkeeping would be on the employee or the person incurring the expense rather than the corporation which, it seems to me, should not have that additional liability.

Another section of the bill provides that there shall be a reasonable allowance for meals and lodging while on business travel status.

This is a change from existing law which provides for the deductibility of an entire amount for meals and lodging while on business travel status.

This to us also seems a reasonable approach.

Senator KERR. This what?

Mr. POWER. Seems a reasonable approach to take with respect to travel expenses.

However, we thing that the law or the legislative history and the House committee report merely states that this is a statement of existing law, it does not say anything to the meaning of the word "reasonable"——

Senator KERR. You think that the approach that the allowance should be deductible if it is reasonable is a reasonable approach?

Mr. POWER. Yes, we do, Senator. However——

Senator KERR. Pardon me, Mr. Chairman, I don't like to interrupt until he gets through. I have been trying to get an anthology of views of my close acquaintances consisting of an individual definition and dissertation by each on his interpretation of the word "reasonable."

I must say that the differences between their definitions seem to me to be rather unreasonable.

Mr. POWER. I think it is a rather clear cut——

Senator KERR. Do you know of any other provisions in the law anywhere that says a reasonable amount should be allowed.

Mr. POWER. Yes. It already exists in section 162 of the code that is being contemplated to amend with respect to salaries of corporate officers.

Senator KERR. What does it say?

Mr. POWER. It says that there shall be an allowance for all ordinary and necessary expenses including a reasonable amount for compensation for officers of the corporation.

Senator KERR. What section is that?

Mr. POWER. The same, section 162 of the code with respect to the salaries of officers of corporations. It seems that Internal Revenue——

Senator KERR. I would think that your organization would be the last one that would want a provision in the law that would be indefinite and the effect of which would be subject to the changing concept of personnel in the Treasury or Internal Revenue Service of "reasonableness."

Mr. POWER. Reasonableness as a judicial concept in American jurisprudence has existed for a very long time. It very definitely exists in the field of torts. It exists under the present law with respect to the salaries of corporate officers.

Frankly, we are not in favor of any law which would perpetuate expenses or enhance expense account abuse. What we do oppose is the arbitrary disallowance of legitimate and reasonable business expenses.

It does not seem to us that there can possibly be any definite law with respect to what is reasonable while on business travel status. There are too many variables.

Senator KERR. If the Congress doesn't have enough sense to define the term, I would say I don't react, as you haven't been very complimentary, to think anonymous personnel in the Internal Revenue Department would have.

Mr. POWER. Well, I don't think that it would ultimately depend on anonymous personnel in the Department of Internal Revenue. I think it would ultimately depend upon the courts and ultimately would——

Senator KERR. You know that the only way the language could be implemented would be by regulation, don't you?

Mr. POWER. Yes, but the regulations themselves would have to remain somewhat indefinite. We would suggest that not only——

Senator KERR. You think that is reasonable for them to be indefinite?

Mr. POWER. Yes, we do. Not only that it would be reasonable but that is the only way it could be reasonable because there are too many variables.

Senator KERR. Is to be indefinite?

Mr. POWER. To be indefinite. By that, I mean the standard is a workable one but——

Senator KERR. Well, it couldn't be workable according to your testimony unless it were indefinite.

Mr. POWER. That is correct.

Senator KERR. How could it be workable unless it is definite?

Mr. POWER. Well, because you are dealing with an objective standard, Senator. I mean you are dealing with a standard of reasonableness——

Senator KERR. It seems to me you are trying to deal with that as an unobjective standard. Anything to be objective has to have some element of definiteness in it, doesn't it?

Mr. POWER. No, I don't think it has to have—well, an element, it could have an element of definiteness—but, no, I don't agree with that, Senator, that it has to have an element of definiteness to it. I think that the element of definiteness comes when it is applied to a particular circumstance.

Senator KERR. But if it is indefinite how could you apply it to anything?

Mr. POWER. Well, a man must act in a reasonable and prudent manner.

Would you try to establish a definiteness as to what constitutes a reasonable and prudent manner under all conceivable circumstances?

Senator KERR. It would depend on whether I was dealing with something with reference to which an individual has his own right of decision.

Mr. POWER. Yes, but——

Senator KERR. Or whether I was dealing with something with reference to which the Government is dealing with me.

Mr. POWER. Well, our whole judicial concept works on the theory that what 12 men sitting in truth decide is reasonable is in fact reasonable.

Senator KERR. Well now, did you know that the concept of the 12 men is not with reference to the judicial aspect of our judiciary? I practiced law for a number of years, and I was always under the impression that the function of the 12 men was to determine the facts.

Mr. POWER. Well, that is why I say——

Senator KERR. I didn't know that they had judicial responsibilities.

Mr. POWER. Well, they have the responsibility of determining the facts and one of the facts is whether a given act is or is not reasonable.

Senator KERR. Oh, no, oh, no, not at all.

Are you a lawyer?

Mr. POWER. Yes, I am, Senator.

Senator KERR. You must be a Harvard lawyer. [Laughter.]

Mr. POWER. I am a Georgetown lawyer.

Senator KERR. We sure didn't have that kind of law in Oklahoma. A jury in Oklahoma is asked to decide the question of fact and then to apply the law as given to them by the court with reference——

Mr. POWER. In a negligence case whose function would it be——

Senator KERR. Sir?

Mr. POWER. In a negligence case whose function would it be to determine whether a given defendant acted in a reasonable and prudent manner?

Senator KERR. Well, the jury has to decide but they do it on the basis of the court's instruction of what is reasonable and prudent.

Mr. POWER. Oh, no, I don't agree with you there. I think the court would instruct the jury that the jury should find, for example, for the defendant if it finds that the defendant acted in a reasonable and prudent manner, and it would be up to the jury to apply that standard to a given set of facts.

Senator KERR. What standard?

Mr. POWER. Reasonable and prudent which apparently is regarded by the courts as an objective standard and a workable one.

Senator KERR. Well, I guess they have changed the law since I practiced because in those days there were judicial interpretations where the law did not provide them with what is reasonable and prudent, and juries in all the cases that I knew about in those days when I was attempting to make a living as a trial lawyer, were advised by the court of what "reasonable and prudent" meant——

Mr. POWER. As applied to a given case.

Senator KERR (continuing). And then directed that if they found the defendant had acted in a reasonable and prudent manner as defined by the court then their finding would be such and such.

Mr. POWER. Well, we have a very definite disagreement as to the function of a jury.

Senator KERR. And it might not even be a reasonable one. [Laughter.]

Mr. POWER. I will say this, Senator; there was a decision recently made by the court with respect to the reasonableness of a salary of a corporate official applied to a given instance under section 162 of the code, which is the section we are presently discussing, and the court held——

Senator KERR. I have a telephone call I must take. I want to resume this with you when I come back. You go ahead.

Mr. POWER. All right.

At any rate we think the standard is a workable one, Mr. Chairman.

The CHAIRMAN. What page are you on now?

Mr. POWER. Well, I really wasn't reading it, but I was approaching the middle of page 3 where it says, "Add two" at the top.

With respect to the requirement that facilities, entertainment facilities, be used primarily for business purposes, this, too, we think is a reasonable approach, and that this would eliminate a substantial amount of the abuse.

This provision will do much to cure the flagrant abuses widely reported by IRS with respect to yachts, hunting lodges, fishing clubs, et cetera.

These three changes; that is, the elimination of the Cohan rule, the requirement that travel be reasonable or the allowance for meals and lodging be reasonable while on business travel status, and the requirement that entertainment facilities be primarily used for business in order for there to be any deductibility, in our opinion, are sufficient when coupled with increased enforcement and the automatic data-processing system presently being introduced by IRS.

There has been no evidence of significant abuse in the expense account area since the IRS new enforcement procedure (TIR No. 221) went into effect. As a matter of fact, sales in our industry would indicate that the businessmen have substantially curtailed their expense account spending since that time.

Despite our conviction that restriction on entertainment expense, in addition to the three foregoing restrictions is unwarranted and will produce economic harm, we do not seriously object to the language presently contained in the House bill in section 274(a), which provides that entertainment expenses must be directly related to the active conduct of the taxpayer's trade or business.

It appears to us this language merely required the establishment of a greater degree of proximate relationship between the entertainment expenditure and the taxpayer's trade or business than is required under present law.

It did not appear to be much of a substantive change from existing law.

The Treasury Department revised its estimates downward as to the amount of revenue it anticipated from the new restriction. Even legislative history appearing during the floor debate in the House would indicate that the proposed section was a reasonable approach.

The committee report, however, creates a tremendous amount of confusion as to the meaning of code section 274(a), subparagraph (A).

We would certainly agree with the statement made by Secretary Dillon last week to this committee to the effect that this section will engender endless litigation. We think that it is confusing, and litigation will result not from the language of the bill itself, as adopted by the Ways and Means Committee and the House of Representatives, but because of the committee report which accompanied or commented on this section of the bill.

"The committee report would indicate that proposed section 274(a), subparagraph (A), was identical to the recommendation of the administration.

Tax guides such as Prentice-Hall and Research Institute of America since the introduction of the committee report would indicate that these experts also regard the section as confusing and as virtually identical to the administration recommendation.

This is a statement, Mr. Chairman, of the Research Institute of America which is extensively used by businessmen in the tax field. It makes this comment—

a strict interpretation of the provision adopted by the House could jeopardize all entertainment expense deductions except for business lunches and similar meetings.

Initially the administration recommended the elimination of the deductibility of all entertainment expenses except food and beverage entertainment which would facilitate business meetings or would be conducive to business discussion. The committee report of the House adopts the same approach in interpreting the code section 274(a), subparagraph (A).

It would appear that the committee report and the administration proposals are virtually identical. Both in essence disallow goodwill entertaining.

We would not seriously object to a reasonable approach with respect to entertainment expenses, but we regard the administration's proposal and the apparent interpretation of the House-passed measure in the committee report as somewhat silly.

Senator KERR. As what?

Mr. POWER. As somewhat silly. The administration's proposal and the apparent interpretation of the House.

Actually the two——

Senator KERR. I want to tell you you are making lots of progress before this committee. You just stay with it and you will be one of the most effective witnesses that has ever been before this committee so far as I am concerned, adverse to your position.

Mr. POWER. The committee report and the administration proposal attempt to distinguish between entertaining that is conducive to business discussion or facilitates business meetings.

Both of them attempt to disallow the former and allow the latter. In the first place, the distinction is virtually impossible to make because there is no logical distinction between the two for virtually all entertaining is designed to create good will and virtually all entertaining presents an opportunity for some business discussion.

Apparently it is assumed that the greatest occasion for expense account abuse is in the area of good will entertaining, and that good will entertaining is more apt to be unreasonable than entertaining that facilitates business discussion.

Yet there is no evidence to support such assumptions.

Much good will entertaining presents virtually no opportunity for expense account abuse. Much good will entertaining is perfectly reasonaable and would be readily recognized as such by any fair-minded person.

The amount of such good will entertaining is far more extensive than proponents of the elimination of good will entertaining apparently realize.

Business banquets and convention entertaining are typical examples involving several hundred million dollars annually.

We would recommend although we do not feel that legislation in the entertainment area is essential, that if it is deemed by the committee essential we would recommend that a prudent man concept be applied to the allowability or deductibility of business entertainment expenses.

We would recommend this specific language—

entertainment expenses be disallowed except to the extent that a prudent man in a similar trade or business might reasonably be expected to incur them.

This amendment would permit the Government to question the wisdom of an expense using an objective standard in determining whether or not it is reasonable.

The standard would be whether a prudent man would make the expense bearing in mind that it must be likely to benefit the business of the taxpayer. The prudent man concept is a well-established legal concept in American jurisprudence.

The prudent man test is not, of course, as exact or precise a formula as has been recommended by the Treasury Department. But no reasonable formula can be precise because reasonable entertainment expenses depend on the facts in the individual case.

They are reasonable if a prudent man could reasonably have made such an expense for the benefit of a similar trade or business.

Any exact formula by necessity must deny some reasonable expenses along with the denial of unreasonable expenses.

That concludes my statement.

Senator I apologize to the committee for using the word silly. Perhaps the word "silly" was not an appropriate one to make before this group and I apologize to the committee for it.

The CHAIRMAN. What was not appropriate?

Mr. POWER. Beg pardon?

The CHAIRMAN. What was not appropriate?

Mr. POWER. To make the comment the administration's proposal was silly.

Senator KERR. You not only made the comment that the administration's proposal was silly, you made the statement that the Ways and Means Committee action and report was silly.

Mr. POWER. The committee's report on that provision, I apologize for that remark as well, Senator.

Senator KERR. You need not apologize to us because we neither made the proposal nor wrote the report.

Mr. POWER. Well, you seemed to be offended by it and I do think it was an ill-chosen word.

Senator KERR. The remark that I have for the Ways and Means Committee is such that when a matter on which they worked for a year and longer and then come forth with the action which I would regard as something which they thought was the best that they could do——

Mr. POWER. I think they did a very excellent job.

Senator KERR. To be referred to by a witness as silly indicts the witness to me more than it does the committee.

Mr. POWER. I didn't mean to apply it either to the committee or to the administration or to the Treasury Department.

What I did mean to say was that the distinction itself was not a sound one or was not an intelligent one.

The CHAIRMAN. Any further questions?

Senator KERR. Yes. I believe that you took the position that the tax credit was unsound?

Mr. POWER. I don't take the position that the tax credit of itself is unsound but I think that it is an unsound application at a time when unemployment is our greatest problem.

I believe that that militates against the interests of the service industries, or those industries which employ primarily manpower as opposed to machines.

I think that there are many ways to stimualte business investment generally without stimulating machinery alone.

Now, I recognize the wisdom of the tax credit——

Senator KERR. Did you have the impression that the tax credit was applicable to machinery alone?

Mr. POWER. Well, no, I recognize the tax credit would apply to any depreciable equipment or any machinery, any capital investment, no, I recognize that, Senator. What I had in mind, however, was that it discriminated against those industries that use manpower, service industries, as opposed to industries which use machinery or equipment, industries with a relatively high-labor cost as a percentage of sales as opposed to industries with a relatively high investment in capital equipment as a percentage of sales.

Senator KERR. Well, is there any relationship between those employed in selling a product and the salability of the product?

Mr. POWER. Yes, I believe there is very definitely, Senator.

Senator KERR. Is it possible that if a company by more efficient equipment could produce a product which would either be better or cheaper than it would otherwise be, would it have some relationship to the amount of the product that would be sold?

Mr. POWER. Very definitely. As a matter of fact, I think that is one of the features that would militate against our interests. For example, if the shoe manufacturing industry were to introduce more efficient machinery for the production of shoes, they would reduce the cost of producing those shoes and ultimately would have a competitive advantage in the sale of the shoes. The public might be more apt to buy shoes at the expense of restaurant meals, because in the competition for the consumer's dollar there is a competition between all commodities; the consumer has a choice either to buy shoes or restaurant meals.

Senator KERR. Either eat or wear a pair of shoes?

Mr. POWER. Beg your pardon?

Senator KERR. You mean——

Mr. POWER. No; he can eat at home and wear shoes out.

Senator KERR. If he could buy shoes cheaper he might have a little more money to spend at the restaurant, mightn't he?

Mr. POWER. That is quite true but if you give——

Senator KERR. If a salesman had a new and less expensive shoe he might even come to town and take a customer to a restaurant and feed him and tell him about that improved shoe, mightn't he?

Mr. POWER. Anything is possible, Senator, yes. He might do it without any shoes at all. The point that I am making, however, is that when you——

Senator KERR. Make that last statement again. He might do what if he didn't have any shoes?

Mr. POWER. He might do the same whether he had any new shoes or not.

Senator KERR. You didn't say the new one but that is what you meant.

Mr. POWER. Well, I meant——

Senator KERR. I thought you said he might do that if he didn't have any shoes at all.

Mr. POWER. He might take—go to a restaurant whether he had his shoes or not, I suppose.

Senator KERR. Well, I guess he might at that.

Mr. POWER. It is possible.

Senator KERR. He would have a better physical approach than most of them have, or he might get discouraged before he got to the restaurant.

Mr. POWER. But the point I am trying to make is the tax approach of stimulating investment in machinery I think is good for the country.

Senator KERR. You do think it is good?

Mr. POWER. Yes. The thing that I think is wrong about it, Senator, is that it is a bad time when you have a problem of unemployment.

Why stimulate the area of capital investment at this time when the stimulation of capital investment is most apt to militate against employment?

Senator KERR. What do you think would be the result of the application of the tax credit to the industries that could use it?

Mr. POWER. What would be the result?

Senator KERR. Yes.

Mr. POWER. I think those industries which were capable of using the tax credit and did use the tax credit would be able to reduce cost, and to increase efficiency and productivity.

Senator KERR. Well now, we have in this country competition for the consumer dollar, you say?

Mr. POWER. Yes.

Senator KERR. That is a well-recognized fact.

You are aware of the fact that competition is not limited between domestic producers alone, aren't you?

Mr. POWER. I am.

Senator KERR. That regardless of how much domestic producers compete with each other they also must compete against foreign products?

Mr. POWER. In the area of foreign competition, I recognize the value of tax credits. I still think that is not our principal economic problem, however, and I think that the tax credit——

Senator KERR. We are confronted with a situation where we have an adverse balance of payments insofar as our gold reserve is concerned of which I am sure you are aware?

Mr. POWER. Yes.

Senator KERR. And that is affected to two ways that I will refer to; it is affected otherwise also, but it is affected by the amount of products manufactured abroad that are shipped into this country and bought by American consumers and paid for with American dollars, thereby buying abroad; is that correct?

Mr. POWER. Yes.

Senator KERR. It is also affected by the amount of products which we make here and export abroad which are paid for by dollars on the part of foreign purchases; is that correct?

Mr. POWER. Yes.

Senator KERR. Now, do you think in view of the fact that at this time we have an adverse balance of payments in excess of $2 billion a year, at a time when we already have a greater amount of foreign claims against our gold than we have gold with which to meet them if they were presented for redemption, that that is an element in our overall economic picture.

Mr. POWER. Absolutely, Senator.

Senator KERR. Do you think that Congress should find ways and means to improve that situation?

Mr. POWER. I do.

Senator KERR. Do you think that the tax credit approach has any merit in that regard?

Mr. POWER. I do.

I do not feel, however, that that correctly recognizes the principal economic problem of our country today—unemployment, and I do think that it would be ill advised to select this means to solve the problem of international competition when the means is going to militate against employment.

I do not think——

Senator KERR. How could it militate against employment if the result was twofold: No. 1, that it resulted in the production of more articles that would be purchased locally in the domestic market, and, No. 2, reduce the imports of products from foreign sources.

The buying of products in this market that are produced by foreign sources doesn't increase local employment, does it?

Mr. POWER. No, it does not.

Senator KERR. But if we could do something which would replace foreign-produced products made with foreign labor by products which were domestically made with American labor, wouldn't that beneficially affect domestic employment rather than adversely affect it?

Mr. POWER. It would beneficially. It would beneficially affect it by itself, if we look at that restricted view of the economic effect of it, yes.

Senator KERR. We are talking about employment.

Mr. POWER. Well, I am still saying that artificial stimulation of capital investment alone is going to militate against the industries that do not use capital equipment in the competition for the consumer's dollar.

The service industries and the sales dollar in the service industries is greatly in excess of our entire foreign market by three or four times.

Senator KERR. What you are saying is that there might be a better approach to it?

Mr. POWER. Yes.

Senator KERR. Or there should be additional features to a tax bill, but you recognize that this would have a beneficial effect in that limited area?

Mr. POWER. Yes, it would have a beneficial effect in that limited area.

Senator KERR. Let me ask you another question: You referred to the tax credit as a tax subsidy or as a subsidy?

Mr. POWER. Well——

Senator KERR. Would you make a further observation on that score? How do you justify that statement?

Mr. POWER. Well, it is a payment by the Federal Government, at least it is a reduction in taxes, say——

Senator KERR. Those are two different things, aren't they?

Mr. POWER. I suppose you could work up a technical distinction between the two, but as a practical matter in dollars and cents——

Senator KERR. You think it is only a technical distinction between a payment by the Government to a taxpayer on the one hand and a reduction of the amount of taxes owed by the taxpayer on the other? You think the difference between those two situations is merely technical?

Mr. POWER. Well, I think as a practical matter it means that the taxpayer has more money left at the end.

Senator KERR. Well, it means that he has had a tax reduction, doesn't it?

Mr. POWER. It means that he has a tax deduction that someone else did not get.

Senator KERR. If he has a tax deduction in connection with a tax which he would otherwise owe, isn't that a reduction of his taxes?

Mr. POWER. That is true.

Senator KERR. Do you regard a tax reduction as a subsidy?

Mr. POWER. I would not—my concept of Government would not be that a tax reduction is a subsidy but I think this, Senator, if a tax reduction is given on a selective basis to certain individuals——

Senator KERR. This is not a tax deduction. This is a tax credit.

Mr. POWER. I beg pardon?

Senator KERR. This provides a tax credit, it doesn't reduce the amount of taxable income as such. It just says——

Mr. POWER. It reduced the amount of taxes.

Senator KERR. It shall be a tax credit against the liability that the taxpayer owes of a certain amount.

Mr. POWER. But you asked me if I regarded a tax reduction as a subsidy, yes, as a subsidy.

Senator KERR. Yes.

Mr. POWER. Well, whether you call it a tax credit or tax reduction, I would not ordinarily regard it as a subsidy but if it is on a selective basis, and on a discriminatory basis of one individual as opposed to another, I think it is fair to call it——

Senator KERR. It is available to anybody who meets the specifications of the law, isn't it?

Mr. POWER. Yes, it is.

It is available to anyone who meets the specifications of the law, those specifications are so drawn that——

Senator KERR. Anybody who makes an investment described in this law is eligible for this tax credit, isn't he?

Mr. POWER. Anyone who purchases capital equipment.

Senator KERR. Anyone who makes an investment under the specifications of this law is entitled to the credit.

Mr. POWER. That is correct.

Senator KERR. Now, you pay individual taxes, don't you?

Mr. POWER. Yes.

Senator KERR. You pay them in accordance with the rates set forth in the Internal Revenue Code?

Mr. POWER. Yes.

Senator KERR. Let's say you are in—you have income that puts you in a situation where with reference to part of it you pay 60 percent of a certain amount of your income tax to your Government.

Mr. POWER. It is a hypothetical case.

Senator KERR. I understand, I just want to make a point and see if we can agree on a principle.

If you are among those with reference to whom a portion of your income is subject to a 60 percent tax, and if Congress passed a law which said that there shall be no higher rate than 50 percent applied to the income of any person in computing their income tax liability, that would affect a tax reduction for you, wouldn't it?

Mr. POWER. Yes, it would.

Senator KERR. Would you regard that as a subsidy?

Mr. POWER. No, I would not. I would not.

Senator KERR. Well, then, why would you regard as a subsidy a tax reduction which is applicable to anybody in the United States regardless of the rate of their income tax, whether it is 52 percent or what it is, if they establish their eligibility under the specification of the general law?

Why would you regard that tax credit as a subsidy and not the other?

Mr. POWER. Well, the tax credit results in increased money with the taxpayer.

Senator KERR. Wait a minute.

Say that again?

Mr. POWER. The tax credit results in more, as a practical matter the taxpayer pays less taxes.

Senator KERR. Sure, any time anybody's taxes are reduced they pay less taxes. That would not be limited to this, would it?

Mr. POWER. I beg pardon?

Senator KERR. That principle, that statement, wouldn't be limited to this law, would it?

Mr. POWER. No, it would not.

Senator KERR. Anybody who, by the passage of an act, pays less taxes has more money left than he would have had otherwise, doesn't he?

Mr. POWER. Now, the reason he pays less is in order to stimulate him, as I understand it, to buy more capital equipment.

Now, if he is in a position to buy capital equipment he is in an advantage over the taxpayer who is not in a position or who has no need for capital equipment or who might better make a choice to invest in his business in some other way.

Senator KERR. Well, you could say the same thing about a tax reduction bill that said that instead of an 87 percent rate there would be no rate above 70 percent; then you would say that would be a subsidy because a lot of people there are to whom it doesn't apply.

Mr. POWER. How would you define a subsidy, Senator? Maybe we are differing on that meaning.

Senator KERR. Let's not go to either one of us to find it. Let's get the dictionary. When we—I think now you are making a constructive approach. Let's find out what authoritative spokesmen have said.

The discussion on this bill is the first time I have ever heard a tax reduction referred to as a subsidy. And it may be I am in loneliness, in error in my interpretation of it.

Error does not become truth no matter how often repeated. "S-u-b-s-i-d-y," isn't that right?

Mr. POWER. Yes, it is.

Senator KERR (reading):

Pecuniary aid directly granted by Government to an individual or commercial enterprise deemed productive of public benefit; money furnished by one nation to another to aid it in carrying on a war against a third; an English cabinet resolved to animate the enemies of France with hopes and to aid them with subsidies; formerly an aid or tax granted by the House of Commons to the King for urgent needs of the Kingdom; any financial assistance offered by one individual to another.

Senator MORTON. Read the first one again, Senator.

Senator KERR (reading):

Pecuniary aid directly granted by Government to an individual or commercial enterprise deemed productive of public benefit.

Now, when you reduce the penalty or the amount of the tax required you certainly benefit the taxpayer but you do it by reducing the amount which he has been required to pay not by granting to him pecuniary aid.

That is the opinion of the Senator from Oklahoma.

Mr. POWERS. As I said before, as a practical matter, it is a grant of aid.

Senator KERR. As a practical matter, it is a tax reduction, I thought you said?

Mr. POWER. Well, it is a tax reduction and returning back to the original statement——

Senator KERR. That is of great aid to the taxpayer, I am ready to admit that and I don't know of any taxpayer that wouldn't like to have that kind of consideration by his Government, but when you reduce the amount of tax he has to pay, we have helped him.

Mr. POWER. Yes.

Senator KERR. But you have done it by reducing his tax, not by giving him something with which to pay his tax, haven't you?

Mr. POWER. Yes, and I agree there is a distinction.

Senator KERR. All right. That is all.

The CHAIRMAN. Any further questions?

Senator MORTON. Mr. Power, with the indulgence of the committee, I would like to return to the restaurant business. I understand you are representing the National Restaurant Association?

Mr. POWER. That is correct, Senator.

Senator MORTON. We have taken you into the field of balance of payments and gold reserves and subsidies and all over the lot, but let's get back to the restaurant business, if you don't mind just for a moment.

You say that about $2 billion are spent on what is commonly termed the expense account in the restaurants of America.

Mr. POWER. In the restaurants of America for food and beverage entertainment, we would estimate that, yes, sir.

Senator MORTON. You would have no way of knowing, of course, but isn't it your opinion that a high percentage of this group, just the average traveling man, who is away from home, who goes into the hotel restaurant or some other restaurant to buy his dinner——

Mr. POWER. That is correct, Senator. A good percentage of it, although the entertainment aspect of it would probably outweigh the meal and lodging or the meals while in business travel status.

But a good percentage of it is the typical business luncheon or the businessman's convention, not the lavish type entertaining but the bread and butter stuff really is about 90 percent.

Senator MORTON. I don't know how many thousands of men and women there are engaged in sales work who travel, with modern day communication, it is perhaps not as extensive as it used to be proportionately to the business that is done in this Nation, but it is normal business procedure for a man who is traveling for his company in a sales capacity to have his meals and lodging furnished him when he is on the road.

Mr. POWER. Yes, it is.

Senator MORTON. I don't think business has changed so much since my day but I think sales managers operate under a budget and that they are constantly applying some degree of surveillance to these expense accounts.

Mr. POWER. Yes, sir.

Senator MORTON. Trying to keep their salesmen operating within their total budget.

M. POWER. That is correct, Senator.

Senator MORTON. Isn't that the normal business practice?

I don't approve of these examples of horrors we have had spread before this committee ever since this hearing began on yachts and hunting lodges, and things of that kind. I am as anxious as anyone on this committee to see them eliminated as part of—because I think they have been abused—as part of contributing toward the goodwill of the company or in generating sales. But the stockholders have an interest in these expense accounts.

Mr. POWER. Yes, they do.

Senator MORTON. I am afraid these hearings have given the impression that just because we have something that is tax deductible, that every businessman runs wild on his expenses.

Mr. POWER. As a general rule, Senator, it is very closely related to the production of income. I mean the amount for the validity of an entertainment expense or food and beverage expense is related to the amount of kind of income a salesman produces.

There are very few companies that give the salesmen the license to deduct anything and everything they want, if any. The idea is if a man produces the income and contributes to the financial welfare of the company then the deduction would be permissible.

Senator MORTON. Yes. The point is that the exercise of judgment on the part of management——

Mr. POWER. Yes, it is.

Senator MORTON (continuing). Enters this field long before the Internal Revenue Service enters this field.

Mr. POWER. Yes, it does.

Senator MORTON. Management, with its responsibility to stockholders——

Mr. POWER. Yes, it does.

Senator MORTON (continuing). Makes a determination as to whether this expenditure is in the interest of the stockholders, in the interests of the company. The decision as to whether or not a man is allowed $8 a night or $12 a night for a room, a traveling salesman, is not made because it is a deductible expense from a standpoint of taxes.

Mr. POWER. I agree, Senator.

Senator MORTON. It is in the interest of the equity of the business itself.

Now the $2 billion figure that you gave, was that inclusive of conventions?

Mr. POWER. Yes, it is.

Senator MORTON. That is the overall figure?

Mr. POWER. Inclusive of food and beverage consumption at conventions, yes. It would not include the travel or the lodging.

Senator MORTON. As I get your point on the investment credit, you recognize that it would be a stimulant to companies that have——

Mr. POWER. Manufacturing.

Senator MORTON. Manufacturing companies, companies that have heavy capital needs for machine tools and so forth.

Mr. POWER. Yes, sir.

Senator MORTON. Your point as I understand it is, that you represent a service industry whose wages represent some 50 percent of sales?

Mr. POWER. Well, not quite in our industry, Senator.

That would be true of industries that are in the entertainment business as well where they would have maybe a band or musicians playing in a restaurant.

No, our labor cost in our industry would be lower than that but it would be substantial or relatively high.

Senator MORTON. It is substantial. But in the average?

Mr. POWER. Closer to 35 percent.

Senator MORTON. What you are saying is that in the average restaurant the investment credit would be little or no stimulant.

Mr. POWER. That is correct.

Senator Morton. It would not increase, particularly increase, the restaurant business.

Mr. POWER. The only way it would substantially increase it would be in a certain area of our industry; that is, vended restaurant meals.

As you know, at the present time in order to overcome labor costs you can get just about anything from soup to nuts out of a coin-operated machine. Actually we think this tax credit law would facilitate the introduction of vending machines. But it seems to us to be a mistake when unemployment is now a principal problem in the country to stimulate vended meals—why should a vended restaurant meal get a break over a serviced restaurant meal? It is a different commodity and this, I think, is a classic example of what would happen under the tax credit feature of the bill. It stimulates those industries which provide for the employment of the least people. The industries that employ the most people get the least advantage out of the bill.

Of course, we subscribe to the philosophy that there ought to be a realistic depreciation allowance, an allowance for machinery and equipment that takes into consideration obsolescence and its useful life.

But we do not think that there ought to be any artificial stimulation of machinery or capital equipment at this time when unemployment is our problem. This benefits those industries that use machines at the expense of those industries that provide jobs, and this would be true in the restaurant business.

Senator MORTON. Back to my original point. In conclusion, you do recognize the fact that management makes a determination based on what benefits the stockholder——

Mr. POWER. Yes.

Senator MORTON (continuing). In approving expense accounts at all levels.

Mr. POWER. I think that the study made by IRS would support that position very clearly, the audit made by them of 38,000 business returns. For the most part, the area of the problem was in self-owned corporations or owner-managed corporations who are the substantial of the majority of the businessmen in the country.

Senator MORTON. Thank you, sir. I have served as a former salesmanager, and when I rode herd on expense accounts, I got into more trouble with my own people than I got into with the IRS on expense accounts.

The CHAIRMAN. Senator Williams.

Senator WILLIAMS. Mr. Power, under existing law, every taxpayer, as a businessman, is allowed to depreciate 100 percent of the cost of his equipment, his fixtures, his machinery, or his buildings, is he not?

Mr. POWER. Yes, he is, Senator.

Senator WILLIAMS. Under this bill those taxpayers who buy machinery or equipment only would get the advantage of this investment credit, would they not?

Mr. POWER. That is correct.

Senator WILLIAMS. The farmer who built a barn or a shed for his tractor could not get any investment credit on that fixed building.

Mr. POWER. On the real estate, no, he could not.

Senator WILLIAMS. On the real estate, no. He would get the credit only on the machinery or the tractor.

Mr. POWER. That is correct.

Senator WILLIAMS. And under this bill with the 7-percent credit he would, in effect, be permitted to depreciate 114 percent of the cost, would he not, because the 7-percent credit, assuming a 52-percent bracket, is approximately a 14-percent deduction if he were to take it as a deduction, and this would be establishing a precedent for those purchases of machinery and equipment whereby they could recover more than 100 percent of the cost of the item.

It was on that basis, as I understand it, that you could classifiy this as a subsidy and not as a tax deduction.

Mr. POWER. Well, I think it could be; yes, Senator.

Senator WILLIAMS. And the fact that this would be available to all taxpayers in that category, we have subsidies for, we will say for, the American merchant marine, and we all recognize those as subsidies, and even the companies do, and we will not debate the merits of it, but that, too, is available to all of the industry, American merchant marine, which can qualify under the law.

The mere fact that it is available to all taxpayers does not change its classification as a "subsidy."

Mr. POWER. It would not, in my opinion, Senator.

Senator WILLIAMS. No.

The fact that while I agree fully that a tax reduction is not a subsidy, whether it be a tax reduction of a few years ago, a reduction of $7½ billion, or a tax proposal to reduce the ceiling on taxes from 87 percent down to 60 percent is a tax reduction and would not be a subsidy, it would not be a subsidy any more than it would be to confuse the present 87 percent which is in existing law as a subsidy for the American taxpayers, because we are allowing them to keep 13 percent of that which they earned. That certainly would not be a subsidy, would it?

Mr. POWER. No.

Senator WILLIAMS. Thank you.

The CHAIRMAN. Thank you very much, Mr. Power.

Mr. POWER. Thank you, sir.

(Mr. Power's prepared statement follows:)

STATEMENT OF THOMAS W. POWER, WASHINGTON COUNSEL FOR THE NATIONAL RESTAURANT ASSOCIATION

Mr. Chairman and members of this committee: My name is Thomas Power, and I am Washington counsel for the National Restaurant Association. We represent about 100,000 restaurants in the country through our own membership and the membership of 135 State and local associations. We are principally concerned about the expense account section of the tax bill but we would like to comment briefly on the tax credit feature of the bill.

Tax credits will cause substantial job loss in the restaurant industry in our opinion. We are not speaking merely of job loss resulting from increased productivity or increased efficiency. Rather we are referring to job loss resulting from the substitution of a vended restaurant meal for a served restaurant meal. Our industry, to a degree, can switch from the sale of a service to the sale of goods alone with a tremendous cut in jobs. The tax credit feature of this law will accelerate this process.

The vended restaurant meal is a good illustration of the broader economic effect of the tax credit proposal. Any service industry, any industry with a relatively high labor cost as contrasted with industries having a relatively high capital investment will be put at a disadvantage in its competition for the consumer's dollar if the tax credit approach is adopted. The artificial stimulation through any tax gimmick of industries with high capital investment will be at the expense of industries which employ the most people. Reduce the unit cost of a pair of shoes and the public is apt to buy more shoes and less restaurant meals, more goods and less services. Subsidize machines and you do so at the cost of jobs. Tax credits discriminate against industries providing jobs in favor of industries using machines.

We do not wish to convey the impression that we are not progressive or that we would cure the unemployment problem through the perpetuation of human labor instead of more efficient machinery. To subsidize machinery will lead to greater efficiency and the increased productivity of manufactured goods. This by itself is good and may help the unemployment problem. But if it leads to a fall in the demand for services, its disadvantages may well outweigh its advantages. Total economic effect must be considered.

There is no question that the majority of our exports are manufactured products. Tax credits will undoubtedly help us with international competition. If foreign competition were our Nation's principal economic problem, we would understand the reason for this tax gimmick. Perhaps international trade is or was the greatest problem in those foreign countries where tax incentives to stimulate capital investment are given. But in the United States, foreign competition is not the principal economic problem. Unemployment is our concern and particularly unemployment among workers most typical of those in the service industries. Why in the world should our tax policy subsidize manufactured goods at the expense of salable services? Why not stimulate promotion of service industries, or travel, or investment in inventory, or in accounts receivable, or research, or a host of other business investments which would have a more positive effect on our country's unemployment problem. High volume also leads to greater efficiency and greater productivity.

Because of our industry's growing ability to switch to vending restaurant meals, it is possible that we will get our share of this tax windfall. The benefit will go primarily to large operators, however, because they have greater funds for capital investment. Moreover, small operators are generally close to their employees and will find it more difficult to take economic advantage of the subsidized substitution of vending machines for workers.

These same arguments hold true for faster depreciation allowances. We recommend realistic depreciation allowances to correctly reflect the useful life and obsolescence of capital equipment. If adjustments are needed, they should be made; but we do not support unrealistic depreciation which like tax credits militate against employment and against the service industries with their high labor cost and limited capital investment. We are not against tax credits for this purpose if they are more economical to the Government, but we do not see the connection between an across-the-board tax credit with the useful life and obsolescence of depreciable equipment.

We don't see why the tax practice of foreign nations should dictate our country's practices. Tax credits might well help our Nation to compete with foreign countries, but unquestionably they will aggravate our employment problem by stimulating manufactured goods at the expense of services.

Our principal concern with the tax bill is the administration's proposal to disallow good will entertainment expenses as a tax deductible item. Over $2 billion a year is reported as business expenses for food and beverage entertainment. While the administration does not recommend the disallowance of this entire amount, its proposals would result in a sales loss estimated to exceed $1 billion a year. There is over $500 million in wages involved in this volume of business and over 200,000 jobs might be lost. Entertainment expenses in establishments where music or entertainment is provided, the majority of business banquet expenses, and virtually all convention entertainment expenses would be denied. We believe sales of this type of entertainment alone exceed $1 billion annually.

We are not opposed to legislation designed to eliminate expense account abuses provided that the legislation does not arbitrarily eliminate the deductibility of reasonable business entertaining expense. A major problem of the Department of Internal Revenue has been expense account abuses made possible through the so-called Cohan rule. We recognize that the elimination of this rule and the requirement of substantiation of all business expense accounts will present a tremendous recordkeeping problem for our industry and will place greater demands on us to provide receipts and to accept credit cards. Nevertheless, we recognize the value of proposed code section 274(c) and approve of its adoption. As a technical point, however, we do not believe that failure to comply with section 275(c) should result in double disallowance of expense accounts. The burden of recordkeeping should be placed upon the person spending the money. A taxpayer should not be held accountable for the inadequate records of his employees or some other person performing services for him. We would recommend that "Section 274(c) shall not apply to expenses paid or incurred by the taxpayer in connection with the performance for him of services by another person (whether or not such other person is his employee) under a reimbursement or expense allowance arrangement with such other person."

Of course, if his expenses are not ordinary and necessary, double disallowance would take place; but we do not believe a taxpayer should be held accountable for recordkeeping over which he has no control. If the expenses are ordinary and necessary and the taxpayer in good faith reimbursed them to another person, the taxpayer should not be held accountable for the faulty records that are not of his making. Such disallowed expenses should be treated as income to the person responsible for keeping adequate records of them.

We also recognize the validity of section 4(b) of the House bill providing that there shall be only a reasonable allowance for meals and lodging while in business travel status. We would hope, however, that the legislative history of this amendment would make the Senate's intention clear that the reasonableness of these expenses will depend upon the facts in individual cases; for example, criteria or standards such as the locality in which travel is performed, the customary and usual standard of living of the person traveling, the purpose of the travel, and the relationship the travel expense bears to the anticipated benefit to the taxpayer's business should all be considered as factors for determining whether an allowance is reasonable in an individual case.

We also recognize the wisdom of proposed Code section 274(a) subparagraph (B) providing that there should be no deduction for entertainment facilities unless the taxpayer establishes that the facility was used primarily for business purposes. This is a reasonable restriction on the deductibility of entertainment facilities and will do much to curb the flagrant abuses widely reported by IRS.

Frankly, it is our opinion that these three legislative changes, that is the elimination of the Cohan rule, the limitation of meals and lodging to a reasonable allowance while on business travel status, and the nondeductibility of the cost of entertainment facilities unless used primarily for business purposes, coupled with the increased enforcement made possible with the additional 3,365 new IRS agents last year and through the introduction of automatic data processing equipment will eliminate virtually all expense account abuse. There has been no evidence of substantial abuse since the new IRS enforcement procedure (TIR No. 221) went into effect. Industry sales since that time would definitely indicate that enforcement procedure has substantially curtailed expense account spending. Faced with a more effective enforcement program, taxpayers unduly cautious because of the danger of double disallowance, have even curtailed legitimate expense account spending; so much so that the announcement of an expense account crackdown was followed by a rash of convention cancellations in resort areas. Publicized reassurance by the Treasury Department of the legitimacy of conventions in resort areas was necessary to overcome the imminent danger of economic harm to important elements in our population.

Despite our conviction that additional restrictions on entertainment expense in addition to the foregoing is unwarranted and will produce economic harm, we do not seriously object to the language of proposed code section 274(a) subparagraph (A) contained in H.R. 10650. When this language was first introduced, we did not find it very definitive as to allowable entertainment expenses. It appeared to us that the language merely required the establishment of a greater degree of proximate relation between the entertainment expenditure and the taxpayer's trade or business than is required under present law. It did not appear to be much of a substantive change from existing law. The Treasury Department revised its estimates downward as to the amount of revenue it anticipated from the new restriction. Even legislative history appearing during the floor debate in the House would indicate that the proposed section was a reasonable approach. The committee report, however, creates a tremendous amount of confusion as to the meaning of proposed code section 274(a) subparagraph (A). We would certainly agree with the statement made by Secretary Dillon to this committee last week to the effect that this section will engender endless litigation. We think this is confusing and litigation will result not from the language itself but because of the committee report. The committee report would indicate that proposed code section 274(a) subparagraph (A) was identical to the recommendation of the administration. Tax guides such as Prentice-Hall and the Research Institute of America since the introduction of the committee report would indicate that these experts also regard the section as confusing and as virtually identical to the administration recommendations. Initially the administration recommended the elimination of the deductibility of all entertainment expenses except food and beverage entertainment which would facilitate business meetings or would be conducive to business discussion. The committee report of the House adopts this same approach in interpreting proposed code section 274(a) subparagraph (A). It would appear that the committee report and the administration proposal are virtually identical. Both would in essence disallow good-will entertainment.

We would not seriously object to a reasonable approach with respect to entertainment expenses, but we regard the administration's proposal and the apparent interpretation of the House-passed measure contained in the committee report as just plain silly. Under this section, the Coca-Cola Co. could not deduct the cost of providing a meeting of Boy Scouts with cases of Coca-Colas because obviously such entertainment would be designed to create good will for the product of the Coca-Cola Co. To illustrate still further the absurdity of the administration proposal, I suppose we could say that it is not entirely true that Coca-Cola could not be given to the Boy Scouts. If the Coca-Colas were given to the Boy Scouts under circumstances conducive to business discussion, then apparently the expense would be deductible and this despite the fact that obviously the Coca-Cola Co. would have little business to discuss with the Boy Scouts. The committee report of the House points out that good will food and beverage entertaining is possible under proposed code section 274(d) subparagraph (1) because this exception does not require that business actually be discussed but merely that the entertainment be given under circumstances conducive to business discussion. What could be more ridiculous than determining the allowance or disallowance of an entertainment expense on an artificial standard such as the surroundings in which the entertainment is given?

Both the committee report and the administration proposal attempt to distinguish between entertaining that is conducive to business discussion or facilitates business meetings. Both of them attempt to disallow the former and allow the latter. In the first place, the distinction is virtually impossible to make because there is no logical distinction between the two for virtually all entertaining is designed to create good will and virtually all entertaining presents an opportunity for some business discussion. Apparently it is assumed that the greatest occasion for expense account abuse is in the area of good will entertaining and that good will entertaining is more apt to be unreasonable than entertaining that facilitates business discussion. Yet there is no evidence to support such assumption. Much good will entertaining presents virtually no opportunity for expense account abuse. Much good will entertaining is perfectly reasonable and would be readily recognized as such by any fair-minded person. The amount of such good will entertaining is far more extensive than proponents of the elimination of good will entertaining apparently realize. Business banquets and convention entertaining are typical examples involving several hundred million dollars of good will entertaining annually. Attendance of a lawyer at an annual bar association dinner, for example, with or without guests, is a business expense which would be disallowed under the administration proposal and probably under the committee report if inconsistencies are removed. Yet it is an expense which is reasonable and does not present an occasion for expense account abuse.

Good will entertaining by a supplier at a convention in a distant city is far less apt to be a personal expense than some so-called business entertaining at the supplier's favorite home-town restaurant. Neither the administration's proposal nor the House committee report distinguishes between reasonable and unreasonable entertainment expenses because the difference between reasonable and unreasonable entertainment expenses depends not on whether entertaining was for the purpose of creating good will but rather on factual questions, the most important of which is "whether the anticipated benefit to the taxpayer's business is sufficient to reasonably justify the expense for the entertaining."

We suspect that many proponents of the elimination of the deduction of good will entertaining believe the impact of their proposal will be nominal. This is because they mistakenly believe that taxpayers will not have too much difficulty establishing that the food and beverage entertainment was extended during business discussion. Such is far from true. Close to one-half of all business entertaining is under circumstances obviously designed to create good will rather than to occasion or facilitate business discussion. This is principally the banquet and convention entertainment business. Under such restraints, the entire convention business, accounting for more than $2 billion a year, might well be seriously imperiled.

The cost of attending a banquet, or of taking a business guest to a business banquet, would not be directly related to the active conduct of the taxpayer's trade or business as interpreted by the committee report or conducive to business discussion as would be required by the administration proposal. As a matter of fact, banquets are almost invariably for the purpose of creating good will or developing business contacts. We estimate that the majority of convention business, excluding travel, is entertainment for the purpose of creating good will either at annual convention banquets or other forms of business entertaining.

About $2 billion a year is spent at conventions. If suppliers could not entertain at conventions, in most instances they would not attend. At the typical convention, suppliers of the conventioneers entertain extensively; and in many instances, the entertaining expense is in excess of the amounts spent by the conventioneers themselves. There can be no doubt that entertaining at conventions involves several hundred million dollars annually, all of which would be disallowed if extended merely for the purpose of creating good will and as not necessary to the attendance at the convention. We would make an educated guess that over $1 billion annually of the good will and beverage entertaining presently conducted will be lost if the discussion draft is enacted.

This evil effect would be worsened by the fact that the impact of the restrictions would not be evenly distributed. High-priced restaurants and hotels, and all establishments where music is played would bear the brunt of the restrictions. The impact would be on large cities and resorts where business entertaining and particularly where convention business play a substantial part in their economic welfare.

We would recommend if legislation is deemed necessary restricting entertainment expenses that the law provide that entertainment expenses be disallowed "except to the extent that a prudent man engaged in the same type of a trade or business could be reasonably expected to incur them." This amendment would permit the Government to question the wisdom of the expense using an objective standard in determining whether or not it is reasonable. The standard would be whether a prudent man would make the expense bearing in mind that it must be likely to benefit the business of the taxpayer. The prudent man concept is a well-established legal concept in American jurisprudence.

The "prudent-man test" is not, of course, as exact or precise a formula as has been recommended by the Treasury Department; but no reasonable formulas can be precise, because reasonable entertainment expenses depend on the facts in the individual case. They are reasonable if a prudent man could reasonably have made such an expense for the benefit of a similar trade or business. Any exact formula by necessity must deny some reasonable expenses alone with the denial of unreasonable expenses.

The CHAIRMAN. The next witness is Mr. Frank G. Hathaway of the National Club Association. Will you proceed, sir.

STATEMENT OF FRANK G. HATHAWAY, SECRETARY-TREASURER, NATIONAL CLUB ASSOCIATION

Mr. HATHAWAY. My name is Frank G. Hathaway, of Los Angeles, Calif. I am secretary-treasurer of the National Club Association, a new association formed by a group of business, social, and athletic clubs in California; and I am also president and general manager of the Los Angeles Athletic Club, the Pacific Coast Club, and the Riviera Country Club.

The tax bill under consideration affects our clubs and the club industry most vitally in its treatment of club dues and fees. Specifically, under business entertainment, club dues are only deductible to the businessman if more than 50 percent of his usage is provable as ordinary and necessary business expense.

Historically, clubs have existed as self-help institutions, built at no cost to the taxpayer and as gathering places for persons of common purpose.

Five thousand clubs staffed by 175,000 employees exist today for reasons that are analogous to a three-legged stool. The legs are the basic purposes around which physical plants have been built and from which income flows. One leg, or purpose, includes athletic activities often specialized, such as golf, tennis, handball, swimming, or physical conditioning. Another leg, or purpose, includes social interchange; that is, dances, receptions, meetings and gatherings of community nature. The third leg, but most important to the subject today, is that clubs are centers of business activity in the United States. The reasons for this are many. A few of the more obvious include:

(1) Environment conducive to business discussions: Clubs furnish a relief from the noise and rush existing in many restaurants. Tables are set farther apart, service is not rushed, and opportunity is offered for the kind of quiet conversation essential to business conferences. In addition, a businessman is not likely to have a competitor sitting unknown at the next table.

(2) Location: Most large city clubs are located in the heart of the business section of their city, and form a convenient and central meeting place.

(3) In-club business contacts: His club offers the businessman an opportunity to expand his business contacts. In addition to bringing in nonmember guests for business purposes, he meets many customers and potential customers who are fellow members, and he meets them under the best possible circumstances in the relaxed and friendly atmosphere of his club.

Much business entertaining is done by members in the main dining rooms of clubs, but a great deal of business is also conducted in private dining rooms. This private room business use includes sales meetings, staff conferences, trade association meetings, professional group meetings, and new product introduction meetings. Local conditions and individual club policy affect degree of usage.

To illustrate the scope of our private dining room business uses, in 1961 the Los Angeles Athletic Club served 1,358 company meetings either breakfast, lunch or dinner; 503 professional or trade association meetings were held. During the same period, only 230 meetings of a purely social character were held in our private dining rooms. In the year, 42,832 individual meals were served to the persons participating in the meetings. This is a very substantial number of persons, and covers the private dining rooms only.

If the 1,358 company meetings held in our private dining rooms during the year were to be placed in a discriminatory situation so far as business expense tax deductibility of dues, the companies would be encouraged to consider alternate locations for such meetings.

One of these alternates, which the bill specifically approves as a business expense, is the in-plant facility, or so-called executive dining room. Many very large companies now have such dining rooms within their premises. These companies use these rooms for business and social purposes, and will continue to do so. However, there is little question that the executive dining room is the most expensive form of business entertainment and feeding that exists. It is an economic fact that expensive quarters maintained for the use of relatively few must be costly.

Rather than maintain such an expensive operation, many companies prefer to use clubs for the same purpose. Professional offices, sales offices, and small industrial plants cannot afford the costly in-plant dining rooms, and use their clubs in place of such facilities. In this sense, the tax bill as now proposed, discriminates against small business.

To show the extensive use of clubs for business entertaining, we have available the results of a questionnaire submitted to our members on this point. Eighty percent of our members indicated they used the club at times for business entertaining, and 30 percent said that their company paid all or part of these business expenses.

These facts point up the very arbitrary nature of the provision in the present bill that at least 50 percent of club use must be of a business character before any deduction will be allowed on the dues. We do not believe that persons should be allowed improper deductions, but we do believe that the proportionate use, whatever it may be, should be allowed. New rules in the bill require absolute proof from the taxpayer of business entertainment expenses, and we believe this covers the point without the extra limitations placed on club dues. No such special limitation is placed on comparable establishments of a nonclub nature, and we do not believe it should be placed on clubs.

Club expenses are among the easiest of all expenses to audit. Most clubs do not accept cash, and therefore there is a record of every expense incurred. These records, properly identified as to the purpose and persons present, serve as an excellent guide to business or nonbusiness use.

It may be argued that as club dues by themselves are not large items on an individual basis, and as the bill allows the deduction of the cost of business entertainment within the club, that the dues restriction will not have a bad effect on clubs. This ignores the fact that American business has for many years recognized the business value of clubs, and that many memberships in clubs are paid for by the employers. So well is this practice established that many companies define the need for club use by employees at various levels, and assign the employees to the clubs indicated. A national corporation, for example, may have memberships in a number of clubs for its key employees.

In making club assignments to employees, such factors are considered as nearness to the club of a branch manager's location, type of membership of the club as related to the employee's duties, and a representative selection of key employees in all the major clubs in the areas served by the corporation. The corporation considers this a worthwhile investment as it enables key employees to widen their circle of business contacts, thus producing new business for the corporation, as well as giving the employees a place to entertain persons who are already clients. Similar reasons for holding club memberships for employees exist in many types of business.

The effect of the bill will be to place in jeopardy memberships of this type, even if only because of the additional burden in accounting created by the arbitrarily imposed 50-percent rule. To protect the deductibility of the dues paid by business firms, the companies would have to formulate a whole new set of requirements dictated not by the really best type of employee use of clubs, but by arbitrary standards imposed by the bill. The cumulative effect of this type of confusion and temptation to withdraw completely could have very serious consequences for clubs.

Many clubs have a problem of turnover in memberships; members die, change jobs, move away from the club and have financial difficulties. It is therefore necessary to keep a constant flow of replacements coming in to fill the vacancies. Anything that slows down the process of acquiring new members will create financial difficulty for clubs. The fact that this bill places club dues on a special basis of restriction creates an artificial stigma on clubs. We know that many incoming new members intend to use the club primarily for business, and that this is an important part of their decision to join. The fact that the bill makes club dues unusually difficult to justify as compared with other business entertainment expenses, may become a deciding factor in a decision not to join a club.

A decision to do business entertaining elsewhere will not result in any reduction in the cost of the business entertaining. As a matter of fact, it may result in an increase in costs. Club meals, for example, are often lower priced than meals in competitive establishments, and club dining rooms are frequently operated at a loss. The difference is made up in dues. Combined dues and meals in the clubs, therefore, may cost no more than the same activities elsewhere. Thus, no revenue will be realized by the Treasury by diverting club dues into other types of business entertainment.

Quite the opposite may be true. Club dues are presently taxed at 20 percent, and this provides almost $70 million annually to the Treasury. If clubs are greatly curtailed, there will be substantial losses from the 20-percent excise tax presently collected without any offsetting gain in revenue as pointed out earlier.

The Treasury's position last summer at the inception of this bill, was to completely disallow club dues as a business deduction. Such an extreme penalty would remove a vital leg from our "three legged club stool," and cause a substantial number of clubs to close or severely curtail programing. Although business usage should not be confused with personal use, still many clubs are dependent on legitimate business use for solvency. Making anything nondeductible today is psychological death.

In conclusion, we believe that history demonstrates the valuable part clubs have played in American business. Our position is that club dues should be treated exactly as any other ordinary business expense, that dues should be deductible in the proportion used, and without regard for any arbitrary 50-percent limitation. The taxpayer is required to justify all business expenses, and it is proper to require him to justify his club dues precisely as he does his other expenses. It is improper and unfair to single out this one industry for a discriminatory policy, and it is also unwise. We ask for equal treatment in the matter of business expense. Any other course will place the future of America's clubs in grave danger.

Our own club, I might add, sir, pays full Federal income taxes, and we are not exempt from Federal income taxes, as some clubs are.

In our case, for example, since World War II, our club organization has paid almost $9 million in direct excise taxes and Federal income taxes to the Government.

If the club dues were returned to the strict treatment recommended by the Treasury, it is my personal belief and my considered belief that as a tax generator for the Government, our organization would stop.

I think this is serious, and I think it is something which should be said.

I also want to make one other short point. The President has repeatedly recommended that the country increase its physical fitness, and I think I can state that clubs, next to scholastic and governmental agencies, have done more for physical fitness in the United States than any other institution.

If the clubs are taxed out of existence, directly or indirectly, even inadvertently, the physical fitness and the recreation which these people are now doing on a self-help basis will fall by default to the taxpayer, and I do not think this is a desirable thing for the Government or for the country. Thank you.

The CHAIRMAN. Thank you very much, Mr. Hathaway.

The Chair would like to state that currently Mr. Clarence L. Turner of the Pennsylvania Chamber of Commerce was unable to be here, and should he send copies of his statements they will be inserted in the record.

(The statements referred to were later received for the record as follows:)

STATEMENT OF THE PENNSYLVANIA STATE CHAMBER OF COMMERCE CONCERNING THE PROPOSED REVENUE ACT OF 1962, H.R. 10650

This statement sets forth the State chamber's position on several of the principal provisions of H.R. 10650. The Pennsylvania State Chamber is appreciative of the concern of the President and the Congress over the need for sound and sustained economic growth and for a tax system consistent with this objective. It is the firm conviction of the Pennsylvania State Chamber, however, that some of the proposals in H.R. 10650 would discourage rather than encourage the attaining of this objective because of their discriminatory and detrimental effects on business investments and operations. For this reason, the State chamber opposes H.R. 10650 in its present form.

Depreciation reform preferable to investment tax credit (sec. 2)

While the investment tax credit would give an inducement to increased investment, it would introduce basic complexities in the income tax, reward firms that would increase investment without such a credit, discriminate against firms which had modernized facilities to the advantage of competitors, provide an entering wedge to Government regulation of investment, and be less effective and desirable as a stimulant to sound and sustained economic growth than tax rate reduction or urgently needed reforms in depreciation policy.

The Pennsylvania State Chamber of Commerce has long advocated a wider latitude in the allowances for depreciation and obsolescence, within the limits of sound and consistent accounting, as an encouragement to the development of new enterprises, the introduction of new products, more efficient production, and the growth in income and employment.

By legislation, Congress should now permit business firms to adopt the principles of the Canadian provisions for depreciation and obsolescence, with respect to new assets. During an initial period of 3 to 5 years, as a safeguard against undue revenue losses during the transition to the new system, taxpayers should be permitted deductions for new assets not exceeding 20 percent of those presently allowed. Subsequently, this limitation should be removed.

Taxpayers should be allowed to follow the declining balance system, as practiced on the Canadian principle, or any of the methods of allowances presently permitted. They should also be permitted to keep separate depreciation accounts, as at present, for tax and book purposes.

Boggs bill provisions preferable to those of H.R. 10650 for legislative expenses (sec. 3)

The provisions of the proposed Revenue Act of 1962 concerning deductions for legislative expenses are a step in the right direction. They do not, however, permit the full allowance of necessary and proper legislative expenses. The provisions of the Boggs bill are, therefore, to be preferred.

Disallowance of entertainment expenses is opposed (sec. 4)

While some abuses in business expense accounts occur, they are the exception, rather than the rule. Better policing by the revenue agents would greatly improve tax enforcement. Each revenue office should have available a man with ample business experience and competence to be able to judge fairly and intelligently whether expenses claimed are deductible or not. Taxpayers should also provide adequate information in defense of their claims, with disclosure of the facts in such detail as may be needed to defend their claims.

Abuses can be minimized without statutory revision as proposed in H.R. 10650. Entertainment expenses are a necessary business cost and, like other business expenses, should be allowed within reason.

It is felt that statutory limits on business expenses would be arbitrary and particularly detrimental to essential business activities.

The principle of fair taxation of mutual thrift associations is sound (sec. 8)

It is only fair that the various types of lending institutions should be taxed in a manner which will permit capital and reserve adequacy and insure competitive equality with respect to Federal taxation. This is apparently the purpose of the provisions of the Revenue Act of 1962.

The taxation of gains from the disposition of certain depreciable property is presently opposed (sec. 14)

Any changes in taxing gains on sales of depreciable personal property should be accompanied by urgently needed reform in depreciation policy. Such reform is not included in the proposed Revenue Act of 1962; therefore, the Pennsylvania State Chamber is opposed to section 14.

The taxation of cooperatives is approved (sec. 17)

The provisions for the taxation of cooperatives are approved as a step toward the adoption of State chamber policy that all organizations engaged in competition with private enterprise should be taxed similarly with such enterprise.

Withholding of tax on dividends, interest, and patronage refunds of cooperatives is opposed (sec. 19)

Withholding would introduce serious complications for some firms in complying with the law and serious hardships for some taxpayers. As automatic data processing is introduced, withholding should also be found unnecessary to assure tax enforcement.

Revision of exemption of foreign earned income and pensions approved (sec. 12)

In exempting such income, however, deferred compensation should be taken into account in the year in which it is granted rather than the year paid.

Estate tax on foreign real property may be accepted (sec. 18)

This provision should apply, however, only for property acquired for business purposes within 3 years of death.

Gross-up of foreign dividends not opposed (sec. 11)

This provision seems similar in principle to provisions for domestic dividends.

The allocation of sales income opposed (sec. 6)

No new provisions are needed to allocate income between a U.S. corporation and a foreign subsidiary. Section 482 of the Code provides the Treasury ample authority.

Provisions for controlled foreign corporations opposed (sec. 13)

The present law is adequate to meet the problem of possible abuses. The proposed provisions may be unconstitutional.

Gains from certain sales of stock of a controlled foreign corporation should not be taxed under certain conditions (sec. 16)

Gains should not be taxed when money cannot be taken out of a foreign country. In forced liquidations, the Du Pont treatment should apply. Any new tax should not become effective before January 1, 1963.

Provisions for taxation of property distributions from foreign corporations opposed (sec. 5)

These provisions are undesirable and would discriminate against distributions from foreign, as compared with domestic, corporations.

Requirements for information returns on foreign entities opposed (sec. 20)

Present requirements are adequate. Additional requirements would necessitate burdensome details of compliance and would handicap some foreign activities which are desirable. (If the provisions are enacted, they should exclude disclosure of detailed transactions not affecting U.S. tax liabilities.)

The Pennsylvania State Chamber wishes to take this opportunity to record its position on three additional tax proposals, not included in H.R. 10650 but which are under active consideration by the Congress or the administration.

Authority to reduce personal income tax rates on evidence of economic need opposed

Such authority has been requested by the President. It would be undesirable for Congress to delegate to the President the authority to revise tax rates according to his estimate of economic needs. This authority should remain with Congress as the legislative body.

Repeal of dividend credit and exclusion opposed

It is the opinion of the Pennsylvania State Chamber that the double taxation of dividends is both unfair to investors and a discouragement to economic growth. No other form of income is subject to such double taxation. The double taxation of dividends should be removed, not restored. The alleviation of double taxation, as proposed in the past by the State chamber, should be adopted as a step toward the elimination of double taxation. A tax credit should be allowed to those receiving taxable dividends of at least the initial rate (20 percent) on individual income.

Extension of high corporate tax rate opposed

The Pennsylvania State Chamber of Commerce recommends that an immediate start be made toward material reduction of the corporate income tax rate. The present tax rates are conducive to inefficiency and are detrimental to the achievement of maximum production and employment. They also place a heavy burden on equity capital and invite borrowing with its attendant strains on the financial structure.

Respectfully submitted.

A. L. EDMONDS, *Executive Director.*

STATEMENT OF CLARENCE L. TURNER ON BEHALF OF VARIOUS STATE CHAMBERS OF COMMERCE INCLUDING THE PENNSYLVANIA STATE CHAMBER OF COMMERCE IN OPPOSITION TO PROVISIONS OF H. R. 10650 AND TREASURY PROPOSALS WITH RESPECT TO EXPENSES FOR TRAVEL, ENTERTAINMENT, AND BUSINESS GIFTS

My name is Clarence L. Turner. I am a certified public accountant engaged in tax practice in Philadelphia. I appear before you on behalf of a number of the State and regional chambers of commerce, including the Pennsylvania State Chamber, which will be listed at the end of my statement. My statement reflects not only my long experience as an independent tax practitioner serving many corporations, unincorporated firms, and individual taxpayers, but also the experience and thinking of numerous businessmen who are members of various State chambers of commerce.

We are grateful for the opportunity to indicate to the Senate Finance Committee the reasons for our opposition to statutory limits on business expenses and incorporating in the law any language attempting to define necessary expenses incurred in the taxpayer's business relating to travel, entertainment, etc., as proposed by the administration. Statutory limitations and/or definitions are bound to be arbitrary, punitive, and unduly restrictive. We believe that the only effective and satisfactory way to meet the tax problem of expense accounts is to improve income tax administration and arrive at reasonable judgments with the aid of adequate information and disclosures from the taxpayers.

The propriety and measurement of every income tax deduction must rest ultimately on a judgment of what is reasonable and fair in interpreting the law. The area of disagreement is not necessarily confined to expense account deductions. If the facts are not fully brought out with respect to business expenses or if the facts are distorted in the heat of argument, deductions which are fully warranted as business expenses may be denied. Furthermore, the taxpayers may be harassed in a witch hunt which discredits many honest taxpayers and weakens the taxpayer morale needed for effective income tax enforcement.

It has been my experience and that of many other tax practitioners that the abuse of expense accounts is confined to a relatively few persons. Some persons may be basically dishonest. Some rationalize that the tax rates are too high, that dividends are subject to heavy double taxation, and that some tax relief should be sought in padded expense accounts.

I might add parenthetically here that the abuse of expense accounts is clearly not confined to businessmen. But the point I wish to make in this connection is that I have found the vast majority of businessmen trying honestly and conscientiously to separate personal from business expenses and report the latter accurately. Some businessmen, indeed, err on the side of not reporting all essential business expenses and pay more income taxes than the law requires.

No restricted definitions or requirements in the law will compel the taxpayers to be good or accomplish complete tax compliance. The dishonest can always find ways to juggle expense accounts and other deductions. Undue restrictions of business expenses will harass and penalize many worthy and honest taxpayers in the futile effort to catch the tax evaders. Only tighter administration will minimize expense account abuses, in the last analysis.

The President's original proposals relating to expense accounts go far beyond the basic purpose of eliminating existing abuses, and H.R. 10650 also errs in this respect. To the extent that expense account deductions are taken for expenditures which are made for personal or other nonbusiness purposes, we say they certainly should be disallowed. If fraud is involved, the penalties of the law should be enforced. But H.R. 10650 and the Treasury proposals do not stop there. They reach much further into the realm of business judgment, and substitute the judgment of the Government for the judgment of the individual businessman as to what expenditures he should make in order to most successfully sell his products or services.

H.R. 10650 recognizes that gifts are a proper business expenditure but not if they are too large. Accordingly, a limitation is set on the cost of gifts, with an annual cost of $25 per recipient being the most that can be deducted. Likewise, it is recognized that travel expenses, including food and lodging, are proper business expenses. Here again, however, a limit may be set on what can be deducted, by regulations prescribed by the Secretary of the Treasury. In no case, in our opinion, should the disallowance of gifts and expenses in excess of any arbitrary amount fixed by law or regulations be denied. If the item is a necessary expenditure of the taxpayer in connection with his business, it should be allowed, irrespective of the amount. If it is not made in connection with his business, no part should be allowed.

Although certain exceptions are made to disallowance of these expenses, the exceptions are relatively minor. In general, the proposal would institute a new policy of disallowing expenditures that are made for the purpose of creating good will.

Our income tax has always been largely a self-assessing tax. The judgment process involved in determining taxable income requires the cooperation of the taxpayers, and their hearty cooperation will be forthcoming only if the Government cooperates with them intelligently and fairly in deciding what is reasonable as a business expense.

Our income tax laws have long provided that reasonable deductions shall be allowed for business expenses, including travel, emtertainment, lodging, meals, and other essential buisness activity. It is the intent of the law—and to this we fully subscribe—that personal expenses shall not be deductible. No matter what is done to separate business and personal expenses, however, it may be difficult in some instances to say just where business expenses end and personal expenses begin.

It is our belief that detailed records of the taxpayers and full disclosure of the facts will show as accurately and completely as may be feasible the activities for which expense deductions are claimed and the degree of justification for the deductions. The facts must always be interpreted, however, and here the rule of reason must finally prevail.

Any limit of business expense accounts in terms of dollars, a percentage of gross or net income, or any other factor, is inevitably arbitrary. It may be too high for some and too low for others. If too high, it invites spending and claims up the limit; if too low, it penalizes the taxpayers who reuire additional outlays. No arbitrary expense limit can allow for the variable requirements of each business situation and for the business operations of each individual. High expenses in dollars may result in high sales and high profits, for example; or, in some instances, they may reflect faulty judgment; or even, in rare instances, the illegal padding of expense accounts.

We believe that business firms, in the great majority of cases, are best qualified to judge what are reasonable business expenses. The businessman seeking sales and profits is in a much better position to judge what activities and expenses are essential for business success than a revenue agent totally removed from the risks, competition, and complexities of modern business who may have only vague or purely arbitrary notions of business requirements to guide him.

The revenues to be gained from minimizing tax evasion in expense accounts have, in my opinion, been greatly exaggerated. For one thing, I believe the amount of such tax evasion is much less than the clamor of the critics would imply. Secondly, if outlays for business expenses are substantially restricted, the sales of goods and services will also be reduced, with direct effects on production and employment as well as profits. Thirdly, as expense expenditures are curbed, the hotel, restaurant service, entertainment, and other activities which are curbed will likewise have unfavorable effects on tax revenues. On balance, there may be little or no gain in revenue, or even a loss.

BETTER POLICING THE ANSWER

In our approach to the problems created by expense accounts, we want to be constructive and aid the Treasury to secure all of the revenue which the law requires. We, too, would like to eliminate the abuses of expense accounts. Our study and experience as tax practitioners and businessmen suggest a threefold course of action for the most effective accomplishment of these results.

1. A better policing of expense accounts by the Internal Revenue Service is imperative both to discourage potential tax evasion through this avenue and also apprehend the tax chiselers. The fair and effective enforcement of the law is always welcomed by the honest taxpayers. It also tends to make the dishonest realize that honesty is, after all, the best policy in minimizing tax liabilities.

Existing law, in our opinion, is fully adequate. It declares that business expense deductions shall be reasonable and must be confined to necessary and ordinary business expenses. Personal expenses are not allowed as business expenses, and are not deductible. On these points the intent of the law is clear. The law may be enforced by the exercise of fair and intelligent judgment.

2. Every revenue office should have available at least one agent with ample business experience to be able to judge competently whether items claimed as business expenses are reasonable and within the law. Much of the hue and cry over expense accounts originates with persons unfamiliar with business needs and expenses. An expense which may appear to be unreasonable or a personal expense to the uninitiated may be an essential business expense which may legally be deducted.

3. The taxpayers must expect to cooperate in the elimination of expense account abuses and in the enforcement of the law. It is only fair and reasonable, as existing law requires, for the taxpayers to keep fully adequate records which will provide detailed justification of business expenses while excluding purely personal outlays. The taxpayers should also make full disclosure of the details of business expenses, as we believe the law now requires. But if the present law should be found inadequate with respect to the disclosure requirement, it could be amended.

To conclude, we are opposed to the business expense account provisions in H.R. 10650 and the Treasury proposals. Our long experience with many taxpayers and our familiarity with business problems and practices clearly point to the fundamental fact that only through improved tax administration can the abuses of expense accounts be prevented and minimized. No legal requirements can take the place of judgment in determining what business expenses are reasonable and proper within the law. We therefore propose that the need for better policing of expense accounts, to deal with the relatively few persons who abuse them, should be faced and that remedial steps should be taken along the lines we have suggested.

With your permission, I would like subsequently to insert a list of the organizations subscribing to this statement, since time has not been available for the consideration of it by all of the interested organizations.

The CHAIRMAN. The next witness is Mr. Richard L. Hirshberg of the National Coal Association. You may proceed, sir.

STATEMENT OF RICHARD L. HIRSHBERG, ASSISTANT GENERAL COUNSEL, NATIONAL COAL ASSOCIATION

Mr. HIRSHBERG. My name is Richard L. Hirshberg and I am assistant general counsel of the National Coal Association with offices in the Coal Building, 1130 17th Street NW., Washington, D.C. The members of our association mine and market more than two-thirds of the commercially produced bituminous coal and lignite in the United States.

My statement deals with three aspects of the Revenue Act of 1962, H.R. 10650: the investment tax credit, gains from the sale of depreciable assets, and appearances with respect to legislation.

With the chairman's permission, I should like to have the entire statement reproduced in the record and just mention some of the highlights of it orally.

The CHAIRMAN. Without objection that will be done.

Mr. HIRSHBERG. Do you have a copy of it, Mr. Chairman?

The CHAIRMAN. Yes.

Mr. HIRSHBERG. I would also like to have incorporated in the record, with the chairman's permission, a letter of April 4, 1962, to the chairman from Stephen F. Dunn, president of the National Coal Association.

The CHAIRMAN. Without objection both items will appear at the end of your testimony.

Mr. HIRSHBERG. My first subject is the investment tax credit which is covered in section 2 of the bill. This is generally a credit equal to 7 percent of qualified investments made by the taxpayer in personal property and certain real property used in business and placed in service after the end of 1961.

As originally reported out by the House Ways and Means Committee, of course, the credit was 8 percent in lieu of 7 percent.

There are also certain limitations on the amount of tax liability that can be absorbed by the credit and on assets with useful lives of less than 8 years. Those are stated in the written statement, and I will not repeat them.

We are very enthusiastically in favor of the tax credit concept because we believe that this approach to tax rate reduction is an excellent way of attacking the problem of obsolescence of production equipment.

The United States, as the record already before this committee will show, is behind the rest of the Western World and Japan as far as the rate of investment in productive equipment is concerned.

In fact, recent studies have shown that we are about at the bottom of the list. The investment tax credit may reasonably be expected to provide business with strong incentives to replace obsolete equipment which, of course, has low productivity with new equipment of higher productivity.

I know the chairman is interested in the revenue aspects. We believe that the generative effect of the tax credit in producing more profits will, in the long run, more than offset the temporary revenue loss. Of course, we cannot prove it, but we certainly hope that would be true, and we suggest that the device be tried out.

I do want to emphasize, though, in connection with my last interpolated remark, that we regard this as being an appropriate provision for permanent enactment into the tax structure.

The administration has already said that it intends to put it into the Internal Revenue Code permanently.

The administration has also said quite frequently, and we believe they are fully committed to this position, that enactment of the tax credit would not preclude further attention to liberalized depreciation allowances, either by the Treasury or by Congress.

At this point I would like to mention the salvage value problem. We are highly in favor of the provision in section 14(c) that the taxpayer may disregard amounts of less than 10 percent of the cost in figuring salvage value for depreciation purposes. We think this will be very helpful in removing a lot of petty controversies between taxpayers and the Internal Revenue Service.

The coal industry is particularly anxious to have the tax credit enacted, rather than some other form of relief such as depreciation allowances, because the tax credit would not adversely affect percentage depletion allowances.

Liberalized depreciation, although desirable, would, in most coal mining cases, have the effect of reducing the depletion allowance because of the 50-percent-of-net-income limitation.

In conclusion, on the tax credit, we would like to see the 8-percent credit, as originally reported out by the House committee, restored with the more liberal limitations reported out by that committee. If that is not considered feasible because of revenue and other considerations, we would certainly like to see the 7-percent credit reported out and enacted.

My second topic is section 14 of the Revenue Act of 1962 providing, in general, that ordinary income is to be recognized in the case of sales or exchanges of depreciable personal property to the extent that the so-called recomputed basis or the amount realized on the sale or exchange, whichever is the lesser, exceeds the adjusted basis of the property.

The reason for this provision, as spelled out in detail in the House committee report, is that under present law some taxpayers may write off the cost of the property over the period of its useful life, and then sell the property at a profit over the adjusted basis which will be taxed as capital gain.

The depreciation deductions taken in such cases will have reduced ordinary income, and a taxpayer who has taken the so-called excessive depreciation deductions, and then has sold an asset has, in effect, converted ordinary income into capital gain.

The point I want to emphasize here, without going into great detail, is that this rationale just does not apply in the coal mining industry because of the interaction of percentage depletion and depreciation.

If a so-called excessive depreciation deduction is taken on a coal-mining property in a particular year, then the depletion deduction in the vast majority of cases is reduced by one-half of that amount.

In the simple example in our prepared statement, it is shown that the taxpayer, by taking a so-called excessive depreciation deduction of $20,000 on a piece of equipment, actually saves only $5,200 in taxes rather than $10,400 as he would appear to do, assuming a 52-percent bracket.

Unless the chairman desires, I will not go through this example in detail. I think it is all spelled out there, and it can be read by the committee.

In order to assure that the Internal Revenue Service will not be able to "recapture"—to use the wording of the House committee report—deductions for depreciation in amounts exceeding the tax benefit to the taxpayer, we propose a simple amendment to section 613(a) of the code to go along with section 14 of the Revenue Act of 1962.

This amendment would provide that the expenses of mining shall be reduced by an amount equal to the amount which is treated as ordinary income under section 1245 in computing taxable income from the property for depletion purposes.

The result of our proposed amendment would be that the Treasury could collect upon the sale of the asset exactly the same net amount it could have collected by disallowing the so-called excessive depreciation allowance in the year in which it was claimed.

Now, in the example given, and I believe in many actual cases, the taking of the so-called excessive allowance results not from negligence or a willful attempt to take more than the taxpayer is entitled to, but from conditions beyond the taxpayer's or the Treasury Department's control that arise later and make the asset worth more upon sale or disposition than had appeared in the year the deduction was taken.

The typical instance, of course, is a wartime or emergency situation where scrap metal and machinery would certainly become very valuable.

Under present law there is another inequity relating to gains and losses resulting from the sale of depreciable personal property in the case of mining.

We think that this inequity could and should be removed simultaneously with the revisions of the code with respect to gain from dispositions of depreciable property.

The courts have held if a taxpayer sells mining equipment at a loss this loss must be taken into account in computing the taxpayer's taxable income from the mining property.

In most coal-mining cases, since the 50-percent-of-net-income limitation is the effective one, this rule results in a lowering of the percentage depletion allowance. However, if the same or similar mining equipment happens to be sold at a profit, the courts have held that the profit cannot be taken into account in determining the gross or the net income from mining and, therefore, any profit cannot possibly increase the depletion deduction.

This, we believe (and the American Mining Congress testified recently to similar effect), should be a two-way street, and our amendment would provide that neither gains nor losses from the sale of mining machinery shall be taken into account in the depletion formula.

The amendment that we propose is set out verbatim in the prepared statement and, with the chairman's permission, I will omit reading it.

My last subject is appearances, et cetera, with respect to legislation. Section 3 of the Revenue Act of 1962 provides that the deduction allowed for ordinary and necessary business expenses shall be allowed regardless of the fact that such expenses are paid or incurred in connection with communicating information regarding legislation or influencing legislation.

Again, I will not go into detail since the whole provision is spelled out in the bill and paraphrased in our prepared statement. This provision was added to the bill by the Ways and Means Committee to reverse the effect of the *Cammarano* and *Straus* cases, decided by the Supreme Court in 1959 and cited in our prepared statement.

These cases held valid internal revenue regulations that were issued many years ago and that actually are pretty unrealistic under present circumstances, where everyone is concerned with communicating views on legislation to the Congress and to State and local bodies.

The National Coal Association strongly endorses section 3 as written into the bill by the House, and our only suggestion in this respect is that the section might well be broadened to include all lawful expenses relating to the influencing of legislation or the communication of information relating to legislation so long as these were ordinary and necessary business expenses.

Thank you very much.

(The prepared statement of Mr. Hirshberg, together with the letter of Mr. Dunn follows:)

STATEMENT OF RICHARD L. HIRSHBERG, ASSISTANT GENERAL COUNSEL, NATIONAL COAL ASSOCIATION, WASHINGTON, D.C.

My name is Richard L. Hirshberg and I am assistant general counsel of the National Coal Association with offices in the Coal Building, 1130 17th Street NW., Washington, D.C. The members of our association mine and market more than two-thirds of the commercially produced bituminous coal and lignite in the United States.

INVESTMENT TAX CREDIT (SEC. 2)

Section 2 of H.R. 10650 (hereafter referred to as the Revenue Act of 1962) provides, in general for a tax credit equal to 7 percent of the investment made by the taxpayer in tangible personal property and certain real property used in business, placed in service by him after December 31, 1961. The credit is limited to $25,000 of the taxpayer's tax liability plus 25 percent of so much of the tax liability as exceeds $25,000, with a provision for a 5-year carryover of unused credits. Reduced credits are provided for assets with useful lives of less than 8 years and reduced credits are allowed with respect to "public utility property." As originally reported by the Committee on Ways and Means of the House of Representatives on March 16, 1962, the credit for investments in new machinery and equipment would have been 8 percent, in lieu of 7 percent, with a similar sliding scale of lower credits for assets with useful lives of less than 8 years. The credit would have been limited to $100,000 of the tax liability plus 50 percent of the tax liability above such amount, with a similar 5-year carryover for unused credits.

The National Coal Association is enthusiastically in favor of the tax credit concept. We believe that this approach to tax rate reduction is an excellent way of attacking the problem of obsolescence of productive equipment. This problem has become acute in the United States and has lessened our ability to compete in foreign markets. Out of 12 nations whose economic growth rates have recently been studied—Japan, Sweden, Germany, Austria, Italy, Netherlands, France Switzerland, Canada, Belgium, the United Kingdom, and the United States—we stand third from the bottom in investment ratio and second from the bottom in growth rate. As far as investment in productive equipment is concerned, the United States is apparently at the bottom of the list.

The investment tax credit may reasonably be expected to provide business in general with strong incentives to replace obsolete equipment of low productivity with new equipment which is more efficient. The generative effect of the tax credit in encouraging investment and increasing the Nation's economic growth rate should be sufficient, in the long run, at least to offset any temporary loss of revenue due to its enactment. Because a major portion of the revenues of the United States are raised by taxing the net incomes of business operations, it is evident that any action which will improve the profit picture will also favorably affect revenue collections. As far as the coal industry is concerned, we believe that the increase in profitability of mining operations resulting from new investments which are encouraged by the tax credit will probably bring about greatly increased payments of income taxes to the Federal Government.

The National Coal Association regards the investment tax credit as being appropriate for enactment as a permanent part of the tax structure. The administration has asserted frequently that this important provision is intended to be permanent rather than a stopgap measure. The administration has also asserted frequently that the enactment of the tax credit by Congress will not lessen the administration's continuing program of depreciation reform. We are highly in favor of this two-pronged attack on the problem of obsolescence of productive equipment, and we believe that the enactment of the tax credit would in no way preclude continuing attention to depreciation problems by the Treasury Department or by Congress.

At this point I would like to mention parenthetically that we are in favor of the enactment of the provision in section 14(c) of the bill that amounts up to 10 percent of the basis of depreciable property may be disregarded by the taxpayer in figuring salvage value.

The investment tax credit would be particularly helpful to the coal industry and to the mining industry generally because its enactment would have no adverse effect on percentage depletion allowances. Liberalized depreciation, although desirable, would in most cases have the effect of reducing depletion allowances because of the 50-percent-of-net-income limitation.

The National Coal Association would like to see the investment tax credit of 8 percent as originally approved by the Ways and Means Committee restored to the bill. If this is not feasible, we want to go on record as favoring the 7-percent provision.

GAIN FROM DISPOSITIONS OF CERTAIN DEPRECIABLE PROPERTY (SEC. 14)

Section 14 of the Revenue Act of 1962 provides, in general, that ordinary income is to be recognized in the case of sales or exchanges of depreciable personal property to the extent that the so-called recomputed basis, or amounts realized on the sale or exchange, whichever is lesser, exceeds the basis of the property in the hands of the person making the sale or exchange. The reason for this proposed provision is that, under present law, some taxpayers may write off the cost or other basis of the property over the period of the useful life of the asset in their hands, and then can have any gain over the adjusted basis taxed as a capital gain. The depreciation deductions in such a case will have reduced ordinary income and a taxpayer who has taken so-called executive deductions and then has sold an asset has, in effect, converted ordinary income into a capital gain. Such is the rationale of section 14 as stated in the report of the Committee on Ways and Means on the Revenue Act of 1962 (pp. 66–67).

We wish to point out that section 14 fails to take into account the fact that, in the vast majority of coal mining operations, the taking of so-called excessive depreciation allowances does not have the effect of converting ordinary income into capital gain as stated in the report of the Ways and Means Committee. The reason that such a result does not occur is that the deduction for percentage depletion is, in most cases, limited to 50 percent of the taxpayer's taxable income from the coal mining property. Under this limitation, any depreciation allowance will automatically reduce the allowance for percentage depletion.

For example, assume that in 1962 the X mining company owns and operates one coal mine, which is treated as one "property" under section 614 for the purpose of computing depletion allowances. The taxable income from this mine during 1962, before computing the allowance for depletion, is less than 20 percent of the "gross income from the property." For this reason the depletion allowance for 1962 is limited to 50 percent of the taxpayer's "taxable income from the property." Further assume that one of the deductions taken by the X company in 1962 is a deduction of $30,000 for depreciation of a piece of mining machinery. In late 1963, due to a sharp and unforeseeable increase in the price of used mining machinery, the taxpayer realizes from the sale of this mining machine an amount of $20,000 in excess of the adjusted basis of the machine, such excess being due to the taking of a depreciation deduction of $30,000 instead of $10,000 for the year 1962.

In the above example (assuming the X company to be at all relevant times in the 52-percent bracket) the tax saving attributable to the taking of the $20,000 "excessive" depreciation deduction in 1962 is only $5,200 instead of $10,400.

The reason for this is that the $20,000 "excessive" deduction reduces the taxable income from the property (before the computation of depletion) by that amount and therefore results in the allowance for depletion being $10,000 less than it otherwise would have been. The taxpayer saves $10,400 on depreciation (52 percent of $20,000), but loses $5,200 due to the reduction of the depletion allowance (52 percent of $10,000). By treating the $20,000 attributable to the "excessive" depreciation allowance as ordinary income in 1963, the Treasury would be able to collect $10,400—twice the amount of the tax saved by the taxpayer by claiming such "excessive" allowance.

In order to assure that the Internal Revenue Service will not be able to "recapture" deductions for depreciation in amounts exceeding the tax benefit to the taxpayer, we are proposing a simple amendment to section 613(a) of the Internal Revenue Code of 1954, which we believe should accompany the enactment of section 14 of the Revenue Act of 1962. This amendment would provide that the expenses of mining shall be reduced by an amount equal to the amount which is treated as ordinary income under section 14 of the bill, in computing the taxable income from the mining property for purposes of percentage depletion.

In the example given above, our proposed amendment would reduce the expenses of mining by $20,000 (the amount treated as ordinary income under the new section 1245) and would thus increase the taxpayer's taxable income from the mining property by an equal amount. This would have the effect of increasing the depletion deduction for 1963 (the year of sale of the mining equipment) by $10,000. Such increase in the depletion deduction would save the taxpayer $5,200 in 1963, which he could offset against the $10,400 of additional tax liability for that year resulting from the enactment of section 14.

The result of our proposed amendment would be that the Internal Revenue Service could collect, under section 14 of the bill (which would become a new section 1245 of the code), the same net amount that could have been collected as a result of the disallowance of so-called excessive depreciation deductions during the year or years in which those deductions were being taken by the coal mining company. Again referring to the example given above, the end result would be that the X company pays back to the Treasury $5,200 in 1963, exactly the amount that it saved in 1962 by taking the so-called excessive depreciation deduction—that is, the Treasury collects the same additional tax upon the sale of the mining machine in 1963 that it would have been able to collect by the disallowance of the "excessive" depreciation deduction for 1962, if it had been able to foresee the postulated sharp and unforeseen increase in the value of used mining machinery in 1963.

Under present law, there is another inequity relating to gains and losses resulting from the sale of depreciable personal property which could, and we think should, be removed in connection with the revision of the provisions of the code relating to gain from dispositions of depreciable property. The courts have held that if a taxpayer sells mining equipment at a loss, such loss must be taken into account in computing the taxpayer's taxable income from the property. In most cases involving coal, the 50-percent-of-net-income limitation applies to limit the allowable depletion deduction, and thus a loss from the sale of mining property reduces the depletion allowance.

If the same mining equipment were to be sold at a profit, however, such profit could not be taken into account in computing either the net or the gross income from the property, according to the court cases on this subject. Some Internal Revenue agents have even contended that gains from the sale of mining machinery cannot be used to offset losses from the sale of similar machinery in the same year.

This result is quite obviously unfair to the taxpayer. If profit from the sale of mining machinery is not depletable income, then any loss from the sale of the same machinery should logically not have to be taken as a deduction from mining income. In order to correct this inequity, and to provide for the problem of the reduction of percentage depletion allowances because of so-called excessive depreciation allowances in connection with the enactment of the proposed new section 1245, we suggest the following simple amendment to section 613(a) of the code:

"After the second sentence of section 613(a) of the Internal Revenue Code of 1954 add the following new sentence:

" 'In computing the taxpayer's taxable income from the property, the expenses of mining shall be reduced by an amount equal to the amount which is treated as ordinary income under section 1245, and losses from the disposition or abandonment of depreciable personal property shall not be taken into account.'"

APPEARANCES, ETC., WITH RESPECT TO LEGISLATION

Section 3 of the Revenue Act of 1962 provides that the deduction allowed by section 162(a) (relating to trade or business expenses) shall include all the ordinary and necessary expenses paid or incurred in carrying on any trade or business in direct connection with appearances before, submission of statements to, or sending communications to, the committees, or individual Members of Congress or of any legislative body of a State, a possession of the United States, or a political subdivision of any of the foregoing with respect to legislation or proposed legislation of direct interest to the taxpayer, or in direct connection with communicaiton of information between the taxpayer and an organization of which he is a member with respect to legislation or proposed legislation of indirect interest to the taxpayer and to such organization, and that portion of the dues so paid or incurred with respect to any organization of which the taxpayer is a member which is attributable to the expenses of the activities described above carried on by such organization.

This provision was written into the bill by the Ways and Means Committee to reverse the effect of two companion decisions of the Supreme Court in 1959 upholding the validity of the so-called lobbying regulations issued many years ago by the Treasury Department (*Cammarano* v. *United States* and *F. Straus & Sons, Inc.* v. *United States*, 358 U.S.C. 498). A detailed justification for the proposed new section 162(e) of the code may be found in the report of the Ways and Means Committee on the Revenue Act of 1962 (pp. 16–17).

We have long urged legislation along the lines of section 3 of the Revenue Act of 1962 and wish to endorse this provision strongly. Our only suggestion is that it might well be broadened to include all lawful expenses relating to the influencing of legislation or the communication of information relating to legislation, so long as such expenses were "ordinary and necessary" within the meaning of section 162(a).

NATIONAL COAL ASSOCIATION,
Washington, D.C., April 4, 1962.

Hon. HARRY FLOOD BYRD,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: The National Coal Association desires to advise you of its support of the House-passed bill (H.R. 10650) which contains the tax credit incentive for new investment.

Representations have been made during the course of the consideration of the measure in the House of Representatives to the effect that business was opposed to this form of needed tax relief. The purpose of this letter is to advise you that the incentive tax credit not only has coal support but also many other significant industries, such as the railroads, textiles, machine tools, and the like.

Since the end of World War II the bituminous coal mining industry has more than doubled production efficiency, but continued improvement in equipment is necessary if mining companies are to have an opportunity to meet fuel competition. The tax credit provision of H.R. 10650 will assist materially in enabling the coal industry to achieve this objective.

From the public interest point of view, there is ample evidence that obsolescence of productive equipment has become an acute problem for the United States and has lessened our ability to compete in foreign markets. We think this trend can be effectively reversed through the tax credit approach.

We hope that you will be able to support the investment tax credit provision when H.R. 10650 is presented for final consideration.

Sincerely,

STEPHEN F. DUNN, *President.*

The CHAIRMAN. Thank you very much.

Mr. HIRSHBERG. I will be glad to answer any questions the committee may have.

The CHAIRMAN. Thank you very much for your information.

The committee will recess until 10 o'clock tomorrow morning.

(By direction of the chairman, the following is made a part of the record:)

DOAK SPECIALTIES,
Springfield, Mo., February 27, 1962.

Hon. HARRY BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: It is my understanding that an omnibus bill will be in the Senate Finance Committee very soon now. As I understand it, this bill is the tax revision bill and that there is a specified $25 limit on business gifts to any one individual in a calendar year. This limit is to include all specialty advertising items that would carry an advertising imprint.

Although I can understand a limitation of $25 for a business gift item or items in any one calendar year, it is incomprehensible to me why advertising specialties, such as calendars, wooden pencils and other writing instruments, coin holders, etc., should be included in this interpretation.

It is my understanding that the Internal Revenue Service has interpreted all advertising specialty items and gift items such as liquor, cheese, etc. as coming under this $25 ruling. I ask that clear and definitive language be set forth, exempting advertising specialty items so that there could be no unfair bureaucratic interpretation.

The inclusion of specialty advertising items under the $25 maximum ruling would constitute a hardship on perhaps 2,000 active small businessmen engaged in this field and their approximately 100,000 employees. In addition, many small advertisers cannot use mass media type of advertising due to the huge expenditure required and can only come to the specialty advertising counselor for specific merchandising and sales promotion help. In thousands of cases, specialty advertising is the small businessman's only method of advertising and sale promotion.

I am of the opinion that this has been set forth in this manner because of a lack of understanding of what is specialty advertising and what is a gift on the part of the Congressmen involved and their advisers. At this point, it would also seem that we small businessmen have been negligent in informing our legislators. However, I believe that this has been a well-kept, secretive proposal up to this point.

May I ask that you very carefully consider the deteriorating effect this will have on the specialty advertising industry, its labor, salesmen, suppliers, and the people the industry serves, and that this portion be rewritten before it leaves the Senate Finance Committee.

Very truly yours,

JOHN M. DOAK.

U. G. COLSON CO.,
Paris, Ill., March 7, 1962.

Hon. HARRY F. BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SENATOR BYRD: For many years you have served your country admirably in the U.S. Senate. I say "country" because I have always been impressed that that is what you were serving first with your own native State of Virginia benefiting thereby. I was most pleased when you withdrew your announced retirement plans and decided to run once more for your seat. Without your strong and independent voice particularly on the Finance Committee I wonder how many billions more the New Frontiersmen might have squandered by this time. It is a most frightening prospect for our country. Please keep up your fine American work.

Also in this connection, I am taking the liberty of writing you somewhat in behalf of the entire specialty advertising industry. It is estimated that our industry employs in excess of 350,000 people in the manufacture, sale, and distribution of advertising specialties. Almost without exception the products which we manufacture and sell bear an imprint of the sales promotional and advertising copy of the particular company who has purchased them. They in turn present these to their prospects and customers. Some examples of our type of products are calendars, ballpoint pens, ashtrays, memorandum books, wooden lead pencils, fly swatters, etc.

Unquestionably we have done a poor job of explaining to the Congress exactly of what our advertising media consists. As a part of the administration's tax proposals including such items as the suggested depreciation allowances, control of expense accounts, etc., is one section, namely, section 274(b)(2) currently being considered by the House Ways and Means Committee. This particular section states that business gifts shall be limited for tax deductible purposes to $25 per person, per year which unquestionably has been included in an effort to prevent "payola" such as Cadillacs, mink coats, deep freezes, and other excessive gifts. Certainly no one should or could question the advisability of some kind of a limitation on this kind of "payola."

Advertising by a business firm is a legal deduction. The specialty advertising industry provides the only effective advertising media available to people who cannot afford or cannot economically use mass advertising media such as television, radio, periodicals, and newspapers. The bill in its present form contains discriminatory legislation against our particular advertising media. Advertising specialties are not in reality gifts, but on the contrary make up legitimate and necessary advertising media.

The Internal Revenue Department has already issued a statement that this limitation will apply regardless of whether the item is imprinted or not. Therefore, calendars, ballpoint pens, ashtrays, etc., would be classified as "gifts" according to Treasury interpretation.

Undoubtedly the question has arisen in your mind as to why I am concerned since practically all specialty advertising is relatively inexpensive in cost and therefore probably would be unlikely to reach the $25 limitation. The danger lies in the fact that we receive only a small part of the advertiser's budget in many instances.

In many cases he will have used hams, turkeys, liquor, theater tickets, etc.—perhaps even some of your apples whose fame is widespread—on his more valuable accounts and when our salesmen approach him with an advertising idea involving the use of some of our products, he could very easily say that he had already reached the $25 limitation and we would be out of business. This is why we feel it is so important that specialty advertising should be defined and excluded from the provisions of the new law and its interpretation by the Treasury Department.

Specialty advertising is used primarily by the smaller businessmen—the guts of American business—as sales promotion aids to reach their relatively limited number of prospects and customers in the most effective and least expensive manner. Almost without exception all of the products which we manufacture and sell throughout the entire country are imprinted, hot stamped, engraved, etc., in one form or another with the name and selling copy of the business firm which purchases them, and at the very least are personalized with the recipient's name or initials. For this reason they are of no value to anyone other than to the business firm and/or the recipient. Their commercial value is nonexistent.

It is therefore imperative to our very survival that a definition be written into this bill excluding from the term "gifts" any promotional advertising specialty designed and manufactured for such purpose on which the name of the advertiser is clearly imprinted. It is understood that our industry has no opportunity for relief in the House. The bill will come out under cloture rule from the House Ways and Means Committee and breeze through the House. Our only chance then is in the Senate, and particularly the Finance Committee of which you are chairman.

The following resolution which will be filed in the Senate when the bill hits there sums it up:

"To Members of the Senate of the United States:

"The boards of directors of the Advertising Specialty Guild International and the Advertising Specialty National Association, representing 928 firms, at their respective spring meetings on February 26, 1962, in Chicago, Ill., adopted the following resolution:

" '*Be it resolved*, That certain facts be called to the attention of the Members of the Senate of the United States:

" 'The specialty advertising industry produces, distributes, and sells a recognized advertising medium. Its many products (such as calendars, key cases, pens, pencils, ashtrays, thermometers, memo pads, and many thousands of other items) are useful articles imprinted with the name and selling message of the advertiser and are distributed by the advertiser without condition of sales to his customers and prospects.

"'Specialty advertising provides an effective advertising medium particularly for small businessmen who cannot afford or cannot economically use the mass media such as newspaper, magazine, radio, and television. Specialty advertising also is utilized by many large businesses to effectively reach select lists of customers and prospects.

"'The revenue bill currently being considered by the House Ways and Means Committee discriminates (sec. 274(b)(2)) against the special advertising industry and if enacted would adversely affect the business world and the specialty advertising industry which provides employment for upward of 350,000 persons engaged in the manufacture, distribution, and sale of its products.

"'Therefore, because special advertising is a legitimate and necessary form of advertising and should not be confused with business gifts, the proposed revenue bill should be phrased to eliminate any question as to the intent of Congress. Obviously the purpose of the proposed legislation is to close loopholes in the tax deductibility of gifts as a business expense.

"'The specialty advertising industry is not opposed to legislation designed to provide essential tax revenues. The industry feels, however, that it is highly discriminatory for the bill to be so vague as to possibly permit the classification of this recognized advertising medium with business gifts which usually are high in price and do not carry advertising messages.'"

I understand that you are really disturbed by many other provisions of this bill—and I couldn't agree with you more. If the whole thing could be defeated I'm sure we'd all be better off. Whether or not the "pressure" can be resisted to accomplish this is of course known far better by you. Barring this, I am hopeful that your Finance Committee will see the fairness of my request and that the discrimination against specialty advertising can and will be removed.

Sincerely,

U. GORDON COLSON, *President.*

ADVERTISING ASSOCIATION OF THE WEST,
San Francisco, Calif., March 15, 1962.

Hon. HARRY FLOOD BYRD,
Chairman, Senate Finance Committee,
Washington, D.C.

DEAR SIR: I am sure that as chairman of the Senate Finance Committee, you will be giving early consideration to the proposed provision from the House of Representatives that business gifts in excess of $25 per year per recipient should not be tax deductible.

I understand that the Treasury Department interprets "business gifts" as broad as to include sales aids, point-of-purchase displays, calendars, and so forth. In our opinion such gifts are advertising, remembrance advertising, as we call it, and important in our economy.

Our association represents all classifications of advertising, but we feel that such limitation would not only create a real hardship for business, which wishes to keep its name before its prospects, but also it would be a very serious blow to many very important industries in our country, who themselves are large taxpayers.

May I therefore recommend that this limitation be taken off so that these hardships will not prevail.

All of us are interested in helping in the program, which the President of the United States and the Secretary of Commerce have spoken up so ably for, and that is the increase of our national income, and such restrictions as these would definitely create handicaps to such objectives.

We urgently request that you consider these viewpoints.

Sincerely yours,

CHAS. W. COLLIER.

GEIGER BROS.,
Lewiston, Maine, March 22, 1962.

Hon. MARGARET CHASE SMITH,
U.S. Senate,
Washington, D.C.

MY DEAR SENATOR SMITH: We at Geiger Bros. are in an industry that is currently under siege in Washington, with the new tax bill placing a $25 limit on tax-deductible expense for business gifts per person each year. The bill specifically does not deviate between genuine gifts and specialty advertising and seems to lump into one pot imprinted items, calendars and all sorts of things that we sell as goodwill builders and advertising items. These things that we sell are useful merchandise and most of them could hardly be considered a gift. Most of them carry an advertising message and even where it is a gift, it is generally different than the type of bribe the bill is attempting to curb. To bunch all of these things under a common denominator of giving is unfair and we feel would be very harmful to our business.

In addition, for every one it would seem rather difficult to measure out what is given to a person or how one is entertained throughout the year. It would seem almost astronomical the amount of work to be piled on to the already overburdened bookkeeping departments of companies to try to separate and to keep track of the things that are done for each and every person during the year. I know you will agree with me that already we are overburdened with more work than our people can handle.

It may be that the Members in the House of Representatives who seem to favor this bill are not aware of the implication of bulking together things in our industry in a catchall tax bill, but it would be difficult to keep track of each advertising specialty along with the things that were designated as gifts, such as flowers on the opening of a business, or a ticket to a ball game. I am very much afraid that the apparent disservice to the businessman can only be diluted by good work on the part of those who represent us and understand our problem. I am hopeful you will be one of these.

Kind personal regards,

RAY GEIGER, *President.*

REUTHER MOLD & MFG. CO.,
Cuyahoga Falls, Ohio, March 20, 1962.

The U.S. SENATE,
Senate Office Building,
Washington, D.C.

(Attention of Frank J. Lausche and Stephen M. Young).

DEAR SIRS: After giving the new tax bill considerable thought we would like you to vote against this bill as long as it includes the 8-percent tax credit and business expense account regulations.

We are a small company, doing about a million dollars in sales a year. In the last 6 years we have purchased new equipment as follows: 1956, $60,000; 1957, $15,000; 1958, $30,000; 1959, $85,000; 1960, $25,000; 1961, $60,000; and this year we have already added about $30,000. This amounts to $310,000, all to be depreciated over 10 years or more. We have bought a tremendous amount of new equipment for a small shop facing competition from over 100 other shops in the Summit County area. Now that we have our equipment paid for or being paid for out of earnings after a 52-percent tax bite, Mr. Kennedy now wants to give our competitors an 8-percent tax break. Where is mine? Our equipment is up to date. We have the most modern shop of our size in Ohio, and now for spending our money during some slow years and not being afraid to invest in capital equipment, we get nothing. We want depreciation reform, not a bonus for future good behavior, like a child gets. Am I a fool now for having spent our money?

Please don't vote for the 8-percent tax credit, unless they let us go back 5 years and pick up bonus we have earned for putting our money into the economy.

Very truly yours,

KARL A. A. REUTHER, *Secretary of Corporation.*

WALTER W. CRIBBINS CO., INC.,
San Francisco, March 27, 1962.

The Honorable HARRY F. BYRD,
Chairman, Senate Finance Committtee,
Washington, D.C.

MY DEAR SENATOR BYRD: The tax bill H.R. 10650, which is now before your committee contains this regulation of business gifts:

"Section 274(b) Gifts (1) and (2): No deduction shall be allowed under section 162 or 212 for any expense for gifts made directly or indirectly to any individual to the extent that such expense when added to prior expenses of the taxpayer for gifts made to such individual during the same taxable year, exceeds $25. For purposes of this section, the term "gift" means any item excludable from gross income of the recipient under section 102 which is not excludable from his gross income under any other provision of this chapter."

I interpret this to mean stripped of its legalese that no businessman can claim for tax purposes any expenses for gifts exceeding $25 per recipient per year.

This piece of legislation has its origin in the payola scandals and thus is not really a revenue measure, but is a ruling on business morality. As a tax-producing measure, it is probably useless, because a lowering of business spending means a lowering of income for those with whom the money would be spent, and thus, overall, most likely a reduction in tax revenue.

In its effort to enforce business morality, for however that may be possible by legislation, the House of Representatives has gone overboard and a correction is necessary unless it is your intention to destroy the whole field of sales promotion.

The key is in the second sentence quoted above: "The term 'gift' means any item excludable from gross income under section 102." Inquiry to the U.S. Treasury has indicated that this would include everything and anything given by one businessman to another, flowers on the occasion of an anniversary or opening, displays and point-of-sale posters, and calendars, ashtrays, ball pens. This latter field, commonly known as advertising specialties, is my specific interest as past president of the Advertising Specialty Guild International and current chairman of Government relations committee.

I would like to make it clear that advertising specialties, i.e., merchandise of some usefulness, to which an advertising message is affixed or which is given to the recipient with an advertising message attached, or in conjunction with an overall advertising program, is advertising, not business gifts, although for obvious reasons no charge is made to the recipient and it would be a gift under above formula. We feel very strongly that such gifts are not bribe, but that they carry a specific advertising appeal, and, therefore, should be exempted.

With a copy of this letter, I am sending you examples. There is a large man-size ashtray made for the Kerr-McGee Oil Co. It is obvious from its appearance that this was used for advertising. There is another glass tray made for J. P. Coates depicting the history of thread, a very subtle form, and therefore, more effective form of advertising. There is a large tray showing coins of all U.S. Presidents, which we developed for the American President Lines. We made a similar tray recently, including silver dollar embedments and special engraving exceeding the $25 limit all by itself, yet it was advertising. I do not need to tell you that there are thousands of different advertising specialties, comprising an industry estimated to amount to about a half billion dollars in volume and employing directly or indirectly about 350,000 people.

Advertising is a legitimate business function. Most of the advertising dollars go to TV, radio, newspapers and magazines, including thousands of business publications. However, as you probably know, these mass media are unsuited for the small businessman. They cover usually an area vastly in excess of the trading area of the small enterprise. Specialty advertising, directly to the recipient prospect or customer, in a controlled area by mail, messenger, or at the point of sale, is the only form of advertising suitable to him.

The same applies to the large industrial producer of raw materials or fabrications with a relatively small market. Mass media are thoroughly unsuited to advertise their products economically (even if tax allowable). Only clever use of advertising specialties can accomplish an adequate and low-cost market coverage.

For example, take the producer of refractories or firebrick. The market is national in scope, but scattered through many industries; steelmaking, glass firing, production of cement, to name a few. No trade magazine covers all these markets and there are on a national scale only about 1,500 decisionmakers in this whole market. These are general managers, vice presidents of operation, purchasing agents; busy people. To reach them only an advertising specialty, cleverly designed, suitably packaged to carry a story will get through. A few years ago, we designed a program consisting of five mailings, each built around the theme "More Heats From K/A Refractories"—different kinds of matches and lighters in specially designed packages. It was a definite factor in increasing the sale of refractories, opening doors for salesmen, and won a national advertising specialty award for our client.

And this opens the Pandora box of interpretations. Does the limitation of $25 include or exclude the plus value added by advertising, or does one use the net cost of the item as basis? Is the cigarette lighter—a $2 item in computing the gifts to one individual, or because we have added $5 for special boxes, printing, packaging, mailing, etc., including the fees of an advertising agency—is it now a $7 gift? Or do we use the retail value of the lighter, say $3.95 as our base?

What about a point-of-sale sign, such as an electric clock with an advertising message on its face? Customary procedure is for the advertiser to pay a portion of the value, the balance charged to the distributor or retailer. Is the contribution of the advertiser a gift? We supply large thermometers, mirrors, etc., with advertising to get the advertiser's message on a wall to be read by many. Are they gifts if free, not gifts if a nominal charge is made, or if there is a tie-in with merchandise such as with special display racks?

Imprinting costs become smaller per unit as quantity increases. Thus, under the ruling, the smaller advertiser would get penalized over the big one, not only because he pays a higher unit cost, as he does, but also because he reaches the ceiling sooner.

The first part of the legislation before you—loosely interpreted "per person per year"—makes the distribution of advertising specialities an impossible task at bookkeeping. It would mean that a businessman has to keep exact tabs on his prospects and customers and account for every "gift" to make sure that not one or the other received over $25 per year. And under present attitudes of the tax collectors, they would disallow anything that cannot be proven. In effect, this rule alone would make it practically impossible for any firm to purchase advertising specialities. Some programs overlap. The same person buying refractories may buy aluminum "shot" used in steelmaking. The "giver" is the same corporation, but they are entirely different divisions, with different sales forces, different advertising managers, different promotion problems. How can a large concern keep track of "gifts" under such circumstances? These problems would apply to almost any national organization. Calendars, pocketknives, paniters caps and ball pens, added net or with packaging, including freight and sales tax per recipient make this a frightful venture in bookkeeping and administration.

Another subject for later court action is contained in the phrase "directly or indirectly." If a businessman sends another firm a floral gift for a branch opening, does a subsequent "gift" of a ball pen to the manager disqualify the "gift" because directly or indirectly they were to the same person? Or, would one have to add all gifts of advertising specialties to the same office or the same firm? In that case, I, myself, am probably guilty of exceeding the limits because throughout the year I distribute to receptionists, secretaries and prospects low-cost advertising specialties, but totaled up within a large organization, certainly in excess of $25 per corporation.

If there must be legislation to curb abuses, it must be as flexible as business transactions usually are. Not all businesses require the same amount of sales promotion or advertising. Twenty-five dollars in one industry may be excessive, in another, not enough. Last year, in a brief submitted to the House Ways and Means Committee in lieu of a personal appearance I proposed that: "Expenses for the cost of travel, entertainment, and gifts cannot be deducted for tax purposes to the extent that they exceed the usual or reasonable standards of the trade."

As an alternative, I suggest now to add to the first sentence of section 274(b) after "$25"—"except advertising matters usually distributed to promote the sale of products and services."

If that is not practical or acceptable, may I urge you, Senator Byrd, to see that the law clearly says that advertising specialities; i.e., merchandise to which an advertising message has been attached by means of imprinting, stamping, embossing, decalcomanias or other similar methods of reasonable permanency, are not gifts in the meaning of section 274(b).

Respectfully,

CARL E. ROSENFELD, *President.*

JOHN K. WAITE & SONS, INC.,
Seattle, Wash., March 27, 1962.

Senator H. F. BYRD,
Chairman of the Finance Committee,
U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: Re H.R. 10650: It is most important for small businesses such as ours, to be permitted to take full deductions on entertainment and expense accounts because we use this approach in getting business in the same manner as the grocery stores and department stores use the media of advertising in the local newspapers, radio and television.

I don't know of any small business that has yachts or apartments in Honolulu that are written off as a business expense, but I do know that most small businesses wine and dine their customers, sometimes their wives, as well as take them to plays or athletic activities and also give them reasonable Christmas gifts.

Not only do I do much of this personally, as head of the company, but my salesmen also find it necessary for that is part of their job.

Lord knows, the taxes on the small businessmen are sufficiently high already, working such a hardship on them that if any greater tax is added, many of them will close.

I have written my friend, Senator Warren Magnuson, numerous times on this subject and I am sure that he fully appreciates what small business is up against if this tax is allowed to go through.

Yours very truly,

JOHN K. WAITE, *President.*

THE THOMAS D. MURPHY CO.,
Red Oak, Iowa, March 28, 1962.

Hon. HARRY F. BYRD,
Committee on Finance, U.S. Senate,
Washington, D.C.

DEAR MR. BYRD: I can hardly be considered a voting constituent of yours, but undoubtedly you are aware of the fact that your constituency, because of your activities and sound positions in the Senate, covers a wide area in this U.S.A. of ours. It is upon this basis that I am writing you this letter.

Our problem is House bill H.R. 10650 on which the Senate has rescheduled hearings to begin April 8.

The above bill discriminates in section 274(B) (2) against the specialty advertising industry in that it groups this form of advertising and its varied media with the field of individual gifts which carry no imprinted message. The endeavor, evidently, is to stop the payola gap in deductions for business expenses, a purpose we all endorse.

I understand Senator McCarthy of Minnesota intends to introduce an amendment to this section to clear up this fallacy of placing advertising calendars and imprinted advertising items such as pens and pencils in the same category as expensive gifts and entertainment.

It will be a simple matter to clarify the situation by explicitly exempting from the gift classification imprinted calendars, pens, pencils and other advertising specialties. This form of legitimate advertising does not belong in the category of gifts for which a total of $25 per individual is indicated for the year's expense for tax deduction purposes.

I'm sure that you are familiar with our type of advertising calendars that carry a business message. They are sold to the largest concerns in the country and all the way down to the small service station. They're given out by priests and ministers to their parishioners so that they will know about church services and other religious regulations. They are distributed by banks, steamship companies, manufacturers, and insurance companies, to advertise their services. They are distributed for a purpose, and that purpose is strictly an advertising purpose.

The calendar carries a date pad and a picture which enables it to "buy," so to speak, wall space, where the many viewers throughout the year can read the message that the distributor of the calendar wants read in order to increase his business. By the same token, the small retail merchant does the same thing by placing a calendar in the home to keep his name before the people to improve his business.

We really are in business to make business better across the country. From that increased business, taxes can legitimately be assessed; but to handicap us in the process of making business better doesn't sound like very good logic. It appears an unfair discrimination against one department of the advertising industry that would put a lot of handicaps on every participant in developing this business and using its products to increase business.

I am confident that you can place these facts before the Finance Committee in a way to make them see the fairness of eliminating our advertising calendars and other imprinted advertising media from the unimprinted gift field and I shall certainly appreciate your help in this direction.

Cordially yours,

GEORGE E. WOOD, *Vice President.*

STATEMENT SUBMITTED BY IRA W. RUBEL, OF RUBEL, RICH & HUMPHRY, INC., CHICAGO, ILL.

ENTERTAINMENT EXPENSES

Certain business concerns, particularly those in personal service businesses, advertising agencies, management consultants, etc., develop long-range associations with their clients. The 100 largest advertisers retain their association with their advertising agencies, on the average, for 20 years. Before employing an agency, through whom they will spend millions, perhaps hundreds of millions, they want to know the principals of the agency well. It is for such reasons that personal service executives often seek the opportunity of exposing themselves to clients and prospects in pleasant surroundings where neither the executive nor the prospect or client is under pressure from normal business routine. A pleasant hour or so at dinner, over cocktails or in a relaxed atmosphere elsewhere, is a dignified and proper business means of entertaining prospects and clients and for the consideration of long-term and other business matters. Unlike a direct sales contact, personal services are often sold over a long period of time, which involves a necessary amount of entertaining.

TRAVELING EXPENSES

What it is necessary to spend for meals and lodging while away from home is a question that depends on many factors. To permit a revenue agent to determine what is reasonable is to make a man a judge about matters that he has no experience with and no understanding of. A man with an income of $7,000 to $9,000 annually, who has never been an executive of a business, perhaps who has never traveled on business, perhaps who has never done business with a client or prospect in his hotel room or suite, who lives at home in a modest dwelling, just cannot comprehend why a business executive needs to spend two, three, or five times as much as he would spend.

To incorporate in tax legislation the prohibition of deductions for entertainment expenses and to put the judgment of what is reasonable in the hands of a revenue agent who, by experience, is not qualified to make judgments about these things would be a serious mistake and a blow to a vital segment of American business—the personal service companies involved in the function of marketing. Marketing costs of all products in the United States, according to Nielsen, account for more than 50 percent of the total cost of these products. Skillful, professional advice can help promote U.S. economy and can further our foreign business interests.

Put enough handcuffs and restrictions on top business executives and they will be sufficiently discouraged and hampered so as to reflect seriously on the proud pace of American business.

I urge you to carefully consider restricting legitimate entertaining expenses, or to put the judgment as to what is reasonable in the hands of people who are not qualified to make such judgments. I say this after a period of 30 years of being a certified public accountant and a tax consultant, as well as 10 years as a management consultant to advertising agencies and personal service businesses.

APRIL 9, 1962.

Mr. IRA RUBEL,
Chicago, Ill.

DEAR MR. RUBEL: I have your letter of April 3 together with the remarks which you made before the Chicago Federated Advertising Club explaining your position on the tax bill now before the Congress.

In view of the peculiar situation created by the bill in respect to your business I would suggest that you prepare a statement outlining your position in respect to the legislation and send it to Senator Harry Byrd, chairman of the Finance Committee of the U.S. Senate, together with 17 copies for the other members. The Finance Committee is currently holding hearings on this bill, and your statement can be made a part of the record if you wish. In this way, it will be brought to the attention of the full Senate. The hearings will last for another 2 weeks.

If there is any further way in which I can be of assistance, do not hesitate to advise.

Sincerely,

EVERETT MCKINLEY DIRKSEN,
U.S. Senate Minority Leader.

CHICAGO FEDERATED ADVERTISING CLUB SPEECH

Tax planning has become a necessity for every executive because tax laws and regulations have become unbelievably complicated. The situation reminds me of a chapter in "Gulliver's Travels." Gulliver was sitting in the palm of the hand of the King of Giants and had spent 2 days telling the king about the laws of England. When he finished the king showed contempt for the English laws and when Gulliver asked why, the king commented on the complexity of the English legal system. He said that they permitted no law to have more words than there were letters in their alphabet (24). He said further that it was provided in their system that no one be permitted to write an explanation, annotation, or other comment explaining a law under the penalty of death.

Today we have decisions for and against almost every tax situation you can think of. But since no discussion about the complexity of the tax law can be helpful to the individual taxpayer or the small corporation, there is little point in discussing the legal provisions.

Whether an item is a business or personal expense, whether a trip was made for business or personal reasons and whether a luncheon is an ordinary business expense or a personal matter are not questions of law but matters of fact.

The one thing that all of us are interested in is how to take home more after-tax dollars and keep them for our own use.

Many years ago it was comparatively easy for a man to put a few dollars away out of each paycheck to create a nest egg for a rainy day. But with the ever increasing tax bite through direct and indirect taxes, it becomes more and more difficult for the individual or the small business to create a reserve for future use.

It looks as though Federal income tax rates will not be increased for this year or next year, but the amount of taxes that the Government intends to secure will be greater because the examination of tax returns is ever more stringent. The proposed new tax legislation, which is primarily intended to close tax loopholes, for the most part simply makes law out of practices that revenue agents have been following. The principal points that you are affected by are:

1. Proposed disallowance of 50 percent of club dues and assessments.
2. The disallowance of entertainment where it is not in the ordinary course of business but merelay for goodwill purposes. I will go over this in detail later.
3. Allowance of only reasonable travel and entertainment expenses on out-of-town trips, instead of the entire amount spent for meals and lodgings.
4. Disallowance of the cost of your own lunch when you take people to lunch for business purposes. (Suggestion: Bring your own apple and sandwich.)

The President's suggested amendments to the Internal Revenue Code include one provision that advertising men in all fields of the advertising business should be aware of. It is the provision related to the disallowance of certain entertainment expenses. Specifically the proposed law would state, "no deduction is to be allowed by entertainment, amusement, or recreational expenses or for related facilities except to the extent that the taxpayer established that the item was 'directly related to the production of income and was not merely for good will.'" This provision would deny expenses for entertaining guests at night clubs, theaters, country clubs, etc., unless the taxpayer can show that the incurring of such expenses was directly related to specific attempts to obtain or continue business. They would not be deductible if they are made merely in the hope of creating friendships or obligations which may or may not lead to business in the future.

The wording of the draft of the President's proposals implies to me that the taxpayer must be able to show that he was actually trying to secure an order during the period of the entertainment. It sounds to me as though those who framed this legislation were thinking of a commodity salesman who could ask for the order then and there. This proposed legislation will undoubtedly lead to a great deal of trouble for advertising men.

It is ordinary and necessary in the advertising business for an executive of an advertising agency, a public relations company, for an attorney, an accountant, or a management consultant to entertain people for the purpose of exposing their ideas, character, way of thought to prospective clients so that in the future when they have occasion to use the services of such a person or company, they will be in position to make a selection on the basis of a knowledge of the philosophy, personality, experience, and work of the individual.

Agency men, seeking to secure accounts running into millions of dollars, find it necessary, desirable, and productive of income to become acquainted with prospects and to be with them occasionally over long periods of time. To do this, key people in advertising agencies do certain types of entertainment of a dignified nature in order to make it possible to become acquainted with and to expose themselves to prospects.

Revenue agents, who are charged with the administration of the Federal tax laws, cannot easily understand the special nature of advertising agencies and other marketing service businesses, nor are they readily able to come to grips with the need of advertising agency and publicity people to meet with prospective clients under circumstances in which the agency can expose themselves leisurely to prospects when they are not harassed by other business demands. Being rather low paid individuals compared to the advertising men, an unfavorable climate will be set up in which revenue agents will follow the letter of the law and disallow entertainment expenses because if the law passes in its proposed form, it will say that the entertainment must be in such circumstances that production income must be directly related to the entertaining.

The advertising man, industrial designer, and the public relations man are not looking for an order of a few hundred or few thousand dollars, but wants to establish a long term (agency's term of service to advertisers averages in excess of 10 years) during which an agency may secure $10 million to $100 million in business from the client.

Agency men throughout the country should be alerted to this situation and should do something about it. It is never too late until the agent has made the reassessment against you or your company.

These are proposals. The final tax legislation and the Commissioner's regulations interpreting it remain to be determined. It must be remembered that the way the tax laws are administered are as important as the law itself. Revenue agents have become more critical of all expenses that are not clear-cut business items. In this category are business lunches, cocktails and dinners, traveling, entertaining, automobile expenses, club dues, recreational facilities, convention expenses, etc. The problem has always been one of proof.

The "tax game" has become a common practice. The game is this: Since there is no way in which a business expense can be clearly distinguished from a personal expense, the deductibility in many cases becomes a matter of judgment. Individuals who may benefit by a deduction tend to deduct items, rationalizing that the items were expended for business purposes. Revenue agents, on the other hand, many of whom have never been in business, take the attitude of the policeman and assume that the taxpayer is taking advantage of the situation. They may look at questionable items with a jaundiced eye, often insisting on disallowance of at least a portion of the "questionable" items.

What part of an automobile's use is business and what is for personal reasons is a difficult matter to ascertain, so the tax game consists of taxpayers maximizing deductions, revenue agents realizing this, disallowing part of the claimed deductions and the taxpayer knowing that a disallowance will inevitably follow, continues to claim maximum deductions.

Advertising men are particularly vulnerable, because people involved in the service industries, dealing with the sale of intangible services, are often called on to entertain, to travel, to drive automobiles for business purposes, to belong to clubs in order to have an opportunity to invite their prospects and clients to business luncheons, cocktails, and dinners. It is productive for them to attend conventions and furnish tickets to a ball game, a prize fight, etc. A business gift sometimes shows good will and income.

But this is all difficult for revenue agents to understand, because they have seldom if ever been in a situation that required them to entertain, to take someone to lunch, etc. Revenue agents, like public accountants and auditors, are people whose personalities permit them to operate best in work situations where their routines are rigidly fixed, where they operate according to rules, regulations, and prescribed practices. The use of personal judgment is minimized in their jobs. They operate in accordance with the letter of the law.

Recently, developments and proposed legislation tells taxpayers what they must do to maximize their deductions and minimize their taxes. This requires effort, meticulousness, and adequate records, but we live in an age where proof of tax deductions is necessary for allowance and where lack of substantiation will undoubtedly lead to disallowances. You must be able to show agents why, when, where, whom and how much for each item you deduct and if you do this, you should have an airtight case. If you have the kind of proof the Internal Revenue Service requires, you should not permit the agent to disallow anything.

We can stop this vicious circle of: Taxpayers maximize deductions—revenue agents disallow part of deduction—further maximization of deductions, etc., if both revenue agents and taxpayers will stop playing games.

Taxpayers can stop this vicious circle from continuing by having adequate proof for their deductions and by refusing to permit agents to disallow any part of proofable items. Yes; I mean that if an agent refuses to settle for full allowances of proofable items that the taxpayer should go to the administrative staff or even the Tax Court.

In addition to securing full allowance for travel and entertaining and other deductions, there are a few important suggestions that I can make to help you build a reserve for future use. The legal tax means for accumulating a personal reserve involve profit-sharing plans, pension plans, deferred compensation, company paid group and other life insurance and stock options. Time doesn't permit me to discuss any of these items in detail, but simply to say a word or two about each one, so that if they are applicable in your case, you can investigate the matter further.

With our present highly complicated tax laws, every business spends a good deal of time and employs one or more experts to help the company in its tax planning so as to legally minimize its tax cost.

Seldom does the individual do any careful advance tax planning and if he does, he often feels he cannot afford to employ skilled specialists to help him. The result is considerably fewer take-home after-tax dollars.

The legal devices for accumulating a personal reserve just don't happen by themselves. They have to be planned and worked out carefully. The tax laws are highly technical and complex and so the devices used must meet the requirements of the laws and the regulations. The top executives of every business who administer the affairs of the business spend their time in planning for the business, so each individual executive must protect his own interests. That is why you individuals must know something about profit-sharing plans, pension plans, deferred compensation, etc., and certainly I cannot tell you much about these things today but perhaps I can whet your appetite so that you will go on and do the rest of the research yourself.

Some companies have established qualified profit-sharing plans through which they deposit part of their profits each year in a trust fund, which is exclusively for the benefit of employees. The amount deposited in such funds are fully tax deductible to the corporation making the deposit, but the proportion of the deposit which benefits each employee is not reportable in the employees income until he receives the funds and at such time, the funds may be reportable as capital gains under some circumstances and thus only one-half of the proceeds are reported and a tax of not more than 25 percent is imposed on the proceeds. Such funds as inured to the employees benefit through a profit-sharing trust may reduce the executives tax by as much as half.

For example, assume that a man with a $15,000 a year annual taxable income receives $1,000 a year in a profit-sharing contribution instead of as a raise in salary. If such a deposit is made annually from the time the employee is 40 years old until he retires at 65, $25,000 would have been so deposited. So as not to complicate the matter we will not consider the earnings on the funds deposited. When the employee receives these funds, at age 65, he may report them as a capital gain and pay a tax on only $12,500 instead of $25,000. If his tax rate at that time is 25 percent, he would only pay $3,125 instead of perhaps $7,500. Here is a tax saving of more than 50 percent. The same kind of a tax saving can be accomplished if the employer company develops a pension fund for the employee or a deferred compensation arrangement.

The advertising man is singled out and becomes sort of a special tax target, because so much is written and said about the huckster that the internal revenue agent smacks his lips in glee when he is handed an advertising man's tax return to audit.

The psychological climate that is set up when an $8,000- or $9,000-a-year revenue agent examines the tax return of a $20,000- or $25,000-a-year advertising man is not favorable to an unprejudiced judgment and judgment there must be because there is no clear-cut way of defining what is the business expense.

Recently the Internal Revenue Service has become more critical of the quasi-business expense. Most of you are familiar with the various means that have been used by the Service to try to eliminate claims for expenses that may not be proper. But in the final analysis, the problem is one of proof. We live in a paper age where documentation is all-important. If you want to secure the maximum allowable deductions for business luncheons, entertainment, business gifts and travel costs, you will need to have carefully documented evidence to prove when, where, whom, why, and how much. Yes; even the $2 taxi ride and the $3 business lunch will need documentation. Perfect records are the basis for maximum allowances.

Many business executives complain about the need to keep such records, but all of us have to suffer for the sins of a few. The Treasury has taken the attitude that business expenses will not be allowed unless they are completely documented.

There are two ways in which some business expenses are paid:

(1) The corporation pays the restaurant, the club, or automobile rental directly or by reimbursing the employee for the expenditures that he makes in behalf of the corporation; and

(2) The compensation paid to the employee includes a sufficient amount to permit the employee to do the necessary business entertaining, to drive a car for business purposes, etc.

In the first case, the employee reports the reimbursement he receives from the corporation as income. He deducts the amount of expense he incurred so that the net reported would be zero if he was reimbursed in full for all expenses. In the second case, the employee reports his total compensation from which he deducts the total of business expenses incurred by him. In the first case, if the employee is not a major shareholder, the fact that the corporation reimbursed him for the expenses is fairly convincing proof that the expenses incurred were for business purposes and are legitimate business expenses. The expense reports that the individual submitted to the corporation, if detailed, should be adequate proof of the deductible nature and extent of the items.

If the employee is a major shareholder, then the corporation's reimbursement is not so convincing, since a major shareholder may have an ulterior motive in having his corporation reimburse him for some items.

Adequate and complete proof will be of great importance in such a case for a disallowance of reimbursed expenses creates a double tax. It increases the corporate tax and is treated as a dividend paid to the employee shareholder and, therefore, adds to his tax so that the total effect of such a disallowance can create a tax in excess of 100 percent of the amount disallowed.

Assume that corporation A is in a 52-percent tax bracket and that its president, Mr. Y, is in a 60-percent tax bracket; assume that Mr. Y has been reimbursed by the corporation for $3,000 of expenses that he has reported and that the internal revenue agent, in examining Mr. Y's tax return, disallows $1,000 of these expenses. The disallowance costs the corporation 52 percent of the $1,000 disallowed or $520 and the $1,000 disallowed is treated as a preferential dividend paid to Mr. Y and as such, adds $1,000 to his income creating an additional tax of $600. The total tax assessed to the corporation and its president amounts to $1,120 as a result of the disallowance of $1,000 of reimbursed expenses.

Where the employee's compensation is paid in an amount sufficient to cover his own incurred business expenses, to assure a full deduction for such expenses, the taxpayer needs two things—(1) proof from the corporation that the compensation paid was intended to cover not only compensation for services but reimbursement for certain expenses incurred. The nature of the expenses to be incurred had better be spelled out. (2) In addition, the taxpayer needs proof of the items deducted and the proof needs to show when, where, whom, why, and how much.

I know it is difficult to document every single business lunch and every single business item of entertaining, but if you want to deduct the items and avoid disallowances, you must have such proof. Time doesn't permit me to detail the kinds of proof necessary for deductions covering club dues, gifts, automobile expenses, and other fringe items, but the general statement that adequate proof of the business nature of the expense, as well as the detail of the expenditures, is necessary.

The advertising agency man faces more acute tax problems than some others, because advertising agencies are small businesses comparatively. The nature of a personal service business requires more than average freedom of activity and this, together with the pressure of the business, creates a need for long-time cultivation of profits and for more out-of-office activities.

CINCINNATI, OHIO, *April 18, 1962.*

Hon. HARRY FLOOD BYRD,
U.S. Senate, Washington, D.C.:

It has just come to our attention that the pending revenue bill labeled H.R. 10650 limits deductions as business expenses which in our opinion will greatly reduce our advance sale of season box seats and other ticket plans. As Cincinnati is the second smallest city in the major leagues this support from business firms in our area is extremely important to the success of our club. We urgently and respectfully request you to oppose this portion of the bill for best interests of baseball in the city of Cincinnati. Thanks and regards.

WILLIAM O. DEWITT,
President, Cincinnati Reds.

HOTEL AND RESTAURANT EMPLOYEES AND
BARTENDERS INTERNATIONAL UNION,
Cincinnati, Ohio, April 11, 1962.

Hon. HARRY F. BYRD,
Chairman, Committee on Finance, U.S. Senate, Washington, D.C.

DEAR SENATOR BYRD: President Ed S. Miller of our international union has asked me to convey to your committee our deep interest in the matter of personal expense account treatment in the tax revision bill now being considered in your committee.

Our union is deeply concerned that the present effort to close tax loopholes not do irreparable damage to the hotel and restaurant industry.

We believe that a business expenditure is reasonable if it is one that might normally be incurred in the conduct of one's affairs. We believe that the place in which this expenditure takes place is only incidental to the central fact that the expenditure is reasonable and normal. Any effort to confine business expense to certain types of establishments and to deny all expenditures in other types of establishments is an intrusion upon the rights of taxpayers.

Most important of all, we believe that any circumscribing of the right of individuals to entertain business prospects and customers in advancing the goodwill of their businesses is unwise. We feel that this will have a very harmful effect and do great damage to established patterns of business conduct.

We respectfully urge that your committee draft any tax revision bill in such a way as to enable individuals and businessmen to continue the present practice of charging normal and justifiable business expense as a cost of doing business. We ask that this letter be made part of the record of your current hearings on tax revision.

Sincerely yours.

CYRUS T. ANDERSON.

CLUB MANAGERS ASSOCIATION OF AMERICA,
Washington, D.C. April 10, 1962.

To the Finance Committee, U.S. Senate:

GENTLEMEN: By way of introduction, I am the chairman of the Governmental Affairs Committee of the Club Managers Association of America. Our association, numbering over 2,000 members, is composed of the professional managers of bona fide country clubs, city clubs, athletic clubs, yacht clubs, and other social, athletic, and sporting organizations throughout the country.

We are disturbed by the provisions of section 4 of H.R. 10650 now being considered by the Senate Finance Committee, especially the proposed new rule in the new section 274(a)(1)(B) which would deny to a business taxpayer a business deduction for certain club dues when such club is used in connection with his business unless the taxpayer established that his membership in the club was used primarily for the furtherance of the taxpayer's trade or business and that the use of such club was directly related to the active conduct of such trade or business.

Under the present provision of H.R. 10650 it would be mandatory that a taxpayer show that he used his club for business more than 50 percent of the time in order to receive even a partial deduction for the use of the club on legitimate business occasions.

Our association strongly maintains that the expense incurred by a taxpayer with respect to his use of a club for business entertainment purposes should be allowed to whatever extent the club is so used and can be substantiated as a proper business deduction. If a member uses the club for business less than 50 percent of the time, for example only 45 percent of the time, he should be allowed to take that 45-percent portion of club dues as a legitimate business deduction. The test of the club being used "primarily for the furtherance of the taxpayer's trade or business" should be stricken from H. R. 10650.

You are well aware, I know, that a very substantial portion of American business is conducted in clubs, and that the revenue to the Government from club dues tax alone is estimated at above $70 million in 1961. In addition, the Government receives the corporate income tax paid by many clubs that are not exempt under section 501(c)(7); plus liquor taxes, social security taxes, unemployment compensation taxes; in addition to numerous State and local taxes; direct and indirect, which have substantially increased in recent years.

As is generally known, business clubs traditionally lose money on dining room operations, and compensate for this loss by charging higher club dues. Thus, dues and dining room charges combined will approximate the cost of meals at well-established public dining rooms. If this business is driven from the clubs, the Government will lose the excise tax collected on dues because a great number of persons will be forced to give up club memberships and some clubs will be forced to close completely because of the withdrawal of substantial numbers of members.

Our association respectfully requests your committee to revise section 4 of H.R. 10650 to remove the test which requires the taxpayer to establish that the club was used "primarily" for the furtherance of the taxpayer's trade or business. To the extent that the club was used in a manner directly related to the active conduct of such business, a deduction should be granted under section 274.

Your serious consideration of this request will be sincerely appreciated.

Respectfully,

CHARLES E. SMITH,
Chairman, Governmental Affairs Committee.

GEORGIA POWER CO.,
Atlanta, April 17, 1962.

HON. HARRY F. BYRD,
Chairman, Senate Finance Committee,
New Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: Reference is made to H.R. 10650, hearings being now in progress before your committee. It is respectfully requested that this communication be entered in the record in lieu of a personal appearance.

Our company is in agreement with the objective of the proposal to allow as a tax deduction ordinary and necessary business expenses incurred in regard to legislative matters but we feel that the proposal in its present form does not fulfill the entire need for legislative change in code section 162. Accordingly, we strongly urge that the proposal should be modified to make it clear that the cost of advertising incurred by a taxpayer in the ordinary course of his business is deductible for Federal income tax purposes even though the advertisement may have some general reference to pending or prospective legislative matters.

Respectfully,

J. J. MCDONOUGH.

(Whereupon, at 1 p.m., the committee recessed to reconvene at 10 a.m., Wednesday, April 11, 1962.)

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